ART AS VIABLE INVESTMENT TOOL

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Abstract

The paper constitutes an argumentation of art as viable alternative investment tool, presents conception of investments in art. One of the most important art market features is value; it earns capital gains rather than dividends. Due to this, investing in art is particularly suitable for investors who value stability and long-term profitability. On the other hand, there is a risk for such investors to become a collector, in other words – art investors should be free of the purchased creations. Moreover, this paper represents the basic features of investment in art and analyses characteristics of investors. The analysis of investment opportunity in art is presented. The main objective of this paper is to investigate art as viable investment tool. In addition, the basic art market indexes are compared. In order to show, that art is viable investment tool, the forecast of Artprice Global Index to 2014 year was conducted by three methods: Moving Averages, Exponential Smoothing and Trend Line.

Key words: investments, art, Artprice Global Index

JEL Code: D14, G11, P45

Introduction

Art became fashionable among alternative investments during last decade. The prices paid at auctions for art creations increased, new private investment funds, which help to analyse art market trends, were established. Notwithstanding art works are not very liquid assets, almost never divisible, transaction costs are high, and there are lengthy delays between the decision to sell and actual sale. Investing in art typically requires substantial knowledge of art and the art world, and a large amount of capital to acquire the work of well-known artists (Worthington, Higgs, 2004).

The interest in this market increases nonetheless investing money in art is not as straightforward as investing in bonds or equities. This alternative investment earns capital gains rather than dividends. Investment in art exists already four centuries and still grows developing new artistic directions every century or decade and immediately attracts new

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investors. Investment in art has both: some typical features for common investments and a few unique ones. Therefore, before investing, one should study art market carefully and found out all the subtleties. The art market is segmented and dominated by a few large auction houses (such as "Sotheby's" and "Christie's"); risk is pervasive, deriving from both the physical risks of fire and theft and the possibility of reattribution to a different artist. And while auction prices represent, in part, a consensus opinion on the value of art works, values in turn are determined by a complex and subjective set of beliefs based on past, present and future prices, individual tastes and changing fashion.

The art market is different from other markets for its exclusive features: investment in this market is long-term - investors are advised to keep a work of art no less than 10 years. In addition, it is a profitable investment (return may reach up to 20%) and, o course, risky. Therefore, it is important to predict possible art market changes in the future -it is important to examine art market forecasts.

1   Conception of Investment in Art

Investments in art are often called alternative investments, because art market, investors differ from other markets and investors. There not many opportunities made for investing in art comparing with investing in shares, bonds or other investment tools. Art creations become not only the collecting mean, but also a tangible asset used in trade and monetary relations (Art Brand, 2007). History of investment in art dates back to the 17th century. Since the year dot the rich and famous old European families followed a simple strategy of capital formation: one-third of stocks, bonds and other securities, one third of real estate and one third of investments in art and precious metals, gemstones and etc. (Makselienė, 2007). The first art boom occurred in the Netherlands in the 17th century, when this country has won worldwide fame not only in trade but also in art. Even after hundred years the Netherlands' painting was the most expensive in the world. "Name buying" principle was established in 18th century, which is applied till now. For both: the buyer and the seller is important not only the artwork itself, but more important its author. At the end of 19th century and at the beginning of 20th century art auctions were established which became famous in later times. Their influence on the art market has grown steadily and today has reached unprecedented scales. There were many important events that affected the art market in the 20th century: the two world wars, economic crisis in 1929–1933, the Cold War and so on.

Art market prices are reflected by differentials of income in society. Revenues of the 0,1 % of the richest people in the United States increased by 343 % from 1973 to 2000 (Plečkaitis, 2008). This affected increase of art prices. Only the richest people could pay a great many for their favourite art work, but the prices of number of art works didn't changed, because average personal income didn't increase enough. The global art market began to grow rapidly in 2003, but during 2005–2006 significantly increased both: the average costs of creations and sales volumes. In 2006 at least 810 (although in 2000 this number ranged from 100 to 200) art works were sold for more than a million dollars and income of auction houses in the same year amounted to 2.7 billion dollars (Molloy, 2007).

Law on Protection of Movable Cultural Properties of the Republic of Lithuania defines the art creations as a "fine art and applied art" (Law on Protection of Movable Cultural Properties of the Republic of Lithuania, 1996). Using this classification various creations could be attributed to these two groups (see Fig. 1).

Fig. 1: Classification of Art creations
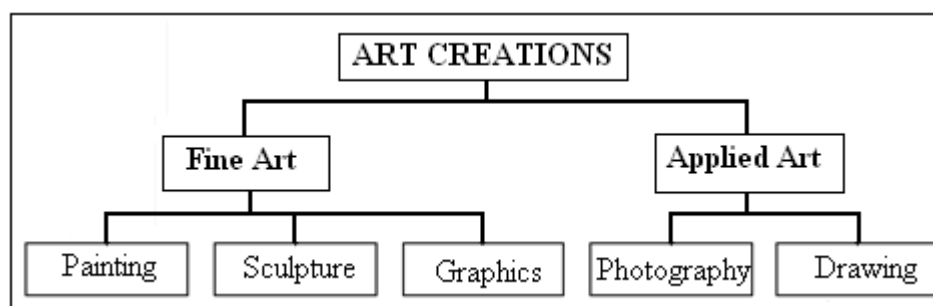
The most comprehensive indicator of various sorts of art creations is Artprice Global Index which is compiled by Artprice Organization operating in France. This organization takes care of art creations and divides them into two groups according to type and period (Fig. 2).

Figure 2 shows that art creations as investment tool can be classified even more, i.e. the same type of creation could be accredited to different period (e. g. Old Masters or Modern Art paintings). A direct relation exists between the art type and art period. Thus, Fig. 2 shows that investing in particular art creation has a direct impact on the entire art market (the total investment will increase the amount of art creations sales and the index itself).

Fig. 2: Art creations structuring
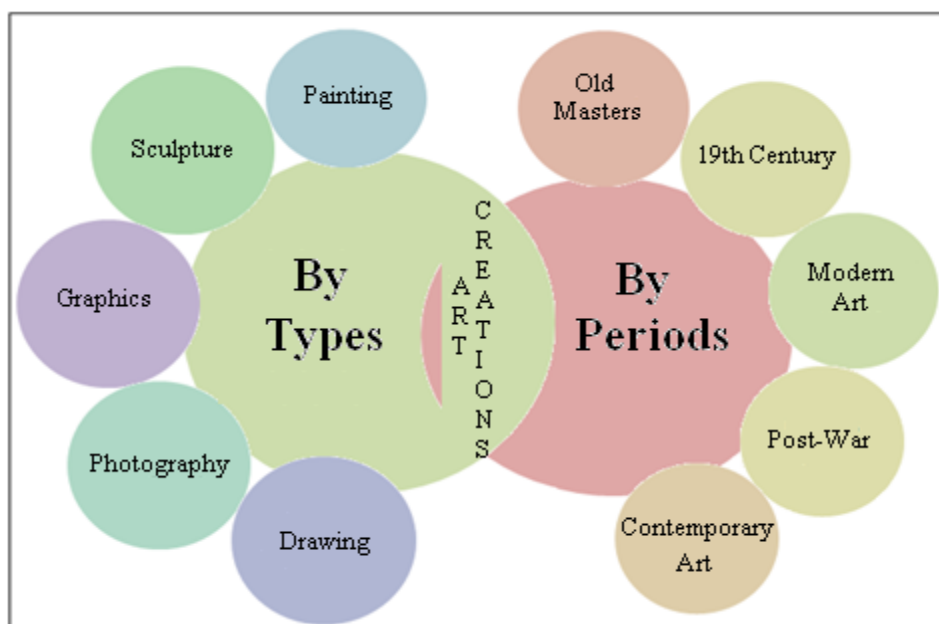
Source: *Artprice...,2011*

Art market is characterized by increased confidence in public auctions, wider dissemination of catalogues, main exhibitions, globalization of major art galleries, comprehensive information about prices, etc. (Melnik, Plaut, 2008). Although investing in art exists the fourth age (Makselienė, 2007) and covers a wide range of art types, such as graphics, photography, painting, sculpture and so on, originating new directions help to attract new investors.

2 The Basic Features of Investments in Art

Investments in art should be a very deliberate decision. The basic features of investments in art differ from other investment tools (Fig. 3). There are qualitative criteria and investment trends. The value of art works are strongly influenced by the critics, public attitude, aesthetic perception. Unlike other assets, the investment cash value of art in part determined by the enduring value of art and a certain artist's work demand, which is determined by its popularity. Popularity, as an important factor of the value of the artist's creation, is inconstant one (Kancerevyčius 2009: 727). Therefore, for art market investor it is important to have reliable information and not to follow other investors, it is better to rely on intuition. G. Kancerevyčius (2009) designates the following basic features of the art value: authenticity, condition, rarity, storage, awareness and the technique.

Fig. 3: Features of Art Value
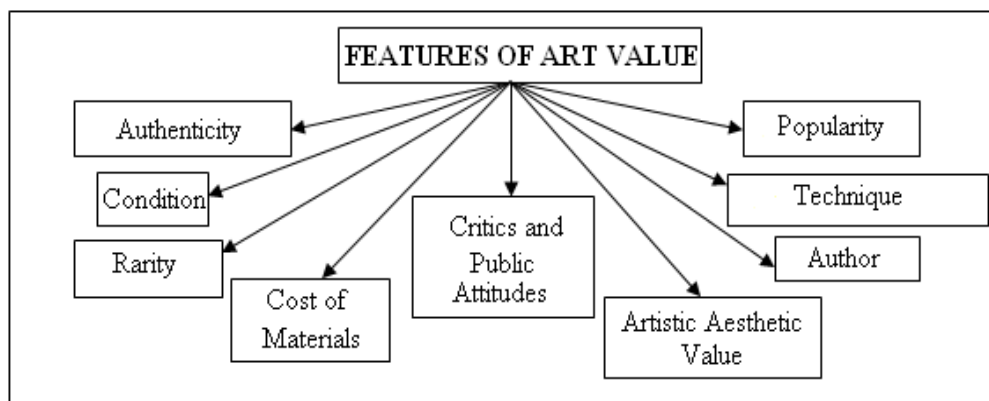
According to S.Makselienė (2007) it is important to take into account the criteria that determine the art work value: the cost of materials, artistic aesthetic value, rarity and authenticity of the author's name and prestige, sales history. It's worth paying attention to the specific location of the work in the author's sales history, although it is quite difficult to do this without an index. Besides, S. Makselienė emphasizes the need to pay attention to professionals' advice. According to D. Juškus - gallery owner, it is very important to turn attention to the market conditions (the present situation), it depends on the country's and the city's cultural strategy a lot (Fig. 3) (Kutkaitytė, 2008). Art works prices are determined by auctions' history (Mikalajūnas, 2008). Value or the art creations also depends on records of the famous artist's teachers or art critics. What are especially important - in art markets economic laws also exist: say, the prices of copious authors works is usually lower than of non-copious. Art market professionals note that the art investment portfolio can be formed according to the art works creation time, genre, technique, the author (Pilibaitis, 2008).

Thus, there are several features of investments in art: firstly, it is an investment in capital, secondly, it is investment in self-promotion and thirdly, it is an investment in what can give you joy - brighten your life, because art can be felt. The most important features of investment in art are the reputation of the author, the authenticity of the work, the quality and the investor's aesthetic taste.

3   The Basic Characteristics of Investors in Art

Investing in art is characterized by a specific object - works of art. So, art market should be carefully examined. Moreover, investor in art is different from other investors, who invest in precious metal, the wine, etc. Investor in art has to know where he invests his

money. S. Makselienė (2007) claims, that art market specialist with considerable economic knowledge can recommend in which art work to invest. However, not only person, having financial education, can competently advise to invest in the art market. And investor can not have an education: he can rely on his instincts or can rely on expert comments (Kutkaitytė, 2008).

Investor in art has to be interested in high culture, has to keep track all of the art market trends. "He must be sophisticated, smart, interested in culture human"- says gallery owner Donatas Juškus (Kutkaitytė, 2008). In fact, investors have to know a lot of different things, because only then they could invest their money successfully.

A rational equity investor can rely on statistics and other things that he likes or not. An investor in art must rely not only on statistics, but also its emotions, and fashion trends. This is very individual. Psychologically, investing in art is particularly suitable for investors who value stability and long-term profitability (Makselienė, 2007). For investors in art, it is important not to become a collector, in other words - to be free of the purchased creations (Skirkevičius, 2008).

In summary it can be said that investor in the art should follow the art market trends, it is advisable to walk as much to art exhibitions, galleries, museums, in other words, to see more art creations. Thus, an artistic criterion is formed, but the investor should always evaluate the risk (illiquidity risk and risk to become a collector).

4   Artprice Global Index Forecast

For each investor in art is important to know the future of Artprice Global Index. It is the most important index in art market. The world's art market is not stable, it is changing constantly. Forecasting is an integral part of the investor's decisions and can help one to choose a certain investment. Artprice Global Index (AGI) forecast was conducted by Moving Averages, Exponential Smoothing and Trend Line methods.

Forecast by Moving Average method demand by calculating an average of actual demands from a specified number of prior periods (1). Quarterly data values in 1990–2012 periods were used for Artprice Global Index forecast from 2012.07.01 to 2013.04.01.

$$MA_n = \frac{\sum_{i=1}^{n} D_i}{n},$$ (1)

Where: n – number of periods in the moving average

D_i – demand in period i

Artprice Global Index forecast was calculated, where n=2. The results are presented in Table 1.

Tab. 1: Artprice Global Index Forecast by Moving Averages Method

Date	2012.07.01	2012.10.01	2013.01.01	2013.04.01
Forecast result ($)	84,46	101,94	85,95	96,08

The results of Artprice Global Index forecast show that the index will increase and decrease in the future. The biggest index value should be in third quarter of 2012 year and the lowest value is in second quarter of 2012.

Forecast by Exponential Smoothing method is most widely used of all forecasting techniques. At each period t, an exponentially smoothed level, S_{t+1}, is calculated which updates the previous level, S_t, as the best current (2). Exponential Smoothing uses all the time series values to generate a forecast with lesser weights given to the observations further back in time. Quarterly data values in 1990–2012 periods were used for Artprice Global Index forecast from 2012.07.01 to 2013.04.01.

$$S_{t+1} = \alpha y_t + (1-\alpha)S_t , \qquad\qquad (2)$$

Where: α - smoothing constant $0 < \alpha \le 1$ and $t > 0$

Artprice Global Index forecast was calculated, where α=0,4. The results are presented in Table 2.

Tab. 2: Artprice Global Index Forecast by Moving Averages Method

Date	2012.07.01	2012.10.01	2013.01.01	2013.04.01
Forecast result ($)	84,81	100,11	84,98	92,94

The results of Artprice Global Index forecast show that the index will increase and decrease in the future. The biggest index value should be in third quarter of 2012 year and the lowest value is in second quarter of 2012. These results are very similar to forecast, calculated by Average Moving method.

Forecast by trend line method shows how to predict the data in long term (Pabedinskaitė, 2006). Quarterly data values in 1995–2012 periods were used for Artprice

Global Index forecast from 2012.07.01 to 2015.01.01. Trend lines are graphical representations of data trends that could be used to analyse problems of prediction. It is very important to choose the right trend line. A linear trend line was used for Artprice Global Index forecast, because in 1995–2012 period indices were rising. A linear trend line is a best-fit straight line that is used with simple linear data sets. Data are linear if the pattern in these data points resembles a line. A linear trend line usually shows that something is increasing or decreasing at a steady rate. Artprice Global Index function can be written as follows (3):

$$T_t = a_0 + a_1 t : \tag{3}$$

where: t – quarters, T_t – trend value for the period t, a_0 and a_1 – coefficients.

Coefficients a_0 and a_1 can be calculated by Microsoft Excel Functions INTERCEPT and SLOPE. Using these functions, the values were obtained such as: a_0=37,91 and a_1=0,86. Trend equation (4) could be written using these data:

$$T_t = 37,91 + 0,86t \tag{4}$$

Coefficient a_1 value 0,86 in this equation (4) means that the value of Artprice Global Index increased in average 0,86 \$ per quarter during 10 quarters. If the mentioned trend be actual in the future equation (4) could be used for future forecast (2012.07.01 to 2015.01.01 period) using numbers from 69 to 79 for (4) equation as t value. The index forecast is made as follows: for 69 quarter (2012.07.01) calculated Artprice Global Index is 97,22 \$, for 70 quarter (2012.10.01) – 98,08 \$, for 71 quarter (2013.01.01) – 98,94 \$, for 72 quarter (2013.04.01) – 99,80 \$, for 73 quarter (2013.07.01) – 100,66 \$, for 74 quarter (2013.10.01) – 101,52 \$, for 75 quarter (2014.01.01) – 102,38 \$, for 76 quarter (2014.04.01) – 103,24 \$, for 77 quarter (2014.07.01) – 104.10 \$, for 78 quarter (2014.10.01) – 104.96 \$ and for 79 quarter (2015.01.01) – 105,82 \$ (see Fig. 8).

Fig. 4: Artprice Global Index Movement during 1995–2012 and Forecast for 2012.07.01– 2015.01.01 Period (base 100 \$ in July 1990)
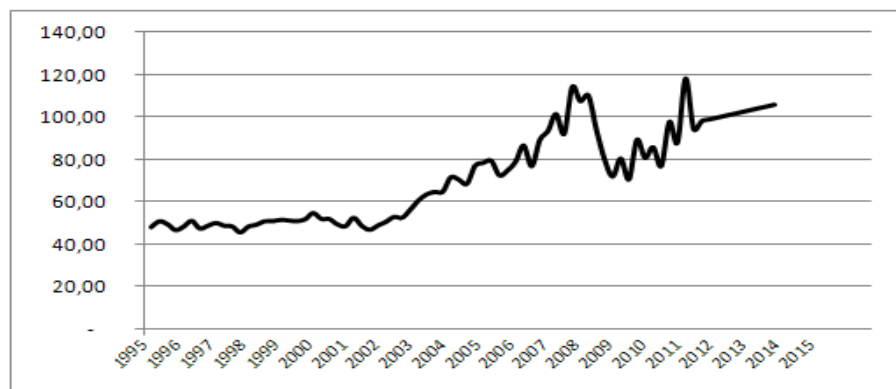
Source: Artprice, 2012

For determination of the error of Artprice Global Index forecast The Mean Absolute Percentage Error (MAPE) were calculated. In addition, this error is called *ex post* indicator. Calculated indicator is MAPE = 11,10.

The results of Artprice Global Index forecast show that the index will increase in the future. It can be called optimistic and accurate forecast with 11,10 % error that the artworks prices and auctions' turnover will raise.

Conclusion

Investment in art is called as alternative investment and art creations as investment tool can be classified by some types: by kind of art: it can be painting, sculpture, graphics, photography and drawing and by period: art can be Old Masters, 19th Century, Modern, Post-War and Contemporary Art.

Before investing, a detailed analysis of basic features of investments in art should be done, their importance for investing in art should be estimated and the particular attention should be paid to the reputation of the author, the authenticity of the work, the quality and the investor's aesthetic taste.

Investor in the art differs from other traditional investors, because art investments are investments in capital and investments in self-promotion. Investors should follow the art market trends; it is advisable to walk as much to art exhibitions, galleries, museums, in other words, to see more art creations. Thus, an artistic criterion is formed, but the investor should always evaluate the risk (illiquidity risk and risk to become a collector).

The results of Artprice Global Index forecast by Moving Average and Exponential Smoothing methods show that during 2012.07.01 to 2013.04.01 the index will change

between 84,46 and 101,94 (while the base in July 1990 was 100 $) and will reach this level in 2012 third quarter. Forecast by Trend Line method showed that the index will increase in the future. It can be called optimistic and accurate forecast with 11,10 % error that the artworks prices and auctions' turnover will raise, because Artprice Global Index covers fine art auction prices

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