CONVERSATION WITH ROMAN KRAEUSSL

ROMAN KRAEUSSL, associate professor of finance at VU University Amsterdam, specializes in research on art investment. In 2006 he founded the Web site art-finance.com, where he publishes studies on art as an asset class and provides indexes that track the market performance of art and individual artists to help investors evaluate and optimize different portfolio allocations. Kraeussl, an *Art+Auction* contributing editor who is also an adjunct associate professor of finance at Emory University's Goizueta Business School, in Atlanta, and a research fellow at both the Center for Financial Studies, in Frankfurt, and the Emory Center for Alternative Investments, spoke with us about the benefits of buying artworks.

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What is the link between art and finance?

Once viewed almost exclusively as the pastime of connoisseurs, art collecting is increasingly seen as an investment. My research evaluates whether such investing is justified financially—and whether art might serve as an alternative to standard assets such as equities and bonds, affecting a portfolio's yield or diversification.

How does art compare with more standard asset classes?

In strictly financial terms, art investing is unattractive. Its risks include attribution errors, fakes, forgeries, thefts, and physical damage. Furthermore, it involves high transaction, insurance, maintenance, and restoration costs, and it has no current cash flow—money comes only when works are sold. Artworks are heterogeneous, illiquid, and sold on a subjective, segmented, and almost monopolistic market in which no valuation guidelines exist. Investors must perform their own due diligence. But artworks, unlike stocks, bonds, real estate, and certain funds, provide aesthetic returns as well as financial ones. It is when these aesthetic aspects are combined with the financial behavior of the assets that it gets interesting.

How do you measure art's financial benefits?

Finance 101 would tell us to consider returns, but this is difficult with unique products like art. No daily closing and opening prices exist. Transactions involving the same artist are infrequent, and for specific artworks the average turnover term is more than 30 years. Academics have developed a number of methods to try to overcome these problems. Investors need not necessarily understand these methods, but learning how to read indexes can be a very important first step in evaluating the risk and return potential of an investment in art.

What is your approach?

I build so-called hedonic price indexes that measure the price appreciation of artworks over time while considering such characteristics as size, medium, provenance, and reputation. The main advantage of these indexes is that they contain all auction records and not just a limited sample of repeat sales. They are thus the most representative and liquid art-market indexes. And they can be constructed for submarkets such as Chinese, Old Masters, and photography, as well as for individual artists. Hedonic indexes can answer the questions: How does art perform? Which segment performs better in turbulent times? How does one artist compare with another in the same genre?

What do you conclude?

My general conclusion is that art investments provide a lower, but still positive, average risk-adjusted return than the broad financial markets with which they have a low but often slightly positive correlation. In the beginning of 2008, for instance, art markets showed a spectacular resistance to the economic trauma caused by the subprime crisis, but they got caught up in it by the fall. My current research indicates that the global art market tends to come late to economic downturns. This makes art useful as a hedge against financial market risk. However, I always recommend you buy something that you enjoy aesthetically and can live with forever.

What do you expect for the future?

Historically art has been viewed as an exclusive market, with limited supply and demand. Today there are more art creators and consumers because of increased disposable income and time to devote to noncommercial endeavors. Moreover, new wealth has opened new market segments, with collectors focused on artworks reflective of their culture. So I expect substantial price increases for such emerging markets as China, India, Russia, and Iran. ⊞

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