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The New Art of Art Finance

By Bijan Khezri
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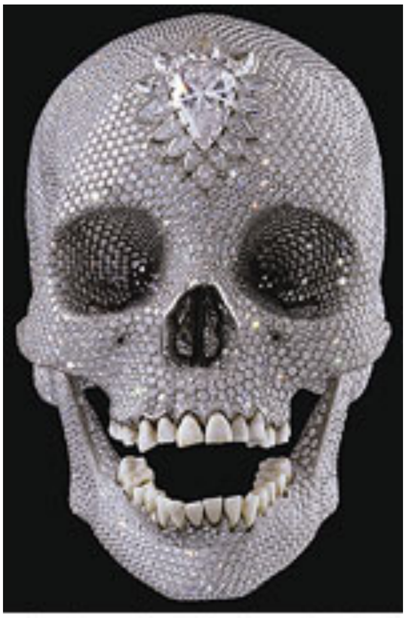
Would it sell, at what price, and, most important, to whom? These questions surrounded British artist Damien Hirst's "For the Love of God" -- a life-size cast of a human skull in platinum covered with 8,601 pave-set diamonds weighing 1,106.18 carats -- from the moment it went on exhibit at London art gallery White Cube in June. With an asking price of £50 million (about $100 million), it instantly became the most expensive artwork by a living artist. And in the minds of many people who follow the art market, "For the Love of God" also became the symbol of an overheated art market ready for an overdue correction.

Following the announcement by a spokesman of Mr. Hirst's gallery that "For the Love of God" had been sold for $100 million at the very end of August, a new question has been added: Did it really sell? The terms of the deal were unprecedented: It was bought by an unnamed investment firm, with Mr. Hirst retaining an undisclosed ownership stake in the artwork. Now, many commentators question the reality of the transaction. Whether the sale was real or fictive, we may never know. Indeed, the general suspicion that those with a vested interest in a particular artist are prepared to either drive up the auction price or invent a nonexistent transaction for the sake of creating the perception of success is as old as the art market.



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Damien Hirst's 'For the Love of God.' An art market bellwether?

Besides making headlines, ever-increasing auction prices have come to symbolize a supercharged, multibillion-dollar industry. In fact, art has emerged as a distinct asset class. Yet as this summer's global credit crunch spilled across a whole range of asset classes, many people wondered if the contemporary art market would be affected too, and when. However, looking toward Mr. Hirst's work as an indicator of the strength or weakness of the art market appears to be shortsighted.

A number of studies analyzing artworks' long-term patterns of price development suggest that an optimally diversified financial portfolio should include art. Most prominently, a celebrated research paper, "Beautiful Asset: Art as Investment" by Profs. Jianping Mei and Michael Moses at New York University gave birth to the Mei-Moses Index, which measures art prices from 1955 to 2004. According to Messrs. Mei and Moses, art has on average outperformed 10-year Treasury bonds during that period. In particular, contemporary art has performed well as an asset class. Average annual returns range between 10% and 15%. Auction records during the past three years suggest returns probably closer to 20%-30% annually. This compares favorably with the S&P index's annual returns of 4.91% in 2005 and 15.79% in 2006.

Last month, billionaire entrepreneur and art collector Eli Broad, founder and former CEO of homebuilder KB Home and the financial giant SunAmerica, warned that art prices will decline as a result of losses by hedge funds and other large contemporary art collectors who are having a difficult time after losing lots of money. The coming auctions in London and New York this fall will certainly be followed as a first and important barometer of the correlation between art and financial markets. The dollar amount of hard underwriting commitments that the auction houses continue to make to consigning clients in order to grow the marketplace would probably be a more insightful indicator for future price expectations, if it were publicly available on a timely basis.

Experience suggests that the art market follows the financial markets with a six-month delay. However, the nature of capital that invests in art has changed substantially during the past decade. This time, the past may offer little insight into how the future will map out. Are certain artists heading for a correction? Most likely. But as a whole, the contemporary art market is unlikely to fall. That is because there are structural forces in place today that secure strong demand for contemporary art for the foreseeable future.

In addition to the traditional art lovers, more and more individuals are getting involved with art through collecting and patronage. Art becomes an important part of lifestyle. A growing number of ultra-wealthy hedge-fund managers, as well as entrepreneurs from emerging markets such as Russia, India and China, have embraced the ownership of a high-profile contemporary art collection as a symbol of success, power and global status.

In addition, the number of collectors' private museums is not only on the rise but can sometimes pit one city against another. This spring, Francois Pinault, owner of Christies' auction house and a majority shareholder of the PPR luxury goods group, decided to house his contemporary art collection in Venice after unsuccessfully wrestling with municipal authorities in Paris for five years. Cash-strapped public museums around the world are in stiff competition with each other for ultra-wealthy benefactors who can either lend or gift their contemporary collections or become patrons in other ways.

Most important, however, cities like Singapore, Dubai, Abu Dhabi and Hong Kong increasingly look toward art as a powerful branding medium. Perhaps the most high-profile example of this trend is Abu Dhabi's $27 billion Saadiyat Island museum project, which is expected to also include a branch of New York's Solomon R. Guggenheim Museum featuring both modern and contemporary art.

A whole new financial sector is emerging with an increasingly structured approach to art investment. Leading financial firms such as Citi, Deutsche Bank and UBS have built art advisory functions within their wealth management or investment banking operations to advise clients on art buying. In addition to the hedge funds opportunistically tapping into the arts market, a number of investment funds solely dedicated to the arts have been set up in London lately.

While the supply of credit is tightening and the price of risk is going up, the world still remains awash in abundant liquidity in the form of savings and massive current account surpluses. Therefore, contracted credit conditions are unlikely to arrest the continuation of this unprecedented wealth creation set free by deregulation, global trade and, consequently, the rise of new economic powerhouses in emerging markets during the past decade.

The growth of the contemporary art market is in its early stages. Indeed, speculative capital is bound to increase. And the current crisis in credit markets may offer a lesson. When traditional lenders turn from principals into agents as risks are traded rather than owned, the quality of, belief in and long-term commitment to the underlying asset are bound to be compromised. And the increasing number of investment funds that enter the art market should keep that in mind. In the long-term, there is no investment success in contemporary art unless one genuinely puts the artists, their artworks and, most important, their careers at the very center of one's focus. Assuming the sale of Mr. Hirst's work really is what it is presented to be, then, maybe, that very opaque investment firm found a successful formula for the purchase of new artworks:

retain the artist as a stakeholder, who then has a financial incentive to actively promote the artwork.

History is unlikely to record the sale of "For the Love of God" as a symbol of a market that lost touch with reality. On the contrary, the transaction is consolidating art's position as both a financial as well as a media asset. In fact, it may indicate the dawn of the future securitization of individual artworks.

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