4 Investing in art

Art as an asset class

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Introduction

This chapter is based on my role as an art investment advisor to the British Rail Pension Fund and ABN Amro. For the most part, 'art' refers principally to paintings, although in fact the principles set out in this chapter apply equally to all categories of high-end works of art (i.e., to pieces with a relatively high unit value) including not only pictures but also drawings, prints, sculpture, porcelain, silver, vertu, jewellery and other categories of works of art and collectibles.

Disclaimer

The art market is not a regulated market. None of the statements contained in this chapter are intended or should be construed as constituting investment advice. As is the case for all asset classes, past performance should not be taken as an indicator of future performance, and therefore investors may not get back all they invest. Consequently art should be considered as an asset class only by investors who fully understand and can afford the risks involved.

Background

For most of the twentieth century art was considered principally in terms of its aesthetic merits. True, there were a few individuals – and one noted institution – who saw the investment opportunities, but they were very much in the minority. The phrase 'aesthetic dividend' was used to describe the pleasure derived from owning art, but all too often it sounded like an uncomfortable apology for the fact that art, unlike 'real' investments, produced no income. It certainly didn't pretend to be a serious observation on the investment merits of art.

Those people who spoke about 'investing in art' tended to be dealers or auction houses, in other words those who had a vested interest in attracting new money into the art market. Their attempts to attract new buyers by

claiming that art was a good investment lacked credibility in the financial markets, because they were unsupported by any robust quantitative analytic evidence. Fluctuations in art prices further undermined their attempts, and as the conventional financial markets became ever more closely regulated, the auction houses were unable to recommend art as an investment, as they did not have the status of recognized registered investment advisors.

The phrase 'alternative investment' was still occasionally heard when discussing motives for acquiring art, but few people were treating it seriously, and fewer still were properly equipped to talk the language of the sophisticated investor interested in diversifying his investment portfolio to include art. A very few banks were offering what they liked to call 'art banking services' to their high net worth private clients, but on close inspection these turned out to be largely advisory services, with little or no attempt to integrate their clients' art dealings into the context of overall wealth asset management.

From the early 1980s onwards, as art prices escalated ever higher, an investment motive was frequently imputed as a justification or rational validation for what was in reality largely an aesthetic decision. Given the outstandingly high prices currently being achieved in many sectors of the art market, it is clearly difficult to ignore the value of art holdings when making decisions about asset allocation or wealth management, but this is not necessarily the same as treating one's artworks as investments.

But in spite of this ambivalence as regards art as an investment *per se*, since the late 1990s there has been an increasing readiness on the part of serious investors to consider the merits of fine and decorative art as an asset class. There are two quite different reasons for this change of attitude. It is partly a recognition of the intrinsic attractiveness of art as an asset class, and partly also a result of the failure of conventional assets to deliver consistently attractive returns over a period of time. Some observers believe that the recent volatility of the world's major stock markets and their short-term over-reaction to news, are signs of an impending correction. This nervousness has only served to emphasize the attractiveness of relatively unvolatile hard asset classes such as art, especially since much of the news about the art market reaching the press at the present time reinforces the perception of its underlying strength.

With paper-backed assets such as stocks and bonds – and the increasingly sophisticated financial derivatives which are based on them – there is always a small but real risk of the asset becoming almost completely worthless; one has only to think of shares in companies such as Enron, WorldCom and others which were once regarded as 'blue-chip' stocks likely to be found in the most conservative pension fund portfolios.

By comparison, given the hard asset-backing of art, the corresponding investment risk is effectively nil. In the language of investment analysis, the downside risk of art is exceptionally low. Art has a high, effectively certain residual value – 'a good Canaletto will always be a good Canaletto'. The only

real risk to the value of the asset is that the collective cultural consensus on which art valuations are based will be withdrawn, and providing the art is carefully chosen, the risk of this happening is remote. That said, there is a considerable difference between the downside potential of Old Masters, say, with a cultural value consensus established over a period of centuries, and the risk involved in buying the works of contemporary artists whose value has yet to be put to the test of time.

The demand for hard information about the performance of art as an asset class has led to the emergence of formal market indices, most notably the Mei Moses Fine Art indices, developed by two professors at New York University's Stern business school. They (and others such as Art Market Research, Artnet and Artprice) provide reliable, independent measures of underlying performance based on the hard empirical evidence provided by large numbers of open market transactions. Although the methodologies underlying their construction may differ, investors may safely use these indices as benchmarks against which to monitor the performance of their art holdings (always providing of course that the indices are based on the same types of artworks as the investor has acquired). In contrast to the stock market, where index performance is very much accepted as the norm, knowledgeable dealers and other expert advisors in the art market are consistently able to add value to the underlying performance indicated by art market data, so that an actively managed art investment fund can expect to achieve returns significantly in excess of those predicated by published indices. This is one of the consequences of the lack of transparency and inefficiency which characterize the art market pricing mechanism, and which can be made to work to the advantage of the canny investor with a good advisor.

Performance characteristics of art

Although the various art market indices testify to the superior returns achieved by art over extended periods of time, in fact the appeal of art as an asset class is based on far more than simply the long-term returns achievable. Other specific fiscal characteristics of art which enhance its investment appeal include: its international marketability; its relative non-correlated or even counter-cyclic properties vis-à-vis conventional stock market assets; and an exceptionally attractive risk/reward profile (see Table 4.1 and Figure 4.1). Together these make for a highly desirable investment class, in which a superior long-term return is just one of the attractions.

Critics in the past were always quick to criticize art for its supposed volatility, claiming that this made it unsuitable for consideration as a serious investment. This claim was shown to be largely unfounded in research carried out in 2003 by the Glenmede Trust Company, a leading US financial institution, which applied the formal techniques of the financial analyst to the Mei Moses art market data. Using the Sharpe Ratio approach to calculate risk/return ratios, the study demonstrated that adding fine art to a diversified

Table 4.1 Mei Moses Fine Art Indices 2006 results

Annual returns	*Mei Moses all art*	*S&P 500 total return*	*US Treasury Bills*	
			10 Year	*Short Term*
Last fifty years	10.0	10.62	6.69	5.45
Last five years	11.63	6.08	5.50	2.08
Last year	18.27	15.79	2.68	3.13

Note: Comparable data is given up to 2006 only.

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portfolio produced a slightly greater return for each unit of risk, and a significantly better return with less volatility than most asset classes on their own. The report concluded:

> Fine art has shown a durable record of price retention and a low correlation to more conventional asset classes. These attributes could make art an interesting addition to a well-diversified portfolio, helping to reduce overall volatility while potentially generating long-term appreciation.

Since Glenmede's groundbreaking analysis, other investment banks have followed suit. The most striking endorsement of art as an asset class in the UK was when Barclay's included art for the first time in its annual review of the performance of a variety of asset classes (Barclays Capital, *Equity-Gilt*

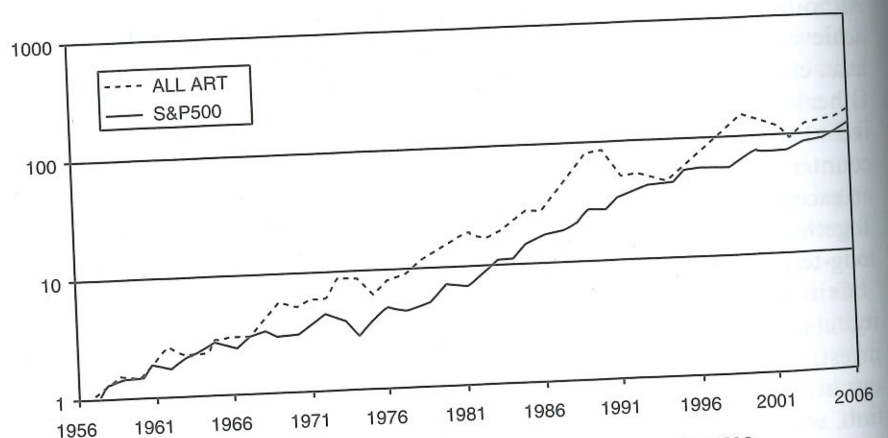

Figure 4.1 Mei Moses Annual All Art Index versus total return S&P500.

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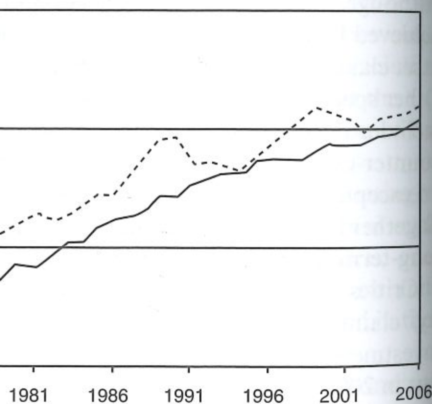

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Study, February 2005). The review examined the performance of a range of asset classes over four classic different business cycle conditions (see Table 4.2). It acknowledged the potential of art as an integral element of a broader asset diversification policy, especially in the context of its volatility profile:

> In the long run, art reveals positive results during years of above trend inflation, which initially suggests that art is able to provide some hedge against inflation. The weakest performance for art is during periods of weak growth and low inflation – the exact point in the business cycle when equity returns are at their strongest. This suggests that combining art and equities within a portfolio may provide good diversification across the four economic scenarios. This diversification [argument] can also be seen when inflation is above trend and growth is below trend.

Using historical data for the UK, the review charted the twenty-year rolling correlation between inflation and the five-year annualized real total returns of each asset class to test how well they hedged inflation over time. Barclays Capital study observed:

> Even over a 5-year holding period equities failed to hedge against inflation for the bulk of the [twentieth-] century. It is only in recent years that equities have shown a positive correlation with inflation. Art, on the other hand, performed quite well between 1942 and 1962, and again from 1999 onwards.

The review also notes that 'art recorded a steady increase [from 1955], outperforming Gilts and cash'. On the basis of these features, the Barclays Capital study recommended an allocation of up to 10 per cent of a diversified portfolio in fine art (the original Glenmede report had recommended up to 12 per cent). The Barclays Capital study also made the following important point:

Table 4.2 Average post-war real total returns (%)

Annual returns	*Above-trend inflation and growth*	*Above-trend growth and below-trend inflation*	*Below-trend inflation and growth*	*Above-trend inflation and below-trend growth*
Equities	4.41	13.42	11.06	4.11
Bonds	–0.21	0.08	9.00	–0.79
Cash	–0.36	1.95	2.18	0.67
Art	9.23	7.54	–0.85	0.31

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> Modern financial theory is placing a much greater emphasis on asset liability matching. As a result, defined benefit pension funds and some insurance companies have been eschewing equity investment in favour of bonds. The post-bubble regulatory environment has eliminated the ability of defined-benefit and insurance funds to ignore short-term equity volatility in favour of the long-run positive return. . . . We also think that European debt managers will increasingly look to issue more inflation-linked and long maturity debt in order to provide its savings industry with liability matching instruments.

The investment profile of the fine art asset class – and especially the historical tendency of art to provide a real return against inflation – makes it ideally suited to such investment objectives.

To summarize, the combination of (1) attractive yields projected for art compared to conventional asset classes, (2) an appreciation of the relatively low risk associated with such hard asset-backing, and (3) the development of sophisticated allocation strategies in a broader investment context, together ensure that art looks increasingly attractive as part of a diversified asset allocation strategy in a post-hedge fund era. The issue is no longer whether or not art is a viable, attractive asset class; that can now be taken as a given. The only substantive issue now is the most effective means of structuring efficient vehicles for investing in art.

British Rail Pension Fund

The first serious example of institutional investment in art was that undertaken by the British Rail Pension Fund, which began investing in works of art at the end of 1974. The original rationale for purchasing works of art must be viewed in the light of the financial and economic conditions prevailing at that time. The OPEC-led Oil Crisis in 1973 had had a catastrophic impact on the world's leading economies, leading many market observers – especially those in the UK – to seek a new paradigm in terms of investment strategy. First, stock markets had fallen dramatically – in the UK, the FT-Actuaries Index (the main indicator of stock market performance at the time) fell by over 70 per cent between the beginning of 1973 and the end of 1974 (when the Fund began to buy works of art) while in the USA the Dow Jones Index fell by more than 40 per cent over the same period. Second, rates of inflation were unprecedentedly high – the annual figure in the UK at the end of 1974 was only a little short of 30 per cent, while US inflation peaked at over 12 per cent per annum at around the same time. Third, sterling was depreciating strongly against other European currencies and the US dollar. Fourth, there was a sharp fall in the commercial property market, which had hitherto been a popular investment for pension funds.

Were such a situation to occur at the present time, an acceptable investment strategy might be to diversify into index-linked securities. However, no such

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investments were available at that time. Against this background, the Fund's investment managers concluded that it would be advisable to seek to diversify a proportion of the Fund's investments into a class of assets where there were reasonable prospects of achieving long-term growth at least equal to inflation. Fine art was identified as an asset-backed investment whose financial characteristics were ideally suited to the Fund's requirements. The asset profile of fine art closely matched the Fund's liabilities, and it offered the further advantage of having an international marketability, thereby providing a hedge against the changing fortunes of the UK economy, as well as a protection against currency realignments. Additionally, artworks provided a convenient means of taking advantage of investment opportunities overseas without attracting the premium which was levied at the time on the purchase of foreign currency for investment purposes.

It was agreed that up to 6 per cent of the annual cash flow of the Fund should be allocated to works of art as part of a long-term diversification strategy, subject to the availability of suitable (i.e., investment-quality) items. During the acquisition period, which lasted from the end of 1974 to 1980, the Fund invested some £40 million in a variety of works of art; the intention was to concentrate principally on forming well-rounded collections, representative of each of the agreed collecting categories, as well as occasional outstanding individual pieces outside of these collections.

By the time the Fund ceased to buy art in 1980 it had acquired altogether some 2,400 works. Seven key collections together accounted for approximately 76 per cent by value of the whole portfolio: Old Master Paintings (18.8 per cent); Old Master Drawings (11.1 per cent); Impressionist Art (10.2 per cent); Chinese Works of Art (10.2 per cent); Books and Manuscripts (10.0 per cent); Antiquities (8.3 per cent); Medieval and Renaissance Works of Art (6.9 per cent). The remaining 24 per cent by value of the art portfolio was spread thinly across a wide range of other collecting categories, including Old Master Prints, Japanese works of art, nineteenth century decorative art, Continental pictures, English pictures, furniture, vertu, and silver.

The works of art acquired by the Fund were initially intended to be long-term investments. However, following a review of the portfolio in 1983 it was decided to sell a number of works which fell outside of the mainstream collecting areas and in 1987, prompted by unexpectedly strong trading conditions, it was decided in principle to dispose of the entire holdings of works of art. Plans were made for a carefully controlled programme of sales, to be implemented over a period of years.

The first sale, consisting of the Fund's collection of Old Master prints, took place in June 1987 and realized a total of approximately £2 million, compared to a book cost of £607,000. The time-weighted cash return (IRR) was equivalent to approximately 11 per cent p.a., which was some 2.5 per cent p.a. greater than the rate of inflation over the period. The satisfactory outcome of this first sale prompted a number of subsequent sales from the

Fund's other collections during the latter part of the 1980s and into 1990 (see Table 4.3 and Figures 4.2, 4.3, 4.4 and 4.5).

The selling programme was temporarily suspended towards the end of 1990 in the light of rapidly deteriorating market conditions. Selling resumed in 1994, with the return of strength in the art market, when it was decided to work actively to dispose of the remainder of the Fund's art holdings. The Fund's collection of Old Master pictures was dispersed in four separate sales: in December 1994 (cash IRR 12.8 per cent p.a.), July 1995 (cash IRR 6.9 per cent p.a.), July 1996 (cash IRR 5.4 per cent p.a.) and January 1997 (cash IRR 6.8 per cent p.a.). The other significant collections sold after 1994 were Persian and Indian Miniatures and Manuscripts in April 1996 (return 0.5 per cent p.a. in excess of inflation), European Works of Art in July 1996 (return 2.3 per cent p.a. in excess of inflation) and Ancient Glass in November 1997 (return 1.5 per cent p.a. in excess of inflation).

As at December 2000 it was estimated that the total income arising from the Fund's sales of its works of art amounted to £168 million. The overall cash IRR achieved on the sales was 11.3 per cent p.a., or approximately 4.0 per cent p.a. in real terms after allowing for inflation.

The Fund's collection of 2,400 items consisted of a relatively small number of high-value works and a much larger number of less valuable works. It was estimated in the early 1980s that no more than fifty of the works were individually worth £250,000 or more, but that together they accounted for well over one-third by value of the whole collection. A 'Top 100' group of works

Table 4.3 Subsequent sales from the Fund's collections

Category	*Sold*	*Return*
English Silver	Nov. 1987	Cash IRR 15.7 per cent p.a.
Japanese Prints	Jul. 1988	Return approx. three times total purchase cost
Oceanic Art	Jul. 1988	Return below the rate of inflation
Books and Manuscripts	Sep. 1988	Cash IRR 8.7 per cent p.a.
Continental Porcelain	Oct. 1988	Cash IRR 11.4 per cent p.a.
Continental Silver	Nov. 1988	Cash IRR 14.1 per cent p.a.
French Furniture	Nov. 1988	Cash IRR 11.6 per cent p.a.
Impressionist and Modern Art	Apr. 1999	Cash IRR 21.3 per cent p.a.
Chinese Porcelain	May 1989	Cash IRR 15.4 per cent p.a.
African Tribal Art	Jul. 1989	Cash IRR 4.1 per cent p.a.
Early Chinese Ceramics	Dec. 1989	Cash IRR 15.8 per cent p.a.
Gold Boxes and Vertu	May 1990	Cash IRR 12.9 per cent p.a.
Nineteenth century Continental Pictures	Jun. 1990	Cash IRR 14.6 per cent p.a.
Nineteenth century Victorian Pictures	Jun. 1990	Cash IRR 17.6 per cent p.a.

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was subsequently identified, broadly corresponding to those works individually valued at £120,000 or more at the time. This group was estimated to account for approximately half of the value of the whole works of art portfolio.

Subsequent experience demonstrated that the returns achieved by these higher value core holdings tended to be generally superior to the returns achieved by the very much larger number of lower value works. In other words, the Fund's overall investment performance would have been markedly improved if the holding had been limited to a much smaller number of high-value, top-quality works of art. For example, just four of the Fund's twenty-five Impressionist and Modern Art collection sold in April 1989 accounted for over 60 per cent of the total realized sale proceeds and eleven accounted for over 90 per cent. The remaining fourteen works (56 per cent by number) accounted for less than 10 per cent of the sale proceeds. Again, just three of the Fund's seventy-five Chinese ceramics sold in December 1989 accounted for over 50 per cent of the total sale proceeds and twenty lots accounted for 90 per cent of the sale proceeds. The remaining fifty-five lots (73 per cent by number) accounted for only 10 per cent of the proceeds.

The fact that excessive diversification into low value works was ultimately detrimental to the Fund's overall performance, and that the same degree of protection against excessive volatility and changes in taste could effectively have been achieved with a substantially smaller portfolio of works of art, is a valuable pointer to the objectives which a fund launching today would want to follow.

Subsequent attitudes towards investing in art

The British Rail Pension Fund's art investment diversification programme had been mired in political controversy from the start, when it had been argued that the pension fund of a state nationalized body had an obligation to invest its funds in enterprises which created employment opportunities, especially during times of economic crisis. The subsequent performance of the art fund vindicated some of its critics, when it achieved its stated objective of producing a real return after inflation. However, no-one could have foreseen the strength of the recovery of the UK stock market during the period. The FTSE-Actuaries Index fell to a low of 61.92 during the fourth quarter of 1974 when the Fund started buying art, and exceeded 3,000 during 2000 when it made its final disposals and calculated the overall returns on the whole exercise. With this level of growth, it is hardly surprising that few if any of the works of art purchased by the Fund succeeded in out-performing the equivalent time-weighted stock market returns; in other words, with the benefit of hindsight, the Fund would have done better in performance terms if it had never made the decision to diversify into art, but had instead simply continued to invest in stock market securities.

Although beating the stock market had never been one of the Fund's objectives, nevertheless the superior performance of the stock market during the period of the programme inevitably cast a cloud over its achievements. Meanwhile, a range of sophisticated high-yielding investment vehicles made their appearance during the latter part of the twentieth century, that provided an ostensibly safer and more profitable home for institutional funds and for high net worth individual investors. As a result, there was little if any incentive to invest in art, and this remained the case until the late 1990s, when a combination of volatile stock markets and strengthening art prices led investors to reassess the comparative merits of the two, and revived interest in art as an asset class.

Recent art investment funds

The revival of interest in art as an effective investment in the late 1990s led to a number of serious attempts to float art investment funds open to sophisticated investors. The proposed structures of such funds varied from closed-end, limited partnerships to open-ended, continuously traded funds, with a variety of ingenious intermediate hybrid structures. Some were devised as essentially no more than straightforward 'buy and hold' operations, while others envisaged more dynamic trading platforms or made specific allocations to more actively traded portfolios. However, what they all had in common was the intention to raise funds from investors, and use the increased leverage opportunities offered by a large pool of money to achieve enhanced returns.

The target growth rates projected by the picture funds varied only slightly from fund to fund. Most based their forward-looking projections on the historical performance of the Mei Moses series, regardless of the fact that the specific investment objectives of a number of them made such a comparison totally invalid. After positing a degree of enhanced performance due to the skills of their chosen managers, most funds typically projected returns in the region of ± 15 per cent p.a.

The development of art investment funds took a further step forward in the summer of 2004, when the international investment bank ABN Amro announced that it intended investing in a range of art funds, thereby creating what amounted to a 'fund of funds'. In the event the bank subsequently decided not to pursue this particular initiative, but it is important to note that this decision was forced on the bank only because it transpired that there were too few already existing properly structured funds at the time to provide the degree of diversification the bank sought. The original endorsement of art as an attractive asset class was never in any doubt. So the way is still clear for the creation of new funds to reap the rewards of the intrinsically superior investment performance available from art.

Present opportunities for investing in art

It has already been noted that the investment characteristics of fine art make it particularly suited to the investment profile of pension funds, so it is no coincidence that one of the earliest documented cases of institutional investment in art was that undertaken by the British Rail Pension Fund (see above). At the end of 2004, in a move designed to open the field to individual investors, the Chancellor of the Exchequer announced that as from April 2006 the existing restrictions on pension fund investments were to be lifted and that individuals would thereafter be allowed to invest tax privileged money in art within the terms of their Self Invested Personal Pension Schemes (SIPPS). Although the concession was unexpectedly withdrawn in November 2005, shortly before it was due to come into effect, the reason for this change of mind was purely political; as in the case of the about-turn by ABN Amro earlier in the year, the decision had nothing whatever to do with the viability of art as an attractive hard asset-backed investment.

It is likely that pension investors will still be eligible for tax privileges if they invested in 'genuinely diverse commercial vehicles', possibly leaving the way open for formally structured Art Investment Trusts. And of course there is nothing to prevent high net worth individuals (HNWIs) investing in art as part of a planned asset diversification strategy outside of their pension provision. At the time of writing, there is at least one mainstream art investment fund, Philip Hoffman's The Fine Art Fund, open to serious investors in the UK and USA, and a number of smaller special situation funds based on the strength of the art markets in certain emerging market economies, such as India and China.

Timing is critical in the success of any investment decision, and this is also true in the case of art investments. Empirical research over a period of years indicates that the art market moves in broad cycles which tend to be uncorrelated with mainstream stock market activity. At the present time art market prices are strong, with every indication of further growth prospects. The big international art fairs and the periodic high-end sales by the major auction houses are a generally reliable barometer of underlying sentiment, and they are presently indicating a consensus that prices for investment quality fine art are strongly underpinned and continuing to move upwards, as long-term collectors are joined by an ever increasing number of new buyers.

So not only is art an attractive alternative asset class, but also the timing is propitious from an investment standpoint. The message is clear: art is a fundamentally attractive alternative asset class for sophisticated investors. Yet the fact remains that the vast majority of embryonic art investment funds that have tried to establish themselves in the past few years, have failed to raise sufficient investment funds for a successful launch, and have sunk without trace.

It is believed that no pension funds or other large institutional funds have followed the example of the British Rail Pension Fund and embarked on

a systematic investment diversification strategy involving art. Indeed, at the time of writing, there is just one well-established operational art fund pursuing an investment strategy based on a spread of conventional, mainstream sectors of the fine art market – and even that has so far reached a significantly lower total value of funds under management than was originally targeted. Apart from this one fund (which offers a number of specialized products) there are only a very few other noteworthy 'special situation' art funds believed to be operational at the present time. One, for example, operates effectively as a dealer-financing operation specializing in the acquisition, display, marketing and sale of works of contemporary art. There are also a small number of (mainly small) special situation funds based on emerging market opportunities – e.g. art funds specializing in Indian art, Chinese art, Latin American art etc.

Beyond these funds, which seek to attract investment money from sophisticated individual investors, there are a number of small informal funds, but these generally operate on a relatively modest scale as private pooled investment opportunities among select groups of investors, and are not open to subscription from the public.

Taken in aggregate, the activities of art investment funds, whatever their area of interest or precise nature, cannot be said to be impacting on the art market to any significant extent at the present time. So we have the interesting – and apparently anomalous – situation that while art is generally acknowledged to be an attractive (in some respects superior) asset class, few investors appear to have the appetite to take advantage of the opportunity.

This inevitably prompts the question: why are investors not prepared to put their money into art investment funds? The answer, sadly, is not hard to find. The art market remains an unregulated market as regards the provision of financial services, so investors are assuming a level of risk when putting their money into unregulated art funds. This risk, however small in practice, remains unquantifiable. Further, the lack of efficiency and transparency that is an acknowledged feature of the art market is a strong deterrent in the eyes of sophisticated investors, who are used to the full transparency of conventional investment classes. Also, transaction costs in the art market are higher by a significant multiple than corresponding expenses in any other asset class. Whether art works are acquired directly, or indirectly through investment in an art fund, it is hard to avoid these costs.

Another very important consideration is that the fund managers who largely represent putative art funds have, not surprisingly, tended to be individuals with an established expertise in art markets. However, they have no established credibility or track record of achieved performance as money managers in the high-end financial markets – again, a strong deterrent to potential investors for whom the experience of the fund manager is a major determining factor when deciding whether or not to invest in a fund.

Finally, the running of an art investment fund inevitably necessitates entering into an arrangement with art experts to advise on potential acquisitions

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contemporary art. There are also a small
uation funds based on emerging market
lizing in Indian art, Chinese art, Latin

attract investment money from sophisti-
a number of small informal funds, but
y modest scale as private pooled invest-
oups of investors, and are not open to

of art investment funds, whatever their
nnot be said to be impacting on the art
e present time. So we have the interesting
tion that while art is generally acknow-
spects superior) asset class, few investors
dvantage of the opportunity.
on: why are investors not prepared to put
nds? The answer, sadly, is not hard to
egulated market as regards the provision
e assuming a level of risk when putting
ds. This risk, however small in practice,
lack of efficiency and transparency that
art market is a strong deterrent in the
o are used to the full transparency of
o, transaction costs in the art market are
n corresponding expenses in any other
acquired directly, or indirectly through
o avoid these costs.
ration is that the fund managers who
nave, not surprisingly, tended to be indi-
se in art markets. However, they have
cord of achieved performance as money
markets – again, a strong deterrent to
perience of the fund manager is a major
nether or not to invest in a fund.
tment fund inevitably necessitates enter-
perts to advise on potential acquisitions

and sales. These experts are likely to be independent dealers, who might also be expected to have an interest in the works they are recommending to the fund. This situation leads to serious concerns over potential conflicts of interest. These conflicts potentially exist in other financial markets, but they have largely been overcome or eliminated in practice, in markets in which such activities are well regulated by the Financial Services Act or similar controls in other countries. The so-called Chinese Walls that protect investors in well-regulated financial service markets are absent as yet in the art market.

The system can be made to work – witness the one art investment fund currently operating in the UK. However, ironically, this offers little reassurance to potential investors because the fund's activities are kept strictly confidential. In particular, although occasional details are released concerning specific opportunistic sales, no general figures are made available regarding the fund's achieved performance overall. In any event, the fund has been operating for only a few years, and its optimum performance is posited over a longer, extended holding period. So there is little reassurance that can be given to potential investors on perhaps the most important feature of all (i.e., the returns which are being achieved in practice, as opposed to the theoretical returns which are being projected on the basis of historical performance benchmarks). Art investment funds are very much uncharted territory.

So potential investors remain wary of existing funds because of the perceived risks and lack of information, and they are unlikely to embrace the investment opportunities they offer until there is greater transparency and evidence of achieved track record. At present, there is little indication that art fund managers are going to open up their dealings for scrutiny. So perhaps art, the last great unregulated investment opportunity, will continue to remain largely unexploited for the foreseeable future.

The response to this state of affairs in the art world is mixed. There are those who would dearly love to see investors buying art, and who see investment interest as being one of the factors sustaining and underpinning strong prices. There are others who view art investment as potentially a destabilizing influence, and who would be happy to see art remaining very much a collectors' or connoisseurs' market.

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