

**GLOBAL FUND NEWS**

**Investing in photography as an alternative investment**



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Amidst the prevailing uncertainty in financial markets, art funds are bucking the trend, holding on to value in most cases, and exceeding expectations in others. One area in particular, art photography, is providing investors with stable long-term growth opportunities. Indeed, since 1976 art photography prices have experienced a steady 14% annual growth. Art photography is coming of age as its own asset category and one example of this trend is the Merit Art Photography Fund ("MAPF", www.artphotographyfund.com), positioned to capitalize on the opportunity. Included among MAPF's collection are some of the world's most famous photographs with a demonstrated record of profitable performance.

The growth potential of the art photography market is enormous. Art photography currently only makes up around 3% of the overall art market. In 1978, however, sales in art photography constituted less than 0.5%. That is a substantial growth of 600%. Art photography's emergence as an asset category coupled with its potential for growth, therefore, makes it a reliable alternative to financial instrument based investments. Much like gold and other precious metals, art is precious. Unlike metals, however, the art market is but a blip on investor radars.

Similar to many financial instruments, art investments are traded frequently and come with big returns. Unfortunately, the art

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world is neither transparent nor easy to predict. Choosing the wrong art or poor managers can prove costly. One notable failure was Fernwood art investments, founded by former Merrill Lynch & Co manager, Bruce Taub in 2004. When Fernwood established offices in London and New York, it announced it would raise hundreds of millions of dollars and set minimum individual investments at \$250,000. It made a large grant to a Brooklyn museum and hired leading art expert Patrick Cooney, the man who helped found Citibank's Art Advisory Service in 1979. Yet Fernwood failed. By 2006, the fund had closed its operations. One of the most notable successes has been that of the London-based Fine Art Fund established in 2000 by former Christie's board member Phillip Hoffman.

**The art of investing in art**

Art funds specialize in different areas. Since collector preferences change, investors need to be cautious about where they invest. In the world of classic modern photography (late 19th century - 1970s), multiple prints may exist of the same photograph, the important price determinants being the artist, the venue, and the material it is printed on; or rather whether or not it is a so-called vintage print. The choice of art class largely determines the stability and growth potential of any art fund.

**Hedging with art**

Art funds are uncorrelated to stocks and bonds. They have the potential to provide an insurance policy against volatility and downturns in financial and derivative markets. Still, where traditional investment funds are measurable in real time and are largely transparent, art's value can only be locked in at auction. All other transactions are private and occur with lesser transparency and predictable time spans.

This lack of transparency leads to profit opportunities. Maximizing such expertise, the MAPF literally creates opportunities through a form of international photographic arbitrage.

Art is bought and sold in two ways, through public auction at houses such as Christie's and Sotheby's, or via private transactions that take place in the

opaque world of art galleries. For an art fund to be successful, it must be able to tap private sources to buy under market price and sell by auction to maximize gain.

**Assessing value in art through indices and benchmarks**

Several indices based on the number of sales-pairs and transaction values are used to reliably measure price-movements over time in the art market. Art Market Research (AMR) has been providing such indices since 1985 and they are widely accepted as the definitive measure. Christie's, Sotheby's, and the Federal Reserve Bank of New York all use AMR indices. Prestigious publications including The Financial Times and The Wall Street Journal regularly publish their figures.

The definitive art photography investment index is the Art Photography Index published by The Photograph Collector. The index, founded in 1980, provides

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a benchmark on the value of specific photographic works based on their auction prices repeatedly traded over time. Strengthening its benchmarking value is its composition consistency, which has retained its entire composition since its founding. The DJIA by comparison has seen significant turnover, retaining only one third of the original companies listed since 1976.

**Managing art and risk**

As in any investment category, art is not without risk. Art is material and can be damaged, destroyed, stolen, or lost. Pricing art can be tricky too. When funds buy art, how certain can they be that they have purchased enough undervalue to secure a win in a short enough period of time? Expertise can help with the latter problem. Sound management and a structured security approach are required for the former.

For example, in the case of MAPF, we recognized and tested investor interest and our strategy before going public with the fund and have continued to do so since its launch. Our managers acquired undervalued buy opportunities at private sales and held them until they could be sold with significant returns, either through private sales or at public auctions. We decided to focus



on rare vintage photographic prints from the classic modern period. They include "old masters" such as Ansel Adams, Henri Cartier-Bresson, and Philippe Halsman. The majority of pieces are of superior quality, equaling the standard of works displayed in museums. This is demonstrated by the fact that we are in discussion with various museums regarding lending of artworks for their exhibitions. Our expert, Johannes Faber, has 26 years of experience in the trade and coordinates all acquisitions and sales. Every object is stored in fireproof bank safes in Switzerland.

Since investors need to know how and at what points in time they can redeem their investments, art funds must be clear about where they are based, the methods they use to calculate net asset value, and they need to provide clear rules about redemption and exit strategies. These issues can not be taken for granted. Investors need to watch out. In our case, we established the fund in the Cayman Islands as a

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recognized domicile for hedge funds. We calculate the NAV by summing the quarterly appraised prices of all photographs in stock and add in remaining cash and time deposits. Approximately one third to a half of the performance is generated by sells and interest on cash deposits. Subscriptions and redemptions occur quarterly. As a rule we decided never to borrow against the fund to payout redemptions, choosing instead to pay them from cash or with specific photographs at their appraised value. Our portfolio is well diversified across a broad spectrum of artists, epochs and regions. As a combined result of this conservative approach and redemption operations, Merit's APF has seen its value grow by 12.2% since its March 2008 launch, well within the expectation of 10-15% annually.

As financial managers, we continually seek new ways to maximize returns for our clients in these volatile economic times. The once intangible world of art is rising to the occasion as a bull in bear territory. Indeed, if a picture is worth a thousand words, it may also be worth a great deal of money. ●

*Friedrich Kiradi is managing partner of the Merit Group and managing director of Merit Alternative Investments GmbH, an investment services firm that was founded in 1995. The firm is licensed by the Austrian Financial Markets Authority (FMA) and specializes in managed futures and commodities. From 2003 to 2007 Friedrich was the executive chairman of the "Alternative Investments Forum Austria (AIFA)", a lobbying platform for the hedge fund industry in Austria.*