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Should I Invest in Art?

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Should I Invest in Art?
# Table of Contents

**Background** .................................................................................................................. 2

**Section I: The Market** ..................................................................................................... 4
  - Art vs. stocks ............................................................................................................... 8
  - Art vs. real estate ....................................................................................................... 10
  - Art vs. gold ................................................................................................................ 11
  - Art vs. wine ............................................................................................................... 13
  - Art as commodity ...................................................................................................... 13
  - Symbolic value .......................................................................................................... 16
  - Transparency, insider trading, and access ................................................................. 19

**Section II: The Claims** .................................................................................................. 21
  - Art price indices ....................................................................................................... 23
  - Diversification and non-correlation .......................................................................... 25

**Section III: The Numbers** ............................................................................................ 27
  - Quantifying ‘art’ ........................................................................................................ 28
  - Repeat sales regression .............................................................................................. 30
  - Hedonic modeling ...................................................................................................... 32
  - Return on investment ................................................................................................. 33
  - Risk ............................................................................................................................ 35
  - The real cost of owning art ....................................................................................... 37
  - Transaction costs ...................................................................................................... 37
  - Taxes ......................................................................................................................... 38
  - Liquidity ..................................................................................................................... 38

**Section IV: The Intangibles** .......................................................................................... 40
  - Intrinsic value .......................................................................................................... 42
  - Social value .............................................................................................................. 43

**Conclusion** ..................................................................................................................... 44

**Bibliography** .................................................................................................................. 46
Background

A market for art is not a new concept. Certain aspects unique to the 21st century art market are new, from professionalization to multi-million dollar price tags, but the underlying relationship between art production and money dates back centuries. Artists working during the Renaissance participated in a patronage system wherein the wealthy elites, notably the Church, would pay them to produce works to various specifications.\(^1\) You could say that today’s Charles Saatchi’s and Eli Broad’s were yesterday’s Medici family. There is no uniform agreement on whether or not this early art-for-hire truly counts, as the culture of the time viewed the profession more as artisan work. But, whether you want to call it art or craft or something in between, as early as the 15th century you can find examples of a thriving market for artistic output. The foundation of our modern art history discipline is often attributed to *Lives of the Most Excellent Italian Painters, Sculptors, Architects, from Cimabue to Our Times* (1550), a text by Giorgio Vasari on the genius of Renaissance artists including Michelangelo.\(^2\)

We might think of the proliferation of art fairs as a uniquely 21st century phenomenon, but the earliest known example of a fair or precursor to fair can be traced to mid-15th century Antwerp. Our Lady’s Pand, also Church sponsored, was an open marketplace where merchants could sell their wares.\(^3\) Wealthy people would send assistants on their behalf to examine and purchase paintings, rugs, and other goods being offered for sale.

In 19th century France, the rise of the Paris Salon led to a hierarchical system that controlled not only who would find success as an artist but also influenced the content of the


work. It was the rejection of this system that led to the Impressionist movement, one of the most well-known genres of painting that continues to greatly impact museum goers today (and has an impressive resale market at auction). Early Impressionist painters found themselves at odds with the market, but ironically it was through their rejection of the status quo that they were able to find market success.4

What these brief examples are meant to demonstrate is that the relationship between ‘art’ and ‘market’ is neither new nor is it inherently sinister. If anything the two are inextricably linked, pushing and pulling against each other but never severing their essential tie. The artist cannot hope to sustain himself without some type of market for his work. This tension between artist and market can even be seen as healthy, often driving both sides forward. To quote contemporary Mexican artist Gabriel Orozco: “[t]he artist in not in his bubble of a studio, rejecting all the forces of the market in a capitalist society. That is a romantic view. It’s just not realistic.”5

Unless you buy into the starving artist cliché and believe suffering is essential for the creation of good art, an artist being compensated for his time spent in the studio can be seen as a positive thing. Regardless, the topic at hand is not whether there should be a market for art or how an artist should make a living, but instead to illustrate that an art market or network of markets has existed for centuries. It was not always the $63.8 billion6 global industry that it is today. However, when we talk about the art market in today’s terms, it is worth remembering

that what we are discussing is an established relationship with a long and well-documented history.

SECTION I: The Market

The year 1970 was a tumultuous one in several respects. It is the year the Beatles disbanded, the year the United States invaded Cambodia, and the year that the famous abstract expressionist artist Mark Rothko, known for his large-scale luminous color field paintings, committed suicide. His daughter Kate Rothko was only 19 years old when she lost her father, completely unaware of the drama that was about to unfold. Together with her brother, the Rothko children accused his close friends and the executors of his estate of waste and fraud. The executors had arranged the sale of 100 Rothko works to Marlborough Gallery at deflated prices, and another 698 were taken on consignment. This move would grant them control over Rothko’s market for years to come, allowing them to sell the paintings at their leisure without flooding the market. Before the executors were stopped by a court order, they had sold over 100 works at decreased prices to their favored gallery clients while collecting an elevated commission on each sale.8


In 1975, at the behest of Rothko’s heirs, the court found the executors guilty. They cancelled the fraudulent contracts and fined the gallery $9.2 million. Frank Lloyd, owner of Marlborough Gallery at the time, fled to the Bahamas to avoid tampering with evidence charges and lived there as a fugitive for years until his eventual conviction in 1983.

The entire case was excruciatingly public, and the media circus surrounding it shone a bright light on some parts of the art world that many people would have rather kept in shadow. It was a pivotal moment, a collective loss of innocence, and what Judith Dobrzynskia of the New York Times called in 1998, “a long-ago case of underhanded greed that bared the inner workings of the supposedly genteel art world.”

A scandal like the Rothko case illustrates some of the complexities inherent to the art business and calls attention to the dangers of a market often defined by its lack of transparency and regulation. This is partially because the art market has long been considered a space that can self-regulate, where handshakes are favored over legally binding contracts, and business is conducted at congenial dinner parties. Many things have changed since 1970, but the art world still operates in a shadowy realm, separate from other legal markets, and certainly differently from any other would-be financial asset class. On a global level, people are demanding greater transparency in their companies and politics as a means to ensure ethical business practices and combat corruption. Perhaps due to its small size and relatively recent ascent into the limelight, the art world has not yet been forced to impose additional regulations on the same scale. In 2013, New York financier and art collector James R. Hedges IV reflected on this difference, saying,

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9 Ibid.
10 Ibid.
“The art world feels like the private equity market of the ‘80s and the hedge funds of the ‘90s… It’s got practically no oversight or regulation.”  

This is not to say that the art market has no legal framework whatsoever, and many people would argue that its ‘unregulated’ reputation is overblown. As Sotheby’s senior director Tom Christopherson explains, applicable regulations that directly impact art business are not limited to but include: “data protection legislation, intellectual property rules (copyright, moral rights and Artists Resale Rights), anti-money-laundering legislation, consumer protection legislation, customs and cultural property regulations and anti-corruption regulations such as the Foreign Corrupt Practices Act in the US and the Bribery Act in the UK.” Still, the art world is small and can sometimes feel unwelcoming or clubby. Creative industries are much more heavily influenced by word-of-mouth and tastemakers, in large measure due to the fickleness of consumers and the subjective nature of their products. This, combined with the role of connoisseurship, a high volume of private transactions, and contemporary art that is often defined by its conceptual complexity, can make the market feel more inaccessible than ever.

Before further examining the ways the art market does or does not function like other markets, it is worth first determining whether or not art possesses the necessary attributes to function as a valid alternative financial asset. Investopedia.com defines a financial asset as “a tangible liquid asset that derives value because of a contractual claim of what it represents.” Good examples of this type of asset include stocks, bonds, and bank deposits. What distinguishes financial assets from tangible physical assets like property or commodities is that financial assets

12 Ibid., 83.
13 Dempster, Risk and Uncertainty in the Art World, 63.
14 Ibid., 33.
do not necessarily have physical worth, meaning that their value is not derived from physical attributes. Clearly art does not qualify as a normal financial asset, since it is (usually) a tangible and illiquid object. However, to begin to understand what art is, it is also important to understand what art is not.

An alternative financial asset can be defined as “any non-traditional asset with potential economic value that would not be found in a standard investment portfolio.” Examples of alternative financial assets include hedge funds, real estate, gold, wine, and -- perhaps -- art. In 2011, Joe Roseman, the former head of economics at Moore Capital Management, created the acronym SWAG to group this type of asset. Standing for silver, wine, art, and gold, this cringe-inducing name was meant to describe assets that had allegedly performed particularly well over the last decade.

It is not surprising that the media loved talking about SWAG, a flashy concept and romantic notion in its own right, but there might also be some factual basis behind it. According to Rachel Campbell in “Art as a Financial Investment” (2008), the comparatively poor performance of more traditional assets over the last decade, combined with a terrible economic recession and resulting distrust of the market, has led many investors to seek out alternative assets. A central tenet of modern portfolio theory is the elimination of risk through portfolio diversification, and this has led people to invest in new asset classes that have a low correlation with their existing portfolio. Art is one such asset that people frequently claim has a low correlation with traditional assets, which would make it ideal for portfolio diversification.

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Whether or not these claims can be substantiated remains to be seen, but the attractiveness of art-as-alternative-asset has certainly led to increased purchases because of it.

Now that we know art has the potential to be a financial asset, the next step is to compare it with other established traditional and alternative asset classes. For the purposes of this comparison, I have chosen two traditional assets with large markets, stocks and real estate, and two alternative assets with active if more niche markets, gold and wine.

**Art vs. stocks**

According to the 2016 TEFAF report, 38.1 million artworks were sold in 2015.\(^{19}\) (This is down from the nearly 50 million works that were sold at the market’s peak in 2007).\(^{20}\) In September 2016 alone, over 36 million group shares were traded on the New York Stock Exchange.\(^{21}\) Thanks to rapid technological innovation, stock markets are now electronic, and the instantaneous trading between entities has created an overall market profile with up-to-the-minute accuracy.\(^{22}\) In contrast, art sales happen much more slowly. Auction preparation is time consuming and takes substantial manpower. It is no wonder that the main auction sales at Christie’s, Sotheby’s, and Phillips only take place twice a year in May and November. There are a range of factors that determine liquidity of art, including the timing and circumstance of the sale,\(^{23}\) and these variables often increase the time it takes for a willing seller to connect with a willing buyer. At first glance, the sheer difference in scale and speed of the two markets is staggering, and makes meaningful comparisons difficult.

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Rarity is a powerful market driver in the art world.\textsuperscript{24} The diversity of art sales and the treatment of each work as wholly unique differentiates it from the standardization of market shares, which are interchangeable with others of the same type. Unlike art, market shares also have the benefit of being productive assets. Investors can expect to receive a dividend, or the amount of profit paid regularly by a company to its shareholders.\textsuperscript{25} The only dividend a person can expect to receive from their art is the enjoyment they get looking at it, and that is much harder to quantify (more on that later).

One stock market strategy is to invest in a number of startup companies. Here, investors are less concerned with the company’s current profitability because they are betting on future growth and performance. The logic behind this method is that while most of the startups will not be successful, it only requires one to make it big for them to make back the money (and then some) lost on other ventures. The analogous art market comparison would be investors who buy works from a variety of emerging artists. While most of these artists will probably not become successful on a large scale, it only requires one success to make the investment worth it.\textsuperscript{26} However, artworks are not securitized the way publicly traded companies are, and buying an entire work of art is not the same in terms of financial outlay as buying stock in a company. Stock markets have a far lower barrier to entry, which increases accessibility and the total number of entrants.

Due in part to the vast number of players, stock markets are subject to much more stringent regulations. They are established, transparent, and typically yield the highest risk-

\textsuperscript{24} Michael Findlay, \textit{The Value of Art: Money, Power, Beauty} (New York: Prestel, 2014) 21.
\textsuperscript{26} Dempster, \textit{Risk and Uncertainty in the Art World}, 71.
adjusted returns compared to other investment categories. In *Art as Investment?* (2013), author Melanie Gerlis discusses the allocation of equities in investment portfolios, concluding that they make up the greatest proportion of portfolios in North America at 37.2 percent. On a global scale, equities (26.1 percent) are second only to cash and deposits (28.2 percent).\(^{27}\) On the other hand, the lack of transparency in the art market leads to investor uncertainty, and that has the potential to further limit participation.

**Art vs. real estate**

As with stocks, it can feel pointless to compare art and real estate due to the significant differences in scale. Shelter is ubiquitous and is considered essential for humans to live. There is a reason that homelessness is generally considered a crisis and a lack of art on people’s walls is not. In contrast, art is often classified as a luxury. The art market is small, niche, and largely reserved for the one percent.\(^{28}\)

Moving past these pronounced differences, art and real estate do have a number of things in common. There is sometimes even a direct relationship between high-end real estate and art, as the same people are buying both things. Both real estate and art indices often use repeat sales and hedonic modeling to begin to assess and quantify the value of the property or object in question. In hedonic models, traits such as number of bedrooms or floors are given specific values depending on their desirability. While real estate has location, art has oil paint. Additional characteristics of art include medium, provenance, subject matter, artist, time period, place in the artist’s oeuvre, exhibition history, and condition.\(^{29}\) For this reason, both real estate and art are heterogeneous goods with variable characteristics that make analysis more challenging. Having

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\(^{27}\) Gerlis, *Art as Investment?*, 29.
\(^{28}\) Ibid., 99.
\(^{29}\) Ibid., 57-8.
said that, the high transaction volume and transparent pricing of real estate is helpful and something the art world lacks. As with stocks, real estate is also considered a productive asset. Land can be utilized for any number of purposes, including the production of agricultural products, and both land and any structures on it can be rented out to generate income. The same cannot be said for art.

**Art vs. alternative assets**

The 2008 credit crisis and subsequent recession have had far-reaching consequences, including its impact on people’s approach to investment. A lack of market confidence combined with the pre-existing diminished performance of traditional assets caused many people to stop investing in stocks. They started to explore other options, and saw alternative financial assets as a potentially superior store of value. Purchases based on this reasoning include collectibles like classic cars and expensive watches, art, gold, and even wine.

**Art vs. gold**

An important difference between traditional and alternative asset classes is the size of the market in question. Since the art market is niche, it may make more sense to compare it with other niche assets, such as gold. On paper, art and gold share a number of characteristics. They are tangible and have part of their worth derived from their physicality. Unlike stocks and real estate, both art and gold are considered sterile because they do not return something measurable like a dividend. Both are also used as a hedge against inflation; in times of economic uncertainty, people often turn to the ‘hard’ asset because its physical attributes appear safer than an asset with

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no intrinsic worth. However, gold is an actual commodity with relatively fixed characteristics that can be priced accordingly.

Where art can be fragile and incur high restoration costs, gold is nearly indestructible. Unlike gold or any of the previously discussed assets, a part of art’s value can only be realized through human interaction. Although some investors may treat art and gold indiscriminately, most people want their art on display. Art has cultural cache, and part of the status it confers can only occur when people see and recognize it from across the room. Unless an investor keeps his gold bouillon on display, this is a critical difference. According to surveys, only 10 percent of people hold art for investment purposes, while 58 percent say that is why they buy gold. 32

Art vs. wine

32 Gerlis, Art as Investment?, 60.
As investments of passion, art and wine have a number of things in common. Like gold, neither produces dividends but both can still increase in value over time. Indeed, Christie’s and Sotheby’s now have dedicated wine departments.\(^{33}\) Additionally, both art and wine are meant to be consumed, albeit in different ways.

Nonetheless, wine behaves more like a typical commodity. It is a production line industry, where cases of an identical product are produced and shipped out. Unlike art, wine is typically consumed at some point, thus decreasing the supply. For this reason, wine is classified as a ‘wasting asset,’ which means it has a useful life of under 50 years.\(^{34}\) Here there may be a rational justification for changes in price. According to basic supply/demand economic theory, a drop in the supply for a good generally increases demand and, consequently, its price rises. Art has the potential for a longer lifespan, as its ‘consumption’ through repeated viewing does not impact the condition of the work in any way. Wine enthusiasts have worked hard to create a transparent, regulated market, and because of this it is easy to track wine prices. Of all the ‘SWAG’ assets, wine has been found to have the highest return at the lowest level of risk.\(^{35}\)

**Art as commodity**

One recurring trait that distinguishes art from other asset classes is that the majority of art is unique, which prevents it from acting as a commodity. By definition, true commodities have a number of fixed characteristics that art does not possess. The core concept here is that a commodity is fungible and can be exchanged with other goods of the same type. There must be little differentiation between one commodity and another, regardless of the producer. For this reason, common examples include oil, oranges, and wheat. We already know that art is not

\(^{33}\) Ibid., 75.
\(^{34}\) Ibid., 76.
\(^{35}\) Ibid., 90.
fungible because perfect substitutes do not exist. Even works of the same medium and same size by the same artist can command significantly different prices at auction.

However, there are instances of art beginning to behave more like a commodity. One example of this is the market for prints. The mechanical process of printmaking allows for a standardized form of production that leads to more uniform products. There are still other issues to consider -- condition, provenance, and exhibition history, to name a few -- but the prints themselves can be seen as nearly interchangeable and thus are easier to price. As non-unique works, they typically command a lower price point than other forms of art.

Another example of this behavior is when artists like the British superstar Damien Hirst create many versions of the same work. Hirst’s ubiquitous spot paintings have been mechanically produced in batches of hundreds. Currently, there are thought to be over 1000 in existence around the world. Unsurprisingly, this increase in quantity has decreased the value of individual works, as well as leading collectors to decide that some of the paintings, notably the earlier ones, are more valuable than others.

Hirst is also known for his individual sale at Sotheby’s in 2008 -- the same day that Lehman Brothers filed for bankruptcy. “Beautiful Inside My Head Head Forever” was a significant sale for a number of reasons. Here, Hirst was circumventing the traditional art world structure and bypassing the primary market entirely. Seldom do artists sell their works directly at auction. If represented by a dealer, they typically consign works to the gallery and receive a

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38 Gerlis, *Art as Investment?*, 74.
39 Ibid., 150.
portion of the sale price. The Hirst sale achieved almost $200 million and boasted a gaudy 97 percent sell-through rate.\footnote{Ibid.} In a market where supply is tightly controlled and the fear of oversaturation looms large, many people were justifiably skeptical that the market could handle 223 lots from a single artist in 24 hours. Optimists considered this proof that the art market was bullet proof, immune to the struggles plaguing financial markets. Others saw it as the last hurrah before everything was about to go downhill.

In the tough financial times to come, it became apparent that art would not remain strong in the face of global financial crisis. Despite the success of “Beautiful,” the Hirst sale was an aberration for several reasons. This was not a typical November evening sale with a variety of artists represented. Instead, it was a one-of-a-kind event bordering on publicity stunt. One press report said that many of Hirst’s works were bid on by business colleagues to ensure a successful sale,\footnote{Adam, Big Bucks, 163-4.} and others have raised doubts about the validity of several sales figures.\footnote{Ibid., 35.} Beyond the questionable finances, this sale further cast doubt on Hirst’s status as an artist. An openly mercenary operation such as this is in many ways anathema to what we believe art should be. Hirst, people thought, had crossed the line from artist to become a luxury product designer.\footnote{Thornton, 33 Artists in 3 Acts, 273.}

**Symbolic Value**

The marked similarities between art and other products that fall under the luxury goods umbrella -- designer handbags, watches, jewelry -- might lead us to conclude that they are one and the same. Certain designer products such as Chanel handbags sometimes behave like an asset and appreciate in value over time. What separates a Hirst spot painting from a pair of Dior sunglasses, for example, is that art has been ascribed unique symbolic value in our culture, which

\footnote{41 Ibid.}
confers special status. Art, we believe, has a unique ability to transcend. Ideally it is durable enough to outlast its creator and time. Its value is not used up the way a consumer product like wine is, and it does not decrease as it ages. In this way every artwork is a wager on the future.

Buyers are paying for immediate pleasure as well as future significance in the art historical canon. This has only become more complicated as we have moved away from an emphasis on technical skill and craftsmanship to the generation of ideas and concepts, frequently pushing the boundaries of what art can be. The knowledge, language, and context now required to determine whether a work of art is ‘good’ or ‘bad’ has become the domain of those well-versed in philosophy and art theory. These people function as the de facto gatekeepers of the art market, determining the importance of individual works in the larger context of art history and further complicating the pricing process. After all, how does one accurately price an abstract idea?

The unique cultural power of art also influences market behavior and perception. We believe that an artist’s prices should only increase over time. Seldom will gallerists decrease the price of an artist’s work as they mature. Their prices will either continue to slowly rise, or the artist will be dropped from the gallery program. Proof of this uneasy marriage between the sacristy of art and the mercenary act of selling can be seen in gallerists’ initial reaction to megadealer Larry Gagosian. When Gagosian arrived on the scene in the 1980s, his no-holds-barred approach to selling and reselling art made many people uncomfortable because he was unapologetically market-driven. In Gagosian’s own words, “I’ve never been what they call a pure gallerist. I find that somewhat pretentious, honestly -- I’m an art dealer […] I like to show

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45 Gerlis, *Art as Investment?*, 77.
great artists of our time, but I also like dealing. And I think they reinforce each other.”

The problem with this way of thinking is that many people do not want to consider art in bleak, capitalist terms. It can feel dirty, as if we are muddying something pure. We want to believe that the ideal placement for art is with a collector who will keep it for most if not all of his life. Or even better, we hope art will enter the collection of a major museum, achieving what in economic terms is referred to as terminal commodity status. There, it will be displayed and cherished and preserved and it will never re-enter the market again. Museums will occasionally deaccession works in their collection, but this has to be done with great care. There is a certain stigma attached to the idea of selling off art to unlock its market value. Typically, museums are only permitted to deaccession a work if the money will be used to purchase a new piece for the collection. Raising funds for any other purpose is seen as unethical or suspect.

Both art and luxury goods fall under the category of positional goods because of the ways in which owning them can confer status and power. They are also considered Veblen goods, which means they violate basic economic theory as demand for them increases when their price goes up. For these reasons, art and luxury goods are a natural pair and have a substantial amount of buyer overlap. The difference is that, as a society, we have elevated art to something higher than a consumer product, and we do not usually grant luxury goods the same cultural power and reverence. Savvy luxury goods retailers regularly try to associate their goods with art to transfer some of this special status onto their products and elevate their prices. Collaborations between luxury goods companies and artists have increased over the last two decades, further

50 Ibid., 44.
51 Dempster, Risk and Uncertainty in the Art World, 196.
blurring the two worlds. In 2003, the French luxury-goods brand LVMH, conveniently owned by art collector Bernard Arnault, collaborated with the Museum of Contemporary Art (MoCA) in Los Angeles and famous artist Haruki Murakami. In this instance, Marc Jacobs and Murakami teamed up to design handbags for Arnault’s Louis Vuitton label, which were installed in MoCA’s exhibition space. This integration of art and commerce came almost too easily; it was a comfortable brand alignment that would benefit both parties. It also benefited museumgoers, who had the opportunity to feel like they owned a Murakami when purchasing their handbag without paying millions of dollars for an actual painting.  

Still, there is a certain functionality related to luxury goods that is absent in art. Asked if art is a definition of fashion, Vanessa Friedman of The Financial Times wrote on her blog, “it seems to me that functionality is an essential characteristic of fashion, and non-functionality is a characteristic of art. Ergo, fashion is not art.” This is a good start at differentiating the two. Art is not generally linked to any essential activity, and for this reason many people remain flabbergasted by the high prices paid for something they view as nonessential. However, relying on utility as a core distinction can prove slippery,

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52 Gerlis, Art as Investment?, 148.
53 Findlay, The Value of Art, 152.
54 Ibid.
55 Gerlis, Art as Investment?, 159.
especially in instances of artists like Murakami acting as designers. You have to look no further than the market for jewelry designed by big names including Pablo Picasso, Alexander Calder, and Lucio Fontana to see that the line between art and consumer products, if present at all, has grown tenuously thin.

**Transparency, insider trading, and access**

The term ‘transparency’ is thrown out so frequently in reference to the art market that it can start to feel meaningless. As defined by Investopedia, “[t]ransparency is the extent to which investors have ready access to required financial information about a company, such as price levels, market depth and audited financial reports. Transparency helps reduce price volatility, because all the market participants can base decisions of value on the same data.”

When people say that there is a lack of transparency in the art market, or that the market needs to be more transparent, they generally mean that there is a significant lack of information and market data available to the general public. In this regard, they are not wrong.

This lack of transparency allows insider trading to thrive and is why access has proven to be such a tricky issue. The lack of regulation and informational asymmetries are part of what allows art businesses to operate differently from those in other markets. However, it is worth distinguishing between information that only select art world people know, and information that nobody knows. In some ways, it may be more accurate to define many of the informational imbalances present in the art world as symmetrical ignorance. Similar to other creative sectors, the market for art is defined by high levels of uncertainty on both the demand and production

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sides, which means that everyone is just guessing to some degree. However, it is important to remember that informational imperfections are not necessarily negative. To quote economist Joseph Stiglitz, “there would be no reason to participate in a market with no investment or arbitrage opportunities.” We accept that no market is perfect, and it is in these imperfections that the clever or lucky people find new and innovative ways to profit.

What would be considered insider trading in the stock market, punishable by law, could be an average Saturday evening dinner in the art world. Well-connected individuals seek out as much industry gossip as possible, including information that is not yet available to the public like upcoming museum show rosters or recent acquisitions. Acclaim in the form of museum recognition helps legitimize artists in the canon and often allows them to reach new market heights. For people in the know, it could be a smart move to buy the artist’s work directly beforehand. This is just one of many thorny issues related to inside access. Dealers can bid up works by artists they represent at auction to help stabilize prices. They can also purchase works of art from their own artists, often having first choice. Collectors can donate money to museums and then have their personal works exhibited, which enhances their provenance and overall value. Unethical? Perhaps. But all is legal business.

The other side of this ‘insider’ position is the question of access. Of course money helps, but it can be challenging for the nouveau riche to gain access to the opaque art world, known to be suspicious of newcomers with unknown agendas. Big galleries have long waiting lists for works of art by their most coveted artists, and this is part of the reason why many people with

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57 Dempster, Risk and Uncertainty in the Art World, 34.
58 Gerlis, Art as Investment?, 128.
59 Velthuis, Talking Prices, 108.
60 Ibid., 44.
61 Horowitz, Art of the Deal, xv-xvi.
money to spend will go the auction route instead. This ends up being the most egalitarian market sector in many ways, as it is easier to buy your way in and requires less time spent building connections to get your foot in the door.

SECTION II: The Claims

In 1967, Englishman Richard Long stopped in a field in Wiltshire. He walked back and forth across the field, gradually flattening the grass until it formed a straight line. The result was A Line Made by Walking, and it was called art.

The rise of Pop and rampant commoditization of art in the 1960s caused a backlash, as artists sought to create works that could not be so easily absorbed by the growing market. To quote American Minimalist sculptor Richard Serra, who was embedded in the art world at the time: “If someone came in and said they’d sold out a show, people would say ‘too bad’ [...] It meant the audience understood what the work was.” Similar to Conceptualism and Minimalism, the land art movement emerged from this anti-market era. Earthworks were defined by their ephemerality -- an understanding that they were fundamentally unstable and would disintegrate over time. But they were permanent or fixed in the sense that it was impossible to divorce them from their environment without destroying the integrity of the

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work. This concept of site-specific installations had a lasting impact on the art world, challenging the idea of art primarily being bought and sold for profit.

It is interesting to contrast the dematerialized art movement with the way market-savvy contemporary artists approach their work. Here, the goal is to make art as digestible as possible. Pieces by an artist like Jeff Koons, for instance, are often used as examples of collector-friendly works. Sculptures from Koons’ famed Celebration series have it all: they are bright, shiny, simple in message, and recognizable as something quintessentially Koons.

Over the past few decades, postwar and contemporary art has become the most profitable market segment for the big auction houses. In 2015, this segment accounted for 46 percent of the market by value and 41 percent of all transactions. According to the 2016 Deloitte Art & Finance Report, Christie’s, Sotheby’s, and Phillips sold 2.81 billion dollars worth of art at their Postwar and Contemporary Evening Sales in New York and London. This is also the market segment most prone to speculation. The astronomical price increases for young contemporary artists over relatively short periods of time has led to ‘flipping’ culture. Flipping is when an art investor purchases a contemporary work on the primary or secondary market and swiftly resells it at auction for a huge mark up. Gallerists are anti-flipping, which they claim causes increased price volatility and destabilizes the markets for their young artists. It disrupts the art world standard of slowly raising prices over time, and can lead the prices for contemporary artists to skyrocket and then crash. Investors in favor of flipping believe the market knows best. They will

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remind you that it is completely legal for them to take advantage of the available resources to profit off their investment.\(^{65}\)

Although the concept of art as an investment is not new, this recent interest in speculation has been made possible through a few key changes. Greater pricing transparency through the availability of online auction records and other technological advances in modern finance theory have lead to more sophisticated ways to measure the return on art.

**Art price indices**

Several companies have created art-specific indices to demonstrate the favorable comparison of art to other financial assets. People with a background in finance have taken the tools available to them and applied the same modes of thinking to measure the performance of the art market. The majority of indices are constructed using the averaged and median prices of artworks sold at auction, which assumes that distribution of the quality of the paintings is fairly constant over time.\(^{66}\)

The most impactful art index as well as the one most likely to be cited in an academic setting is the Mei/Moses All Art Index. Developed in 2002 by Jianping Mei and Michael Moses, two New York University researchers, this index

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uses a repeat sales regression (RSR) to track the performance of artworks at auction. In Figure 1, the All Art Index is compared to the stock market represented by the Standard & Poor’s 500 Index (S&P 500). The intention here is comparing art and stocks to show that art has a similar investment profile.

In October 2016, the Mei Moses brand was purchased by Sotheby’s. Although it is still unclear what the long term impact of this deal will be, initial indications are that the Mei Moses methodology and resources will now be exclusively available for the Sotheby’s staff and clients, rather than the general population.

As more databases appear on the market, it is likely that we will see further proliferation of these types of statistic tracking metrics. The art market, as a space long defined by its pricing opacity, has been made more accessible through the online availability of public secondary market transactions. Large auction price databases such as artnet and Artprice have compiled millions of auction records dating back to the mid-1980s. However, the published prices are not the full story, as the inclusion or exclusion of transaction fees in the form of a buyer’s premium, works that sold but were never paid for, and accurate currency conversion also

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69 Gerlis, *Art as Investment?*, 33.
matter. Most importantly, these numbers only account for secondary market transactions. Sales on the primary market are private business and notoriously difficult to gauge. Nonetheless, it has never been easier to track both the performance of unique works, unique artists, and the art market as a whole. When artnet unveiled their artnet Indices in 2012, they were heralded as “the world’s first comprehensive set of art indices,” able to “provide quantitative market reports on the performance of artists like Andy Warhol or Damien Hirst, just as you might track a Fortune 500 company.”

The creation of indices such as the artnet C50 Index of contemporary art (Figure 2) made comparisons to the S&P 500 easy. Again, the implication is that investing in art can be equally if not more profitable than investing in stocks. Art, these graphs seem to say, is a valid vehicle for investment and we should all jump on board.

**Diversification and non-correlation**

One of the most common reasons cited for investing in art as a form of portfolio diversification is to invoke the low-correlation claim. Commodities are, on average, are thought to have low or even negative correlations to traditional financial assets, making them ideal for diversification. On a broader level, some people say that the performance of the art market does not track other world markets. This claim can appear particularly attractive in times of financial downturn or uncertainty, when investing in hard assets such as gold tends to go up. However, these claims should not be taken at face value.

One way to compare the relationship of the art market to other markets is by looking at trends in stock prices over time. Using Sotheby’s as an example, it is possible to track its stock

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price (BID) and compare it to the U.S. stock market. Studies have found a general positive correlation between Sotheby’s and the S&P 500, indicating that there is a relationship between performance of the stock market and performance of the art market as well.73

In 2008, Christie’s, Sotheby’s, and Phillips all suffered as a result of the financial crisis. Buoyed by their success in May, the auction houses locked themselves into prices for their November sales that quickly became unrealistic after the September market crash. Specialists were forced to encourage consignors to lower their reserves, indicate to bidders that they may be able to purchase works for lower prices than anticipated, and resign themselves to losing money on guarantees.74 Consequently, the auctions at Christie’s, Sotheby’s, and Phillips brought in half their expected sales totals.75

Together, the correlation between Sotheby’s and the S&P 500 and the poor performance of these auction houses in the wake of the financial crisis would appear to indicate that the idiosyncratic art market, despite its pronounced differences from other markets, is not operating in a vacuum. As such, claims regarding the diversification potential of art should be considered with appropriate caution.

73 Gerlis, Art as Investment?, 45.
74 Findlay, The Value of Art, 165.
75 Adam, Big Bucks, 37.
SECTION III: The Numbers

Ask any art lover why they have not started a collection of their own and the answer will likely be the same: it is simply too expensive. Most art requires a significant financial outlay, with prices for emerging artists sometimes starting in the four-figure range. This is not universal, and reasonably priced works, particularly prints, can be accessible for people of more modest means. However, people interested in the bigger names and so-called investment grade art will have to be willing to pay up. But what if it did not have to be that way? What if people could pool their capital and in doing so purchase shares of a single artwork? This way many people could own shares in many different works of art all at once, successfully diversifying their art portfolio. You could lower the barrier to entry, decrease risk, and maximize profit on your investment -- what could go wrong?76

Of course, enterprising people did think of this, and art funds entered the picture. These funds are not new per say, with notable historical examples such as La Peau de l’Ours at the turn of the 20th century and The British Rail Pension Fund in the 1970s. However, as the art market began to skyrocket in the early 2000s, more art funds appeared on the scene.77 The Fine Art Fund entered the market in 2002 with the lofty goal of raising $350 million. A year later, Fernwood

76 Dempster, Risk and Uncertainty in the Art World, 166.
77 Findlay, The Value of Art, 56.
Art Investments followed suit, setting a slightly more modest investment target of $150 million. Other notable funds include the China Fund, ArtVest, and Aurora Fine Art Investments. With record breaking auction sales happening what felt like every other week, it is unsurprising that more people wanted a piece of the art pie. But few of these funds have been able to sustain themselves, and the 2008 financial crisis caused many to shut their doors permanently. In fact, the entire history of art funds is marred by failure, with highly publicized funds like Fernwood shutting down in 2006 after only a few years of operation.

According the 2016 Deloitte Art & Finance Report, the size of the art fund market was estimated at $1.2 billion in 2015, down from $1.27 billion in 2014. Today, most of the existing funds are located in China, where art speculation is more popular than in the United States and Europe. To understand why these business models are often not as effective as they should be, let us first take a look at the data and the metrics surrounding the return on art.

Figure 3: The global art investment fund market 2011-2015; Estimated Assets Under Management (AUM) in billions USD

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78 Horowitz, *Art of the Deal*, 144.
79 Ibid.
The word ‘art’ means different things to different people, and vastly different things when looking at the performance of particular market segments. Even a person with little to no experience in the art world should understand that investing in a Picasso oil painting is probably not the same thing as investing in a Robert Smithson earthwork, which in turn is probably not the same thing as investing in a Damien Hirst skull covered in 8,601 diamonds.  

There is a reason most studies conducted on the return on ‘art,’ including the ones listed below, are actually studies of the return on paintings.

A painting possesses a number of attractive qualities that may begin to make it similar to a commodity. They are a physical object that can be owned; they are relatively sturdy, which means they can endure for a long period of time; they are typically more accessible or at least more universally understood to be a work of art; and, a lot of them can comfortably fit in a Park Avenue penthouse apartment.

The next step when unpacking these claims is to look at the data source. In this instance, studies looking at the return on ‘art’ utilize public auction records to compile their data. There are thousands of auction houses operating around the world, but more often than not when a new article mentions auction house sales they are actually talking about the two largest auction houses: Christie’s and Sotheby’s. This duopoly is responsible for the vast majority of high worth sales, with Phillips ranking a distant third.

Barring exceptions like the Damien Hirst sale, auction houses deal in the secondary market. This means that the work has already passed from the artist to his gallery, and the gallerist has sold it to someone else. In the United States, there is no artist resale right, so these

82 Horowitz, Art of the Deal, xv.
secondary market transactions do not directly benefit the artist. They also account for only about 50 percent of all market transactions.

The other 50 percent of sales occur on the primary market. This is the sphere in which many galleries operate. The artist consigns work to his gallery and the dealer sells them to collectors. All primary market transactions are private sales, which means that there is very little transparency in this sector and no public sales records available for research. What this means for art price indices is that, even with the best metrics, they are only a partial picture of the overall market. The most accurate index can still only account for about half the transactions taking place on a daily basis, and that limits their relevance.

After understanding what type of art is being evaluated and where these figures are coming from, we then have to consider the type of model being used. The majority of the studies done on art investment use either RSR or hedonic modeling. Both of these options have certain benefits as well as significant limitations.

**Repeat sales regression**

Utilizing RSR to model art performance is attractive foremost because you can actually track the performance of the *same* work of art over time. The drawback here is that repeat sales require just that -- the work of art must have been sold (at auction) at least twice. This is problematic for a number of reasons. The percentage of works that appear at auction *once* is very small compared to the overall number of works sold. The number of works that appear at auction at least *twice* is even smaller. This creates a very, very small sample size that is hardly representative of the overall data.\(^4\) In one art investment study conducted by Renneboog and

Spaenjers (2012), they discovered that limiting their data to works with matching characteristics (pairs) would have immediate impact on the study. Doing so reduced “the data set from 1.1 million individual transactions to 30,611 ‘repeated transactions’ -- pairs of identical, or at least very similar, items -- with a holding period of at least one year.”

This issue of data set size does not begin to address other problems with the selected numbers. Works sold at auction multiple times tend to possess certain desirable characteristics -- they are not your average work of art, but something with sufficient worth that the owner believes it has appreciated in value. The second issue is that works of art tend to appear at auction only at times when the consignor is ready to sell and the auction house agrees. If the auction house is not willing to accept the work, the consignor will mostly likely hang onto it until the market has improved. The third issue is that the structure of the auction house naturally creates an upward bias in price trajectory. Most lots include a reserve price, or a minimum value the work must meet to be sold. If the work fails to meet this reserve amount, it will remain unsold. In this way, it is almost impossible for auctioned works to substantially decrease in value because the reserve price forbids it.

The ever popular Mei/Moses Index utilizes this model, which raises concerns about the credibility of their figures. To quote economist Don Thompson, “[t]his is analogous to looking at stocks from the Standard & Poor’s 500 Index that have increased in value, and concluding that investment in shares is a good thing.” At best, the Mei/Moses Index is a measure of the profitability of already successful artists and overstates the return for an average art portfolio.

Hedonic modeling

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85 Ibid.
86 Adam, Big Bucks, 127.
87 Thompson, The $12 Million Stuffed Shark, 243.
A hedonic pricing model is based on assessing the subjective characteristics of a work of art in addition to external market factors. As previously mentioned, they are commonly used in the housing market to assess the desirability of homes in relation to their environment. One benefit of hedonic modeling is that it starts to account for the varied attributes of ‘art,’ and how specific characteristics such as medium, size, artist, time period, or subject matter may affect value. Unlike RSR, hedonic modeling cannot be used to track the performance of a single work of art over time, decreasing specificity, but it does increase the sample size of the available data. Again, it is worth remembering that the original data only accounts for roughly 50 percent of all market transactions.

Next, it is important to look at the time period that these studies consider. The art market has seen incredible expansion over the last 30 years, and a study looking at the early 20th century has little bearing on its current performance. A good study should be as current as possible and, at the same time, assess a significant time period in order to draw meaningful conclusions.

Looking at the time period is also how we can appropriately compare the performance of art to other more traditional asset classes over the same timespan.

In the story of the successful British Rail Pension Fund, there is one crucial detail that is sometimes left out: the performance of the stock market during that period actually yielded higher returns than those seen for art (and by ‘art’ here they mostly mean famous Impressionist paintings). Despite the fortunate performance of the Impressionist paintings in the fund, someone would have still been better off financially if they had invested in stocks instead.88

**Return on investment (ROI)**

88 Findlay, *The Value of Art*, 58.
A number of comprehensive studies have been done on the return on art as investment. As a heterogeneous good characterized by its unique properties, art is a challenge to measure quantitatively. As discussed above, studies have to consider what type of art they will measure, where they will source their data from, what time period they will cover, and what method or formula they will use to aggregate their results. Unsurprisingly, the results have varied depending on the metrics used. The table below depicts a selection of several more recent studies conducted on art returns and their corresponding findings. Here, the nominal rate of return reflects the amount of money generated by the investment before factoring in expenses, and the real rate of return adjusts for inflation. After considering these statistics, it is possible to contextualize them by comparing the return on art to other assets. A very simple way to do this is to compare them to the S&P 500 (represented as stocks) over the same period as the study in question. This is illustrated in Figure 4.

**Table 1:** Ten of the most recent studies done on the return on investment for art

<table>
<thead>
<tr>
<th>Contemporary Studies on Art Investment</th>
<th>Year</th>
<th>Type of Art</th>
<th>Method</th>
<th>Time Period</th>
<th>Nominal Return</th>
<th>Real Return</th>
<th>Data Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>De la Barre et al.</td>
<td>1994</td>
<td>Great Impressionists</td>
<td>Hedonic</td>
<td>1962-1991</td>
<td>12.0%</td>
<td></td>
<td>3% Annual Art Sales Index</td>
</tr>
<tr>
<td>Appollo and Pierce</td>
<td>1996</td>
<td>Popular paintings</td>
<td>Hedonic</td>
<td>1971-1992</td>
<td>9.30%</td>
<td></td>
<td>n/a ArtQuest</td>
</tr>
<tr>
<td>Mal and Moses</td>
<td>2002</td>
<td>Several painting schools</td>
<td>RSA</td>
<td>1879-2000</td>
<td>n/a</td>
<td>4.90%</td>
<td>New York Public and Watson Libraries</td>
</tr>
<tr>
<td>Reneboog and Van Houtte</td>
<td>2002</td>
<td>Belgian paintings</td>
<td>Hedonic</td>
<td>1970-1997</td>
<td>5.60%</td>
<td></td>
<td>n/a ArtQuest</td>
</tr>
<tr>
<td>Hodgson and Vorkink</td>
<td>2003</td>
<td>Canadian paintings</td>
<td>Hedonic</td>
<td>1968-2001</td>
<td>8.50%</td>
<td></td>
<td>n/a Campbell, Sotheby’s, and Westbridge</td>
</tr>
<tr>
<td>Worthington and Higgs</td>
<td>2004</td>
<td>Several schools of painting</td>
<td>Provided by AMR</td>
<td>1979-2001</td>
<td>3.03%</td>
<td></td>
<td>n/a AMR</td>
</tr>
<tr>
<td>Worthington and Higgs</td>
<td>2005</td>
<td>Australian fine art</td>
<td>Hedonic</td>
<td>1973-2003</td>
<td>7.02%</td>
<td></td>
<td>n/A Australian Art Auction Records</td>
</tr>
<tr>
<td>Worthington and Higgs</td>
<td>2006</td>
<td>Australian contemporary and modern art</td>
<td>Hedonic</td>
<td>1973-2003</td>
<td>4.82%</td>
<td></td>
<td>n/A Australian Art Auction Records</td>
</tr>
<tr>
<td>Krawetz and Elsward</td>
<td>2008</td>
<td>German art</td>
<td>Hedonic</td>
<td>1985-2007</td>
<td>1.80%</td>
<td></td>
<td>n/A Arnet price database</td>
</tr>
<tr>
<td>Reneboog and Spaniers</td>
<td>2012</td>
<td>Paintings and works on paper</td>
<td>Hedonic</td>
<td>1957-2007</td>
<td>n/a</td>
<td>3.97%</td>
<td>1.1 million auction sales</td>
</tr>
</tbody>
</table>

**Figure 4:** The nominal and real return on art in comparison to the nominal and real return on the S&P 500 over the same time period
As the chart shows, with the exception of De la Barre et al. (1994), none of the above studies have proven that art outperforms the stock market in terms of return on investment. In some cases, the *nominal* return on art does not exceed the *real* return on stocks over the same period. Renneboog and Spaenjers (2012), the most recent study listed above, is particularly comprehensive in scope. Here, the data set was comprised of 1.1 million auction records from 1957-2007 and included different schools of painting as well as works on paper. These choices distinguish them from previous studies, which drew conclusions based on significantly smaller sample sizes and relied on high-quality paintings sold at top auction houses.\(^8^9\) Table 2 lists their results. Here, they compare the return on art to other asset classes, including stocks, Treasury Bills, bonds, gold, and real estate. The volatility of each investment is represented by the standard deviation (S.D.). Their findings confirm that art does not outperform equities (S&P 500 stocks, Global stocks) and has the second highest standard deviation (19.05%) after gold (24.19%).

One additional study not listed in the table above is Dimson and Spaenjers (2014). They took the data from two previous studies conducted by Goetzmann (1993) and Renneboog and Spaenjers (2011) and chain-linked their findings to five years of returns on the art market.

Based on these results, they then generated a deflated index from 1900-2012 to compare the return on art to equities, government bonds, UK Treasury Bills, gold, as well as the collectible classes stamps and violins (Figure 5). Dimson and Spaenjers concluded that equities have outperformed all other asset classes, while collectible classes have enjoyed higher returns than bonds, Treasury Bills, and gold.

**Risk**

Although these studies have shown that art produces lower average returns than equities, this information alone does not necessarily indicate that art is a bad investment. Treasury Bills, for example, also have a lower average return than equities and art, and people are still willing to invest in them. The reason for this is because Treasury Bills have very low risk.

Conceptualizing risk is deceivingly complicated, due in large measure to the fact that risk has a negative connotation and is often linked to danger. Linking risk to danger or hazard has the potential to paint risk in an unfairly negative light. Outside of danger and its synonyms, another natural word pair for risk is reward. Risk-taking is a process that drives innovation, change, and, ultimately, progress. Our society celebrates and even glorifies the entrepreneurial spirit for this very reason. We believe that

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90 Dempster, *Risk and Uncertainty in the Art World*, 221.
91 Ibid., 26.
92 Ibid., 31.
people who make themselves vulnerable and open themselves up for potential failure should be justly rewarded if and when they succeed. In finance and many other industries, risk is not a factor to be demonized but instead something that must be understood, analyzed, and managed. Risk management and risk elimination are often used interchangeably, but it is worth remembering that a complete elimination of risk is not usually the goal. In investing, appropriate risk-taking is considered essential to reap financial gains. While different investors have different risk tolerance profiles, most are comfortable with shouldering a certain amount of risk if it means there is greater potential to profit.

Art, in addition to having lower returns, is also a riskier, less liquid investment than stocks. According to Renneboog and Spaenjers (2012), the standard deviations for S&P 500 (16.54 percent) and global stocks (16.16 percent) were lower than the standard deviation for art (19.05 percent). On average, the price volatility of emotional assets such as art is larger than standard deviations alone would indicate due to other issues such as consumer fickleness, fluctuating tastes, and potential for forgeries and frauds. The heterogeneity of art also makes appropriate asset selection for your investment portfolio a significant challenge.

The application of risk management in finance stands in stark contrast to the emphasis placed on risk-taking in creative enterprises. Artists are not just encouraged but expected to take great risks. What sets a good artist apart from a great artist is often the degree to which he pushes the boundaries of what is possible. Risking everything is seen as empowering for artists, and is something that separates them from people who are unable to do the same. We live vicariously through artists, trendsetters, and other outsiders who are unafraid to speak their minds and

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94 Dempster, Risk and Uncertainty in the Art World, 234.
95 Ibid., 36.
question the very underpinnings of our society, even if it makes us uncomfortable. *Especially if it makes us uncomfortable.* Tremendous value is placed on the role of chance in the artistic process. Whether this is in the form of readymades à la Marcel Duchamp’s famous *Fountain* or through capitalizing on the unexpected, art runs the gamut from perfectionist hyperrealism to random paint splatters.\(^{96}\)

I do not mean to equate the risk involved in art’s creation to the risk involved in its purchase, but I do think it is worth considering how these different risks inform each other, as well as impact buyers’ behavior and attitudes towards investing in art as opposed to other alternative financial assets.

**The real cost of owning art**

Unlike investing in stocks or bonds, art is a tangible thing that requires a substantial amount of upkeep. Maintaining an art collection in good condition can be very expensive, and a collector should be prepared to incur a variety of costs. These costs can equal 1 to 5 percent of the total value of the art.\(^{97}\) Preparing the art for its space includes costs related to framing, shipping, lighting, and humidity controls. Once the art has been displayed, it may need to be cleaned or restored over time. Most homes are not museums, and kids, pets, and life’s everyday activities are not always art friendly. Keeping your valuable art safe can also include expensive security measures and insurance. All these costs do not include the money spent traveling to visit galleries, consulting art advisors, staying at hotels, and so forth.

**Transaction costs**

The expenditures outlined above do not touch on the substantial transaction costs that can occur when dealing with art. If a collector chooses to buy or sell a work on the secondary market,

\(^{96}\) Ibid.

\(^{97}\) Gerlis, *Art as Investment?*, 68.
it is standard for them to have to pay additional fees for the privilege of doing business with the auction house. These fees apply, to various degrees, regardless if the collector involved chooses to sell or buy publicly or through a private treaty sale. If selling, the consignor often has to pay a seller’s commission. This fee is negotiable and a prominent seller, or someone consigning an especially attractive work, may be able to decrease or outright avoid this fee. If buying, the purchaser must pay a non-negotiable buyer’s premium on top of the hammer price. The buyer’s premium is calculated on a sliding scale, and is freely accessible on the auction house’s website.

**Taxes**

Depending on the jurisdiction, art is subject to a variety of taxes including local sales tax and capital gains tax, which is capped at 28 percent for art and collectibles. Individuals’ desire to avoid paying taxes on their art has had unforeseen consequences in regard to the fate of the art itself. By exploiting loopholes in tax law, investors can sometimes avoid or defer paying taxes by displaying their art at a museum in certain U.S. states or even keeping it in storage.

**Liquidity**

Money is the most liquid of all assets, but stocks are designed to be as liquid as possible, particularly those listed on a major exchange with lots of buyers and sellers. A stock is considered liquid if it can be sold rapidly without the sale having a significant impact on its price. One way to assess a stock’s liquidity is by looking at the bid/ask price; a liquid stock should have a very small spread. All this data can be easily accessed and purchases can be done online with great speed.

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100 Ibid., 26.
Unlike the stock market, art is a highly illiquid asset. Like real estate, it takes time to find the right buyer for an expensive work of art, arrange the sale, and have the money finally exchange hands. Circumstance takes on increased importance in the art world, as placing a work with the right collector requires patience, luck, and time. For these reasons, it is easy to underestimate the amount of time it takes to sell.\textsuperscript{101} Many galleries struggle with cash flow for this reason.

The issue of liquidity (or lack thereof) makes the art loan industry of particular interest, and using art as collateral for a loan must be done with appropriate caution. Art loans can be arranged through specialized departments in big banks, with boutique art loan companies, or through auction houses such as Christie’s or Sotheby’s. Safety measures include deciding whether the loan will be recourse or non-recourse, choosing a conservative percentage of the art’s value that can be loaned against (typically 40-50 percent), and setting a high interest rate.\textsuperscript{102} Art loans done through big banks like Citibank and JPMorgan, for example, are recourse loans. This means that while the bank can seize the artwork as collateral, they can also choose a more liquid security instead.\textsuperscript{103} Essentially, this means that if the client defaults on their loan the auction house are allowed to choose a more liquid asset than art. All art loan businesses also thoroughly vet their clients before proceeding. Their working relationships with these wealthy individuals is incredibly important in ascertaining whether or not they are a trustworthy client. While very wealthy clients with many assets may be able to secure an art loan at a very low

\textsuperscript{101} Findlay, \textit{The Value of Art}, 57.
\textsuperscript{103} John Dizard, “The business of lending against art has never been better,” \textit{Financial Times}, February 5, 2016, accessed December 10, 2016, \url{https://www.ft.com/content/0d4a50f0-cbff-11e5-a8ef-ea66e967dd44}. 
interest rate, it is potentially misleading to call it a loan against the art when it is a loan against the client themselves.\textsuperscript{104}

As outlined above, purchasing art for investment purposes is not as straightforward as it might initially seem. Due to the limited and sometimes dubious available data, it is difficult to create accurate indices and up-to-date studies on art’s investment potential. At best, these results account for half of all market activity, which further limits their use. The cost of owning art does not stop at the purchase price either, and investors must be prepared to incur a variety of other costs, some of them quite high, over the long holding period. Art’s lack of liquidity means that it is still possible that no one will be willing to buy the work later, or that it will take many months to arrange a sale and even longer for money to exchange hands. And after all of this trouble, art is still not as profitable as investing in a more traditional asset like stocks. If this is true, why does art investment remain so popular? The answer to this may lie, partially, in the non-financial motivations for art investment.

SECTION IV: The Intangibles

\textsuperscript{104} Gerlis, \textit{Art as Investment?}, 112.
It is hard to believe that there are collectors who purchase art without ever intending to look at it, and yet it happens all the time. People will sometimes joke that the largest art museum in the world is actually located in Geneva, Switzerland. Not a museum by name, but this Swiss city is home to the world’s largest freeport, Port Francs, which reportedly holds more than $100 billion dollars worth of art.105 A freeport is defined as a series of bonded warehouses where goods are considered ‘in transit’ and are thus not subject to local taxes. Goods can be moved through or stored there for long periods of time. You can think of a freeport as a maximum security deposit box. They can hold gold, cars, and most other valuable physical property. Or, more cynically, they are a tax haven for investors trying to maximize their profit without care for any of art’s symbolic benefits. Advantages of keeping art in a freeport include proper storage, decreased risk of damage, a neutral location to do business, and minimal disclosure. Combined, this description can make freeports start to sound like unfairly shady business. Issues of legitimacy aside, the discreet nature of freeport operations is certainly attractive for an art world population characterized by its desire for anonymity.106

Of course, there is the non-financial cost of storing your art in a freeport; you do not get to interact with it in any way, and this should raise a red flag. People generally agree that the true value of art supersedes its price tag, however high that may be. The many non-monetary reasons for investing in art further sets it apart from other assets, with an average of only 10 percent of

105 Adam, *Big Bucks*, 179.
106 Ibid.
high-net-worth-individuals (HNWI) saying they collect art as a pure financial investment. Art collecting is a hobby grounded foremost in passion -- in love -- and there are many benefits of purchasing art that exclude financial motivations. In his book *The Value of Art*, author Michael Findlay calls these non-monetary motives the intrinsic and social values of art.

**Intrinsic value**

The power of art is that it means something different to every individual. It has vast cultural value, and is representative of our collective history. It can be political or forward-looking. In some cases, it can be reflective of a point in time and serve as an important historical document. It can be beautiful or challenging or both at the same time. The very act of creating it can be transgressive, and it can take just about any form imaginable.

People are naturally drawn to art because it is constantly pushing the boundaries of what is possible. Like comedy, it allows people to critically reflect on our society from an outside perspective. It operates free of taboos and censorship and is a celebration of otherness. It is a powerful unifier. To reduce art to a dollar amount feels inherently disrespectful to its limitless symbolic value. Of course, this conferred ‘pricelessness’ does have a price, and is part of the reason art can become so expensive.

Collectors realize that art has a unique power -- this is generally why they want to collect it. Within the art world, collectors can be divided into two distinct categories: those who buy art for the ‘right’ reasons (passion) and those who buy it for the ‘wrong’ reasons (investment). This is a black-and-white way to understand the difference, as the majority of collectors fall somewhere in between. Nonetheless, dealers are notoriously picky about who they place their

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work with, and if a client has previously bought and then flipped a work at auction, they run the risk of being blacklisted by galleries.\textsuperscript{108}

\textbf{Social value}

Conspicuous consumption may date back to the early 20th century robber barons, but it is equally relevant when profiling the contemporary collector. Buying a Koons or Warhol can make the collector feel like he is gaining access to a special club. He wants something that reflects the artist’s brand and can be displayed in a prominent place in his home or work. In doing so, visitors will be able to see and subsequently recognize the art as something impressive and expensive.\textsuperscript{109}

This type of significance or worth is even more difficult to quantify than the financial return on art, and there is an argument to be made that it cannot be done. Studies on the so-called psychic return on art do exist, indicating that the enjoyment people receive living with their collection can equal up to a 28 percent return on their investment.\textsuperscript{110} This is not the type of figure that you could bring to the bank when you want to take out a loan against your beloved Koons, but it could be significant for those looking to bridge the gap between art and other more prudent investment choices.\textsuperscript{111} Think of it as a visual dividend.\textsuperscript{112} Studies on art have demonstrated that, while risky, it has a higher return than Treasury Bills, bonds, and gold. This psychic return could be the missing component that makes art a savvy investment. That fact of the matter is that this is a highly personal choice.

\textsuperscript{108} Velthuis, \textit{Talking Prices}, 95.
\textsuperscript{109} Dempster, \textit{Risk and Uncertainty in the Art World}, 113.
\textsuperscript{110} Gerlis, \textit{Art as Investment?}, 107.
\textsuperscript{111} Velthuis, \textit{Talking Prices}, 43.
\textsuperscript{112} Gerlis, \textit{Art as Investment?}, 107.
Conclusion

By applying typical market-based logic to a good with essentially unmappable characteristics -- a good that is further celebrated for fighting against any market structure -- we have set ourselves up for disappointment. The first step to understanding the art market is to acknowledge that it is not like any other market, and applying the reasoning that works in other settings may not work as well here due to its idiosyncrasies. Having said that, the art market does not operate in a vacuum either, and the interplay between markets in our increasingly globalized society has significant impact on the success (and failure) of major players like Sotheby’s and Christie’s. We cannot put the art market in a box of its own and pretend that there is no relationship between it and the rest of the world. Yet, the problem with comparing the art market to other more transparent markets is that the underlying data is simply not there. The available statistics are a start, but they only tell part of the story. In this age of sophisticated technology, people have become increasingly reliant on numbers and algorithms as statements of fact. The truth is that finance is often more art than science itself, and the variable numbers surrounding art as an investment are further proof of this.

The intent of this article is not to be prescriptive, or to say what we should or should not do. Rather, it is mainly exploratory. People ought to be able to make informed choices, and this can only occur if they have a clearer understanding of the art market and the many assumptions that surround it. For those still interested, here are a few things potential investors would be wise to consider before making a purchase:

(1) Art is a substantial financial outlay, both in terms of purchase price, associated transaction costs, and upkeep. Art is also risky, and potential investors must be comfortable with
a higher level of uncertainty in their investment. This means that realistic expectations are a must. There is no cheat sheet, and high rates of return will never be a given.

(2) Art is not instantaneous the way stock trading is, and requires a patient temperament. Many things happen at a slower pace -- from forming close connections to selecting the right work to gathering the necessary funds -- building an art collection takes time. Holding onto your art until you are potentially ready to re-sell it at a later date is also part of this.

(3) For all these reasons, passion and engagement are paramount to successfully building a strong collection or investment portfolio alike. The time, energy, and resources required to become a part of the art world are not sacrifices everyone is willing to make.

In general, art exhibits decreased returns when compared to traditional equities. At the same time, investing in art has never been more popular. Unless buyers are completely irrational, there must be an explanation for this behavior. The reasoning here lies somewhere between eternal optimism, overconfidence, high risk tolerance, and the non-monetary reasons for choosing to collect art. The simple answer is art brings many people great joy. If that joy turns out to also be a salient investment in the future -- excellent -- but the best historical investors have also been passionate collectors. To this end, it would appear that investing in art solely with the expectation of making money is a good way to end up on the losing end of the deal.
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