Are Collectibles a Good Investment?

The aesthetic allure of collectibles like artwork, fine wines and classic cars can be hard to resist, especially when compared to more traditional investments. For high or ultra-high net worth investors, the ability to combine the pursuit of potential growth with their personal passions or hobbies holds a lot of appeal. Collectibles are also attractive to investors looking to diversify their portfolios or hedge against inflation.

However, collectibles come with some unique risks. For those looking to diversify, there may be better options. And those who think they can invest in collectibles the same way they invest in stocks or bonds may encounter some unexpected challenges.

GETTING INTO COLLECTIBLES
The best way to get into collectibles is to already have them. The people in the best position to potentially benefit from the long-term appreciation of collectibles are those who inherit existing collections from family members, or those who have amassed a collection through the pursuit of a hobby they are passionate about.

For those who do decide to pursue collectibles for investment purposes, the barriers to entry are high. Starting a collection from scratch requires a significant amount of time, money and patience.

STARTING A WINE COLLECTION
Take wine, for example. According to the Knight Frank Luxury Investment Index, the performance of investment-grade wine grew 24% between 2015 and 2016, the largest rate of growth among the 10 “collectible investments of passion” tracked by the index.1 Worldwide, auctions of fine wine in 2016 generated $338.7 million.2 It’s understandable that this might seem like an attractive market for enterprising investors. But what does it take to confidently invest in wine?

---

It’s estimated that a new investor in wine will need to spend at least $8,000 to purchase, store and insure their initial acquisitions. Ultimately, a wine investor is looking at a time horizon of at least six to 10 years before potentially realizing any gains from the collection. But before an investor even thinks about making a purchase, he or she will need to commit to deeply researching not just the wines themselves, but also the culture surrounding it, which can have a dramatic influence on prices and trends.

A savvy wine investor likely will need to understand, among other things, the difference between Bordeaux and Burgundy wine, how terroir can impact flavor, which wine critics are the most influential, and what publications like Wine Advisor are saying about developments in the industry. He or she will also need to pay close attention to what’s moving the market in order to spot opportunities—which is often easier said than done.

Luxury collectibles can fetch a pretty penny at auction. Here are some of the biggest sales in a few of the most notable classes of collectibles.

<table>
<thead>
<tr>
<th>Collectible Class</th>
<th>Description</th>
<th>Year</th>
<th>Price</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Fine Wine</strong></td>
<td>114 Bottles of Romanée-Conti Wine</td>
<td>2014</td>
<td>$1.6M</td>
</tr>
<tr>
<td></td>
<td>Vintages 1992-2010</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Pablo Picasso</td>
<td>2015</td>
<td>$179.4M</td>
</tr>
<tr>
<td></td>
<td>&quot;Les Femmes d'Alger&quot; Version O</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Fine Art</strong></td>
<td>1933 Ferrari 250 GTO Berlinetta</td>
<td>2014</td>
<td>$38M</td>
</tr>
<tr>
<td><strong>Coins</strong></td>
<td>1933 Gold Double Eagle Coin</td>
<td>2002</td>
<td>$7.6M</td>
</tr>
<tr>
<td><strong>Colored Diamonds</strong></td>
<td>&quot;Pink Star&quot; 59.80 Ct. Diamond</td>
<td>2017</td>
<td>$71.2M</td>
</tr>
<tr>
<td><strong>Watches</strong></td>
<td>1941 Patek Philippe Ref. 1518</td>
<td>2016</td>
<td>$11M</td>
</tr>
</tbody>
</table>

**COLLECTIBLE MARKETS CAN BE VERY VOLATILE**

Collectible markets are highly subjective and greatly influenced by pop culture trends, shifting personal tastes and even politics.

For example, between 2005 and 2011, the London International Vintners Exchange, which tracks the prices of premier Bordeaux wine, saw prices rise 340%. This massive growth is largely attributed to an increase in demand from China that began almost a decade earlier.

In the mid-1990s, Chinese premier Li Peng promoted wine as an alternative to the baijiu grain alcohols that were proving deleterious to public health. In the ensuing wine boom, French wines, particularly those from Bordeaux, were seen as the most desirable. Chinese consumers viewed Bordeaux wines as having higher status because of their historical pedigree.

---

However, prices took a big hit in 2013 after Chinese president Xi Jinping implemented a slew of new policies aimed at reducing government corruption.\(^5\)

Why did this impact wine prices? Because Bordeaux wines were commonly given as gifts to government officials by people looking for political favors. With such gifts prohibited, demand fell and investors were left in the lurch.

Trends like these are not easy to anticipate. Those with a genuine interest in wine, and who relish the opportunity to immerse themselves in the history, science and culture of it, will certainly have an advantage over someone whose interest is purely monetary.

**COLLECTIBLES CARRY SOME OTHER UNIQUE RISKS**

All investments carry some degree of risk, but there are some unique risks that make investing in collectibles particularly challenging.

**Loss, Theft or Damage**

As tangible objects, collectibles can be lost, stolen or seriously damaged. When investors purchase traditional securities, such as stocks or bonds, a financial institution typically acts as a custodian, holding them—either physically or electronically—to protect against these risks. With a collectible item, you must act as your own custodian, and carefully weigh your desire to enjoy or display the items against your need to keep them safe and protect their value. For example, casino magnate Steve Wynn famously poked a hole in Pablo Picasso’s 1932 painting “Le Rêve” with his elbow while showing it off to some friends in 2006, spoiling a pending $139 million sale.\(^6\)

**Counterfeits**

Counterfeiting is also a risk for collectors. Even the savviest collectors can be taken in by a compelling con. Billionaire and noted wine collector Bill Koch spent $500,000 to purchase four bottles of 1787 Chateau Lafite Bordeaux said to have come from Thomas Jefferson’s personal collection. They were later discovered to be fakes. The revelation led Koch to conduct a full audit of his 43,000 bottle collection. He discovered that 211 bottles, for which he had paid over $2 million, were likely fraudulent.\(^7\) Identifying fakes isn’t easy, nor is it inexpensive. In some cases, it could cost more than the price paid for the item in the first place.

**Inefficient Markets and High Fees**

Markets for collectible items tend to be inefficient, meaning that it can be hard to ascertain the true value of an asset because reliable information about supply and demand is not always publicly available. In the case of artwork, for example, it’s estimated that as much as 60% of sales are private.\(^8\) While this creates opportunities for knowledgeable investors, it also makes it hard for them to gauge their own level of knowledge relative to others. An investor may end up on the losing end of a deal and not even realize it.

When collectors do decide to part ways with their valuables, the transaction costs can be substantial. Auction house or dealer commissions can be very high, perhaps as much as 25% or 30% of the sale price.\(^9\) There may also be additional costs associated with transporting, storing and insuring the items during the transaction.

\(^{5}\) Ibid.
ARE COLLECTIBLES A GOOD INVESTMENT?

Tax Consequences

Profits on the sale of collectible items held for more than a year are subject to a maximum 28% federal tax rate; many taxpayers typically pay around 20% on long-term realized capital gains from traditional investments. Additionally, collectors with high incomes may be subject to an additional 3.8% surtax on net investment income. How states treat collectibles for tax purposes can vary. For instance, in Massachusetts, there is a 12% tax rate on collectibles, regardless of how long they have been held.

Those who acquire collectibles primarily for investment purposes are entitled to deduct the cost of acquiring or maintaining their purchases from their taxes. However, those investors must demonstrate to the IRS that they either have sold or are willing to sell items from their collection for a profit.

The illiquidity of collectibles can lead to serious estate tax consequences. The federal government collects a flat 40% tax on the portion of the estate that exceeds the federal exemption amount. Several states also levy taxes on estates or inheritances. It’s possible that a very valuable collection could result in a big tax bill for the estate; the executor may be forced to sell off pieces of the collection just to cover it.

BEST PRACTICES FOR COLLECTIBLES

With all this in mind, here are some best practices for those interested in or currently holding significant collectible assets:

Consider Alternative Asset Classes for Diversification Purposes

“The significant carrying costs and volatility of collectible investments can undercut their effectiveness as a diversifier,” according to Terry Sylvester Charron, Family Wealth Investment Advisor at BNY Mellon Wealth Management. “Investors seeking diversification might be better served by exploring financial alternative asset classes, such as managed futures, commodities or absolute return strategies, which also have low correlations to traditional investments but aren’t as cumbersome.”

Buy What You Like and Hope for the Best

“From a financial safety perspective, it’s generally best to view collectibles more as a hobby than as a way to make money,” says Bill Johnston, Managing Director and Head of Private Banking Solutions. “While they can grow in value over time, there are costs beyond purchase, storage and care, such as auction or broker fees.” In essence, any potential monetary gains from collectibles are best viewed as a fringe benefit, a bonus that serves as a validation of the collector’s keen eye and good taste.

Keep a Detailed Inventory of Your Collectibles

“Collectors should absolutely have an inventory or catalog that captures important details about their collectibles,” says Jere Doyle, Senior Vice President and Estate Planning Specialist at BNY Mellon Wealth Management. “It should include where and from whom they bought them, for how much, and any other distinguishing features of the item.” Doyle says that provenance, a clear record of the history of ownership, is critically important when dealing in collectibles, and can significantly impact the value of the item, as well as the collector’s ability to sell it.

Preserve the Value of Your Collection

Even if your primary motivation for building a collection is personal enjoyment, consider taking steps to preserve and safeguard your collectibles so you can capitalize on them in the event that they do increase in value. This could include purchasing specialized insurance, having your items appraised by a certified expert and making accommodations for proper, long-term storage, whether in your home or in a professional storage facility.

Don’t Forget Your Collection When Planning

“People often don’t disclose their collections unless you specifically ask them,” says Doyle. “They don’t see it as an asset—they just see it as something that they do for pleasure.” Failing to take collections into account when making decisions about your wealth and estate plans can have serious financial consequences. It’s important to recognize and account for their value as you would any other financial asset.

Consider Donating Your Collection

Donating valuable collectibles to a charitable organization is a great way to support a cause you care about and take advantage of a significant tax deduction. Additionally, gifting an entire collection to a charity or other non-profit can help to avoid potential liquidity issues around the estate tax and create a lasting legacy for your life’s passion. Some collectibles, like art, classic cars or sports memorabilia, have exhibition value that might make them good candidates for donation to a museum.

“For many collectors, there’s a desire to see the collection kept in one piece even after they pass it on,” says Doyle. “That’s something that should be discussed with the museum or charity prior to the transfer.” He recommends that donors draft a gift agreement with the recipients to ensure that the donation is put to use in a way that entitles them to the tax deduction and best reflects their wishes.

He also notes that collectors could form their own private operating foundations in order to retain some control over their collection while still enjoying the tax benefits of donating to a charity.  

CONCLUSION

There’s a less obvious risk in approaching collectibles from an investment perspective—the possibility of missing out on the other, more abstract benefits they provide. Collecting offers the chance to indulge your curiosity by exploring something new and unfamiliar. It can connect you with people from different walks of life through a common interest, helping to form vibrant friendships. It can help to enrich your community, not just financially but intellectually and culturally. Though it would be unwise to ignore the financial aspects of collecting, these other benefits should not be overlooked. Over time, they may be more rewarding to you than the possible financial gain.
