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Briefing
May 2020

Investing in collectibles: Which of your passions pays?

For
Your family ✓
Your firm
Your society

Reading time
10 minutes

Enodo can help

By reviewing your current portfolio of collectibles and making strategic recommendations for additions and reductions

By building a strategic portfolio against inflation

By reducing volatility in your portfolio through addition of low correlation positions

By assisting you with the sourcing and selection of collectibles

Executive summary

The market for collectible items has been around for centuries, but has developed into a near-mainstream phenomenon over the past two decades. Encouraged by regular reports about spectacular prices being achieved at auctions for certain collectibles, a growing number of investors have started seeking exposure to passion assets. There is also a perception that they provide good long-term returns. And indeed, several market reports seem to indicate this.

So, should we jump on this bandwagon and consider allocating a relevant amount of our wealth into this asset class? Our analysis finds that it is not as simple. Reports are typically not adjusted for inflation and their method of indexing tends to provide overly optimistic returns. Furthermore, transaction costs – which are substantial – as well as the “costs” from a lack of protective regulation are typically ignored. Having reviewed the more rigorous academic literature, we believe that the attractiveness of passion assets should be determined by focusing on a number of dimensions. Our in-depth balanced score-card analysis has yielded the following ranking amongst collectibles:

Prime real estate and coins have scored highest - driven by at least similar or superior risk-returns profiles versus stocks and bonds, good to strong diversification benefits, and relatively large (i.e. more liquid) markets. The runners-up are watches, jewellery, whisky and classic cars which all scored similarly well. While watches and jewellery score identically across all categories, with strong diversification credentials, but high transaction costs, the classic cars and whisky segments achieve this due to different factors. Classic cars have relatively poor risk-return features, but they score better than others on transaction costs, negative correlation with equities and bonds, and possess a relatively liquid market. At the bottom of the spectrum, we find diamonds, antique furniture, wine, and Chinese ceramics which all share subpar risk/return credentials and less convincing diversification benefits.

Our overall assessment is somewhat cautious. Given the market’s peculiarities we recommend to only get involved if you genuinely can develop or already have a passion for a specific collectible.

"Collectors are happy people" - Johann Wolfgang von Goethe

The world of collectibles and passion assets is a rather obscure one. This report will explore how they could be used to safeguard and further your wealth, and - as Goethe, Germany's greatest literary figure, finds - make you happy. But first of all: What do we mean by collectibles or passion investments?

How we define passion investments

They are - to start with - all tangible in nature, clearly a prerequisite to allow us to be 'passionate' about them. Whilst a few of them can generate "financial dividends" - think of fees earned from lending the artwork to an exhibition - they all promise an "emotional dividend" or psychic return to their owners. This type of return can be gained from visually displaying the beauty of an exclusive piece of artwork, violin, or fine watch, thereby also signalling wealth and hence prestige of the owner. Other categories can even be consumed (wine and whisky) or driven (classic cars), although this usually reduces the value of the collectible markedly.

British private bank Coutts regularly publishes a 'passion index' which consists of a number of categories, ranging from collectibles such as stamps, coins, fine wines, classic cars, to precious items such as jewellery or watches, but also artwork such as paintings and Chinese ceramics and even property.[1] The price range for these collectibles can vary dramatically and there certainly are affordable versions of art, wine, and classic cars, however, those that are being considered as 'investment grade' are typically very pricey.

Why is there heightened interest now?

The market for collectible items has been around for centuries. King Charles I. (1600-1649) a rather controversial ruler of England, was an avid art collector, acquiring one of the most impressive art assortments ever assembled. After his execution, the English parliament decided to sell off his estimated 1760 paintings to a number of buyers across Europe. Thomas Jefferson (1743-1826), founding father and the third President of the United States, was known to be a passionate wine collector and is often referred to as America's first wine connoisseur.

Until a few decades ago, it was predominantly the domain of wealthy, upper class families to indulge in the both aesthetically appealing and status-enhancing pastime of collecting rare items. With the expansion of wealth in developed nations and the creation of a whole new segment of high-net-worth individuals in emerging economies, passion assets have drawn attention to a much wider circle of potential investors more recently.

The expansion of new potential customers has coincided with a dearth of traditional investment opportunities. Since the financial crisis of 2008 and reinforced by the corona virus induced economic slump this year, the low interest rate environment triggered an - increasingly desperate - search for higher-yielding investments.

[1] See (Coutts, 2019)

Encouraged by regular news reports about spectacular prices being achieved at auctions for certain collectibles, a growing number of investors believe that they have found this opportunity in passion assets. A recent study states that the average ultra-high-net-worth-individual (UHNWI), typically defined as people that have more than USD 30m in investable funds, holds six percent of its total assets in the form of collectibles such as art, cars, fine wines and other sought after items compared to 25% in financial assets.[2] Leaving aside all other assets owned by UHNW individuals, which are primarily real estate and their own businesses, it is intriguing that about one in six dollars of investable assets is being ploughed into collectibles.

To invest or not?

It is fair to assume that the popularity of passion assets may be driven by a perception that they provide good long term returns to their investors. And indeed, several market reports seem to indicate this. Knight Frank's Luxury Investment Index for example shows that arts grew in value by +141% over the past decade. During the same period, the report continues, fine wines and coins have performed +120% and +175%, respectively. The true star according to the report, however, is the rare whiskey segment, with phenomenal 564% growth over the past ten years.[3]

So, should we jump on this bandwagon and consider allocating a relevant amount of our wealth into this asset class? Or shall it best be left to the expert investors who know how to identify the next Gerhard Richter - Europe's most valuable living artist, which whiskey will turn out to be another vintage Macallan or whether the stamp on offer will perform like an 1863 Plate 77 Penny Red - worth over half a million pounds?

Or perhaps, this is not the right question to pose. Is it really necessary to pick the next super star collectible item? Surely, it was a good idea to be invested in the equity markets, even if you hadn't picked one of the FAANG[4] stocks early on. After all, the average return of the asset class is what you should care about in the long run. Proponents of passion investments point to further benefits besides their return potential: passion assets add value by helping to diversify your portfolio and by acting as a store of value - the latter being a quality particularly popular in times of excessive inflation.[5]

However, not everyone is convinced. Some researchers, having analysed the asset class in depth, found little evidence that the returns have been attractive once inflation and other aspects are taken into consideration. Also, its vaunted characteristic as portfolio diversifier and inflation hedge have been at least called into question. Other common criticism relates to the fact that they are highly illiquid in nature. Lastly, a lack of meaningful regulation may give an (insurmountable?) edge to market insiders at the expense of less knowledgeable investors.

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[2] See Dimson, Marsh, & Staunton, 2018. Other major categories are the UHNWI's business (23%), real estate for investment purposes (24%), real estate for own use (16%), and other items (6%).
[3] See Knight Frank (2020)
[4] "FAANG" refers to the stocks of five prominent American technology companies which enjoyed a period of very strong growth during the bull market of 2009-2019: Facebook, Amazon, Apple, Netflix, and Google.
[5] See Dimson & Spaenjers (2011) for the case of stamps as an example.

cites recent industry reports that have downgraded their relevance in general and highlighted their exclusion when calculating a High Net Worth's investable wealth.[6]

A framework to decide

Some of our clients were true experts in their fields of passion and knew very well what to buy when and when to sell what. Others - perhaps feeling slightly compelled to get into the 'trade'' by their friends, have been less successful and regret that they wasted their money. From our own experience when advising wealthy families, we have seen this happen time and again. It is with this in mind why we wrote this report: to shed some light on this exciting topic, but also to equip you with a framework of questions that assists you in asking the right questions when such opportunities present themselves to you. Having looked at a range of different collectibles and analysed both the academic and industry literature in-depth on the subject, we believe that the attractiveness of passion assets should be determined by focusing on the following dimensions:

- Risk and return characteristics relative to traditional assets.
- Required return to recoup transaction costs.
- Diversification benefit to investment portfolios.
- Ability to liquidate the investment.
- Reliability of findings based on the breadth and depth of available analysis.

On the basis of this framework, we have generated a weighted average for each collectible. Our forthcoming book goes into great detail on how we measured the various dimensions. Given the length of the analysis we only present the summary of our findings in this report.

And the winner is…

Table 1 gives an overview of all passion asset categories we have investigated and weighted along the framework's dimensions, mentioned above. Overall, prime real estate and coins have scored highest - driven by at least similar or superior risk-returns profiles versus stocks and bonds, good to strong diversification benefits, and relatively large (i.e. more liquid) markets.

Table 1: Balanced score card for various collectibles

Weighting	40%	15%	25%	10%	10%	
Category	**Finanical risk - return profile relative to equities and bonds**	**Required return due to transaction costs**	**Portfolio diversification characteristic**	**Liquidity according to market size**	**Reliability of data (availability and quality)**	**Overall score**
Prime properties	attractive	attractive (top third)	neutral (one negative)	attractive (>10bn)	neutral (5-20 studies)	**0.65**
Coins	neutral	neutral (middle third)	attractive (both negative)	attractive (>10bn)	neutral (5-20 studies)	**0.35**
Watches	neutral	unattractive (bottom third)	attractive (both negative)	neutral (1-10bn)	neutral (5-20 studies)	**0.10**
Jewellery	neutral	unattractive (bottom third)	attractive (both negative)	neutral (1-10bn)	neutral (5-20 studies)	**0.10**
Whisky	attractive	attractive (top third)	unattractive (both positive)	unattractive (<1bn)	unattractive (<5 studies)	**0.10**
Classic cars	unattractive	attractive (top third)	attractive (both negative)	attractive (>10bn)	neutral (5-20 studies)	**0.10**
Muscial instruments	unattractive	attractive (top third)	attractive (both negative)	unattractive (<1bn)	neutral (5-20 studies)	**-0.10**
Stamps	neutral	unattractive (bottom third)	neutral (one negative)	neutral (1-10bn)	neutral (5-20 studies)	**-0.15**
Art	unattractive	neutral (middle third)	neutral (one negative)	attractive (>10bn)	attractive (>20 studies)	**-0.20**
Diamonds	unattractive	neutral (middle third)	neutral (one negative)	neutral (1-10bn)	neutral (5-20 studies)	**-0.40**
Antique furniture	unattractive	neutral (middle third)	neutral (one negative)	neutral (1-10bn)	neutral (5-20 studies)	**-0.40**
Wine	unattractive	neutral (middle third)	unattractive (both positive)	neutral (1-10bn)	attractive (>20 studies)	**-0.55**
Chinese ceramics	unattractive	unattractive (bottom third)	n/a	neutral (1-10bn)	neutral (5-20 studies)	**-0.55**

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[6] Gerlis (2014), p.22-23.

The runners-up are watches, jewellery, whisky and classic cars which all scored similarly well. While watches and jewellery score identically across all categories, with strong diversification credentials, but high transaction costs, the classic cars and whisky segments achieve this due to different factors. Classic cars have relatively poor risk-return features, but they score better than others on transaction costs, negative correlation with equities and bonds, and possess a relatively liquid market.

Despite their spectacular growth in the past ten years, whiskies were - perhaps somewhat surprisingly - not our top choice. While the financial risk-return trade-off, as well as the low transaction costs clearly favour whiskies, it was less convincing when it comes to portfolio diversification and liquidity of its markets. Furthermore, given that it is a recent investment category, we have found relatively few studies investigating its characteristics, giving us somewhat less confidence in the available data.

At the bottom of the spectrum, we find diamonds, antique furniture, wine, and Chinese ceramics which all share subpar risk/return credentials and less convincing diversification benefits.

So, shall we buy coins and avoid a nice bottle of red, then?

It may come as a slight shock to all oenophiles amongst us that fine wines appear to be underperforming other categories (as the occasional drinker of a good bottle of wine, we certainly were!). Similarly, art lovers will be unhappy to see the biggest collectible category of all to rate so poorly in comparison to the others. On the other hand, we expect a clearly audible sigh of relief amongst all property hunters that - after all - it also makes financially sense to own these dwellings.

However, there is neither reason to despair, nor to be overtly jubilant by our analysis - it is, after all, a relative ranking, and based on average outcomes for each category. Savvy wine and art connoisseurs are still likely to outperform these average returns. And the uninformed property investor may end up owning yet another overpriced trophy penthouse flat!

Overall, our verdict is fairly clear: given the market's peculiarities - be it the high transaction costs, little investor protection and long required lead times to find a buyer or seller - you should only get involved if you genuinely can develop or already have a passion for a specific collectible. It also appears prudent to start your investment journey with relatively small amounts as the learning curve is remarkable steep and the risk of taking a poor investment decision high.

What do you think about passion assets? We would love to hear your thoughts on this. Wishing you a lucky hand with your next purchase.

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About the authors

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Nick has over 20 years of experience in wealth management, predominantly spent at UBS where he was a Managing Director. He held a number of senior leadership roles, including Head of Wealth Management for Global Emerging Markets in London, where he led a sizable business advising wealthy families in Central & Eastern Europe, Middle East, Turkey, Israel, Africa, Latin America and Asia-Pacific.

For six years, Nick was Head of Investment Products and Services where he led the investment management, capital markets, alternative investments, lending and wealth planning functions, responsible for over USD50 billion of client assets, and a sizable lending book. He also founded the client philanthropy unit in the UK, which supported clients in maximising the strategic impact of their giving. He has been a regular media commentator. Over the years, he has also maintained a strong academic interest in business psychology.

He has served on numerous non-profit boards and is currently Vice Chairman of the governing body of Royal Holloway, University of London, amongst the top 25 in the UK and 250 globally. He also chairs the committee overseeing the university's USD100 million endowment.

He holds MSc in Organizational Psychology and MBA in Finance degrees from the University of London, is a Chartered Wealth Manager, Chartered Fellow of the Chartered Institute for Securities & Investment and Member of the British Psychological Society. He was elected Fellow of the Royal Society of Arts for his work in philanthropy. He is also a part-time Doctoral researcher in organizational psychology and family-owned business at Durham University.

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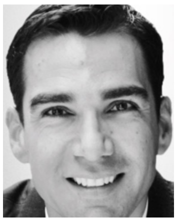

Baris has over 15 years of experience in wealth management and investment banking in London, Zurich and Frankfurt. Between 2006 and 2020, he worked for UBS, where he was a Managing Director.

He served as Head of the Global Family Office, Ultra High Net Worth Emerging Markets and Financial Intermediaries units for UK and Jersey, offering wealth management, structuring, lending and investment banking solutions to the largest clients of the firm. His team was entrusted with over USD12 billion of client assets.

Prior to this, he was responsible for various significant teams serving wealthy families in Central & Eastern Europe, Middle East, Turkey, Israel, Africa, Latin America and Asia-Pacific.

Before joining UBS, Baris was a research assistant to the Chair of International Banking and Finance at the Goethe University Frankfurt and a visiting scholar in Finance at the Wharton School, University of Pennsylvania.

He published papers on global stock exchanges in peer-reviewed academic journals, including the prestigious Journal of Banking & Finance, and was a regular commentator in the media.

Baris holds a Doctoral degree in Finance from Goethe University Frankfurt and the Diplom Kaufmann degree from the University of Regensburg, as well as an MBA degree. He has completed the Chartered Financial Analyst and Financial Risk Manager programmes.

The story of Enodo

Enodo is the Latin word to explain, literally to *unknot* or *untangle*. This encapsulates our vision – to bring clarity to the complexity of being wealthy.

Our founders have had the privilege of advising some of the world's wealthiest families. They've observed first-hand the liberation and opportunity that wealth can bring – unifying families around a common purpose, creating real economic impact via a family business, or contributing to wider society through audacious philanthropy.

At times, they've also seen the stress and confusion that can result. They've witnessed family disharmony, miscalculations in family business or investment strategy, and the hugely detrimental impact of working with advisors who put their own interests first.

Our founders have engaged in the discipline of advanced academic research. Their own analysis of peer-reviewed academic literature across the disciplines of finance, economics and business psychology, combined with their deep professional experiences, have allowed them to arrive at new perspectives on how *to be wealthy* and how *to manage wealth*.

The result of their thinking is the Enodo Leadership in Wealth™ advisory framework which supports wealthy families in using their wealth to lead across all the dimensions of their life – *family, firm* and *society*. Amongst other things, their framework includes:

For your family

- Family governance and family office set-up
- Investment risk and asset allocation – including family business assets and debt
- Chairing a family investment committee
- Selecting the best investment managers
- Analysing investment opportunities, including alternative investments and recent innovations (e.g. cryptocurrencies)
- Understanding the impact of investing in your passions, such as art and collectibles
- Monitoring of performance and risk
- Guiding and analysing where you are in dispute with your investment advisor

For your firm

- Organizational culture and performance
- CEO / founder succession and role of family members
- Financial optimisation – including debt, hedging and foreign exchange
- Reviewing your equity and debt capital market opportunities
- Corporate and social responsibility

For your society

- Philanthropy and impact investing
- Establishing a family foundation

The Enodo Goal-based Asset and Liability Allocation (GALA) Modeller™ offers ground-breaking insights into optimal strategic asset allocation – examining the risk characteristics of a family business shareholding and analysing tolerance for risk from psychological personality profiling. You can experience a shortened version of this powerful tool here.

At Enodo, we offer rigorous, independent and intelligent advice to wealthy families around the world. We aspire to be your trusted partner, wherever life leads you.

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