

Art As an Alternative Investment: Environmental Investment in Nigeria

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Abstract

The paper seeks to examine the trend around the rise of art as an alternative investment. With financial markets in Nigeria and around the globe experiencing meltdowns, the paper demonstrates that art could be an important asset class in many respects, worthy of addition to long-term investment portfolio of individuals and institutions.

Introduction

For decades, wealthy individuals and institutions have patronized and consumed art for aesthetic pleasure. But with the more traditional stock market experiencing turmoil in recent times, investors are beginning to consider alternative investment avenues such as art, stamps and other collectable.

Art as an object of investment has been debated for long. However, in the age of high percentage returns on stock markets, and long bull market, the concept of art as an investment option was passed over. But with corporate scandals, stock market losses and low interest rates, the role of art is changing. Art is no longer just appreciated for its aesthetic value and the expression of its lofty

ideals but as an investment. “In the past, people didn’t consider the value of the things hanging on the walls in their home” said Paul Provost, senior vice president and director of trusts, estates and appraisals at Christie’s. As people are becoming more sophisticated in their financial and estate planning, they are beginning to view art as an investment” Shaheen Pasha (2006).

Interestingly, according to an article posted on euromoney.com “global art market transactions come to approximately 25 billion Euros” annually. Thus, offering excellent diversification benefits as the returns generated by these investments are significantly uncorrelated to traditional stock and bond investments. Ironically, Nigerian investors are yet to tap into this huge financial highway as this avenue is still believed to be unavailable in Nigeria.

The paper will examine the rising profile of art as an investment, how art compares to more traditional assets such as equities and bonds. It will provide insight into the Nigeria investment market and why fund managers and individuals should include art as an asset class.

Nigeria Investment Environment

The Nigeria investment market consists of the money market and the capital market. Money market instruments include, short-term, fixed income, low risk debt securities usually issued by commercial banks and the Central Bank of Nigeria (CBN). While the capital market instruments include long-term riskier instruments issued by companies and Government such as equities and bonds.

Fund managers, investment houses and individuals in Nigeria build their portfolio within this traditional asset classes with no alternative asset class. A look at asset allocation of managed funds such as ‘The Equity Fund’

arguable the biggest mutual fund quoted in NSE and managed by Stanbic IBTC Asset Management Limited and ‘Discovery Fund’ managed by ARM Limited will reveal no alternative investment class. Also, the newly introduced privately managed pension fund in Nigeria under the Pension Reform Act of 2004 (The Act) favors asset allocation strategy that emphasizes the safety of fixed income investment with no room for alternative investments. Making a point against this kind of approaches to investments, Ritchie (1979) argued that “empirical and theoretical studies during the past two decades have raised the question regarding the philosophical basis of the traditional approach to investment decisions, which concentrates on selecting the “best” stock. Such an approach overlooks the interrelationships that exist between rates of return on financial assets and the possibility of reducing risk through diversification. The point made here holds true today going by the catastrophe going on in the financial world.

The thinking of many individuals and institutional investors in Nigeria is that Nigeria is yet to develop any alternative investment avenues. According to Barrow (2008) “many alternative investments that are highly organized and tradable in developed markets are yet to be available in the Nigerian market. While this might be true, this study will like to point out that the major bane of this “non availability of investment alternatives” such as art is mainly due to lack of information and art appreciation. For instance, Nigerians do not attach any financial value to a work of art. At best, it is just seen as something that helps fill up a blank wall space. This can be seen in how individuals and institutions treat works of art in their care. Uncared for, works of art are not even considered as part of an asset of the individual or institution. This is a marked departure from what obtains in Europe and

America were art and other collectable form part of the assets of institutions and individuals. Insurance premiums are even paid out against the market value of an art piece. The Nigerian stock market has enjoyed a bull run since the creation of the Lagos Stock Exchange in 1962. But like all other markets globally, it is experiencing market failure otherwise known as the bear run. With individuals and institution's finances being literally wiped out, this has caused panic in the economy. It has become expedient therefore that investors look to other investment avenues such as art to help spread the risk in their portfolios.

Art as an Investment

When it comes to asset planning, one of the key concerns for investors is how well an asset can hedge against inflation. And art as an investment avenue has been considered an interesting and profitable alternative to hedge inflation. Art investments' performance is alluring, indices tracking the performance of high-class art have held up well in recent economic slowdown.

In one of the most prominent examples of art investment, "British Rail Pension Fund invested 2.9% of its portfolio in the 1970s in art earning a return of 40.0pa above inflation till 1999 (greekshare.com,). Art according to Wilson (2008), "has been an attractive investment for centuries and becoming increasingly recognized as it has outperformed more conservative investment over the last few decades".

Can art be considered as a financial asset? Some critics contend that investing in art disregards the traditional yardsticks of financial analysis, since they do not generate any income streams that can be discounted. According to Muysken (2006), "artworks do not generate and income

except to the extent that income can be obtained from lending them to galleries and they incur negative income in the form of storage and associated cost”.

But advocates of art investing argue with growing volume of supporting analysis about the benefits of including art in a portfolio. Prominent among them are from professors Jianping Mei and Michael Moses who found that art has outperformed the Standard & Poor’s 500 index in the past 50 years. In an article; The Beautiful Asset art as an investment, Mei and Moses (2006), they stated that

The return data for S & P 500 index (dividend reinvested), US treasury bills, US 10-year treasury bonds, and gold prices are obtained from Global Financial Data for each variable, we report the mean, standard deviation, and its correlation with other assets. Art had real annual compounded return of 10.0% comparable to stocks (10.4%) during the 1q954-2004 period. Moreover, art outperformed bonds, treasury bills, and gold, whose returns were 6.5%, 5.3%, 5.0% respectively

This art investment gains analysis against other assets is further collaborated by Caine (2009) “The surge in demand – and prices – is good news for people who collect art. English sporting paintings is up nearly 90% in the decade to June 2005” He buttressed further “the gain compare well with international stock market over the same time period. FSTE all world index has climbed 55% in sterling terms since June 1995. House prices, however, have soared about 200% over the last decade”.

Economics of Art

Art is a heterogeneous product; art works are unique. The relationship between supply and demand for art is very similar to luxury goods. To begin with, there is limited supply, giving art a higher value. Secondly, exclusivity that comes with art often leads to higher prices, thus having an effect on the demand curve. In art, as a rule, the price of the works of art consists of its production cost plus the aesthetic value of the piece.

Factors affecting price are intertwined and can be divided into four groups:

- 1) The work of art
- 2) The artist,
- 3) The market and
- 4) The macroeconomic environment.

Factors relating to the work of art include the quality, content of the work, technique used, size and the authenticity of the artist. Artist fame and valuation of previous works are important. One key distinctive feature is the rarity of the works. Legitimization and reputation affect demand and supply.

Investing in Art

Investing in art in general has proven to be a great venture for people wanting to make a profit over the long term. There are many different genres of art in which an interested buyer

can invest. Those genres include: paintings, prints, photography and abstracts. Choosing art as always,

should be about the individual investor's personal taste.

Chances are that if the investor likes the piece, that their others that do as well.

It is believed that you should like the piece of art you buy, according to Pasha (2006) "the average holding period for a piece of art is about 28 years. While 28 years may seem like a lifetime to hold an investment, experts say that those interested in art are usually motivated by aesthetic appreciation for the investment that makes the wait palatable".

Art also requires knowledge and appreciation of all different types of artist styles. There have literally been hundreds of artistic movements created that apply to fine art. Some examples of the most popular styles are; Impressionism, Dada, surrealism and Baroque. Besides paintings, there are art available in other materials from sculpture to pottery to photography. These items are bought and sold in different arenas.

Investing in art in general, means imputing a sizable sum into an antiquity that will usually appreciate in value over time. Investors can either buy individual works of art on their own by scouring galleries and auctions or through the help of a professional guidance.

Portfolio Diversification through Art Investing

Art investing promises to be an attractive venture to beginners and seasoned investors alike. However, those that

have been in it for a while may know something that someone starting out doesn't.

The key to any good portfolio is diversification. Ideally, Overall investment portfolio should be diversified with investment ranging from low risk, low yield to very high risk, high yield investment. This has proven to be the best way to protect investors from financial ruin if one investment goes belly up. According to Bellemare (1979) "the only purpose of financial diversification is risk reduction. Any reduction of investment risk that results from diversification (efficient or otherwise), moreover is due not to the size of the portfolio, but to a reduction in the degree of inter-correlation among the rates of return, coupon yields, security prices etc; on the financial asset that comprise an individual's portfolio". Art investing acts as a good diversifier to a well-rounded portfolio because of its tangibility.

Financial investment such as stock market, bonds and security are numbers on a computer screen to most investors. Anyone with a great deal of money in the stock market between January 2008 to February 2009 would tell you that all your life's savings can disappear in the blink of an eye if it entirely invested in intangibles like stocks and bonds. However, art survived the stock market crash with "Jeff Koons, whose Hanging Hear sold for \$23.5min New York" Goodwin (2008) over the same period.

Another benefit to including art investing in a portfolio is simply because it is an art. While stocks and bonds may sit in a locker or hard drive of add possible much needed culture to an everyday life. "Nothing makes you smile on the inside

quite like hearing visitors tell you that your copy of a popular Picasso is wonderful then being able to tell them that it is actually an original” (linkroll.com). Simply put, art investing can be a lot more fun than the traditional investment methods.

Overall, art investing really works better when it is incorporated among other types of investments. Short term financial investment will provide needed liquidity while art will provide the needed long term portfolio stability and risk spread.

Pricing of Art Investment

Obviously, the price paid for an art investment is key to determining its current value and its profitability in the future. Many small details surrounding a piece can either add to the value or detract from it.

Buying the work of a well-known artist referred to in the industry as established artist like ‘TolaWewe’ can mean shelling out more money as an investment. Famous artists work is usually well worth the money but most beginning art investor aren’t able to access notable pieces. But arguing against this perception about known artist against the untested new artist. GODWIN (2008) stated that there is a common perception in the market that you should unstintingly buy the best you can afford not so sitting the research work carried out Mei and Moses of NYU, the more you pay for Art the lower the return and the greater the diversification within an art portfolio the greater the benefit

Another factor that affects art investment pricing is the quality or condition in which a piece is bought. If the

condition of the piece acquired is near perfect, then the price the artwork commands will be much higher

The period in an artist life that a piece of art was created also matters greatly in the pricing of art investment. Artists like other people in other walks of life have very successful and productive period. They also have time frames where their work and artistic styles lags. Most certainly, a thriving artist's work is more sought after than the work of an artist who is struggling.

Conclusion

Nigerian investors are yet to start incorporating any form of alternative investment into their portfolio which has increased the risk they carry. But this paper has been able to demonstrate that art is a viable asset class worthy of inclusion to a portfolio. I believe that Nigerian investors should get more knowledgeable about art and how they use it is to better diversify their portfolio.

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