





ART or ASSET?

A significant collection can have a profound effect on your overall financial picture. But estimating its worth can be tricky.

For years, avid stamp collector Van K. Tharp had a successful method for deciding how much to pay for rare stamps.

“I always looked for the best thing that I could afford,” the Cary, N.C., investment-trading consultant says. “If I saw something I wanted, I’d assign it a grade — at least a rough estimation, based on condition of the item and my knowledge of the market — and paid about 80% of what I thought it was worth.”

That process worked well for him until a few years ago, when something significant happened in the world of rare stamp collecting: Professional Stamp Experts, a Newport Beach, Calif., grading company, began assigning professional and widely accepted grades to the majority of stamps that came to market.

Soon, Tharp found that he was no longer able to pay less than what he calculated a stamp to be worth. “The price of rare stamps has gone up so much,” he says. “I’m unlikely to get anything at even 100% of the price now.”

Collectibles long have been considered difficult items to value, which means that a collector’s level of expertise can contribute significantly to deciding how much he or she is willing to pay. A lack of efficient markets, varying opinions about worth and an overall level of illiquidity all can make a collector’s job more difficult when it comes to buying items for his or her collection. What’s more,

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these issues mean that art and collectibles, no matter how well known or valuable, can be difficult to fit effectively into a collector's financial portfolio — even when widely accepted prices are available.

The Slow Sell

Art and collectibles have unique characteristics that can make placing them in your financial portfolio difficult. One roadblock is the general lack of liquidity for art and collectibles, or the ability to turn them into cash. Art and collectibles can be difficult to sell, and even the most sought-after pieces can require a long lead time before a sale is completed.

“Financial analysis models — models for diversification of asset classes, portfolio simulations and the like — are not good at dealing with illiquidity as they currently stand,” says William N. Goetzmann, a professor at the Yale School of Management who has studied art as an investment. “Generally, we assume the market values of things are observable and measurable when you want to sell, and you go through and make your [portfolio] asset allocation decisions based on that.”

Traditionally, a recommendation for a properly balanced asset allocation would shun illiquid assets. With art and collectibles, however, it may be a matter of perspective. While your financial picture may not be a driving factor in whether you acquire or sell a piece, you should consider how the collection and its potential illiquidity fits into your financial big picture.

“Whenever you have, say, 10% of your wealth in any asset class, it's going to change the way the other assets are allocated,” Goetzmann says. “All portfolios are an organic whole where the correlations across the assets are really important.”

But Richard H. Love, who runs R.H. Love Gallery in Chicago, says it all may depend on what your expectations are.

“On one hand, art is illiquid, but on the other hand, it's not,” Love says. “Say you paid \$20,000 for a painting in 1960. Now, say that picture is worth \$3.5 million, and you want to sell it for that amount. It's illiquid in the sense that you may not get \$3.5 million, which you think it's worth. But you may get \$2.5 million, and that's 100 times more than you paid. So, is it illiquid?”

Love suggests considering a wide range of factors when determining whether art can be seen as an illiquid asset.

“All art can be sold at some point,” he says. “But the question is: How does it work with capital gains [issues]? How does a sale relate to your trust? Does it work with your retirement?”

Plan for Uncertain Markets

Another hurdle to effectively valuing a collection is the historical volatility of the art-and-collectibles market. Markets for collectibles are notoriously inefficient, often requiring long lead times, uncertain prices and narrow pools of potential buyers. These markets also can be particularly sensitive to wider economic forces, such as a recession, and can see spikes and drop-offs due to factors beyond the artist’s ability or name recognition.

“I’ve seen situations where people have considered art as a hedge in portfolios [simply because of the volatility],” says Mitch Freedman, a certified public accountant and financial planner based in Sherman Oaks, Calif. “But historically, art as an asset class has extreme volatility. If a collector wants to include [a collection] as an asset class, they have to realize that. Not to mention, art doesn’t pay dividends, which other assets do.”

Goetzmann points out that volatility also can make valuing a collection difficult from a financial planning perspective.

“If you’re counting on [your collection] as wealth, it becomes difficult to plan, because the uncertainty of the auction prices is quite high,” he says. “You may think [a piece] is worth \$5 million, but at any given time and any given auction, you might not be able to get \$3 million and you might get \$15 million. So that level of uncertainty is just something [advisors are] not used to, even when compared to vacation properties or something similar.”

A Matter of Perspective

So how should you come to value your collection? The answer may depend on what role the items play in your life and the reason why you began collecting in the first place.

Freedman, whose firm, MFAC Financial Advisors, specializes in working with performing arts clients, believes that how a collector views his or her items makes a huge difference in how they can fit into a financial portfolio.

“As a general rule, most of my clients do not think of their works [of art] as a financial asset,” Freedman says. “As financial advisors, we certainly want to have the idea of what the risk associated with a collection is for reporting purposes. And that means we are valuing the collection, but not considering part of the investment portfolio.”

Love, who has been an art dealer for more than 41 years, notes that once you have a successful collection, whole sets of new responsibilities — not to mention costs — can come as part of the package.

“When you’re a young kid, and you’ve spent \$3,000 on a piece and your whole worth is \$200,000, that’s one thing,” he says. “But when you’re an older person, and you’ve continued to buy art, and now you’re worth \$10 or \$20 million — it costs money to insure it, people will ask you to loan it, it will be given sometimes as a write off, it will be used in trusts, and all of that affects your financial situation. And the art figures prominently where it might not otherwise have.”

But in the end, Love says, every collection is a balance between passion and profits. “Usually, you’re not only putting a collection together for your own taste, but for the financial value you may gain,” he says. “I always tell people that you don’t buy art because you want to sell it. But it’s like your house: If you must sell it someday, you want to know you can get the value out of it.” ■

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as **art** or an **asset** may
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