INVESTING IN ART: THE CLASH OF HEART AND HEAD

—AN INTERVIEW WITH GREG B DAVIES, FOUNDER OF CENTAPSE

Christie's Auction House: Lombard Odier client event

Art is among the most emotional of asset classes. The journey from art lover to art investor can be littered with pleasure and pitfalls, and the profit may take many forms. For investors who want to take their love of art a step further, the decision to buy a piece of art as an investment may mark the ultimate clash of heart and head. To help us scope the battlefield, Greg B Davies – founder of Centapse (a firm dedicated to applying behavioural insights to financial decision-making) – discusses what his research has revealed about the trends and the challenges of adding art to one's investment portfolio.

What is driving the increasing popularity of art as an asset class ?
Greg Davies: Much of the popularity is driven by nervousness about more traditional financial assets and markets, which can sometimes feel opaque and risky. People find comfort in the tangible aspects of buying something they can touch and feel: however, understanding the physical properties of something is completely different from understanding the risks of owning it, which are far more difficult to pin down for art than for financial assets.

When markets are as uncertain as they are today, investors often look for more tangible alternatives such as art. Aside from a few much-quoted success stories over recent years, are there genuine financial returns to be gained from art investing and what questions should an investor ask themselves before embarking on a purchase?
It is always possible to get lucky and buy something that provides genuine financial returns. However, those stories are much quoted precisely because they are cherry-picked success stories – and many do not adjust for the numerous costs of buying and owning art, which means the annualised returns are usually far less compelling than the headline numbers. Most are less lucky. True financial returns in art investing almost invariably come from genuine skill, knowledge and connections. Unless you are a highly knowledgeable art world insider (or can hire someone who is) financial returns are likely to be much harder to find than the stories suggest.

Buying art is far more than a financial investment, can you talk about the various non-tangible returns to be gained from this type of investment and how much should an investor's like/dislike of a piece play a part in the decision-making process?
The overwhelming reason most people buy art is enjoyment – it interests and fascinates them. Sensibly, only a small portion of people claim to buy art solely for its investment prospects. Many also buy art out of a sense of cultural identity and heritage, wanting to act as cultural custodians for future generations. And owning art offers social recognition, belonging, and status - a tangible badge of sophistication and erudition. These are all very good reasons for owning art. Liking a piece should be the primary factor in any buying decision. If you enjoy a work it will provide a guaranteed emotional return regardless of the financial returns, which are much less reliable.

What are the key considerations that a prospective investor should make when looking to build an art collection? What are the risks that should be considered when buying art as an investment?
The key risk is that you'll only make a positive return if someone in the future is prepared to pay more for the work than you just did. Art generates no interest, no dividends, and no income. Indeed, it costs money to hold it. In addition, transaction costs are large and highly opaque; and the markets are highly illiquid, so you may not be able to sell it at all. In the end, the investment value of art is dependent on fashion – will someone in the future value it more than you do now? These are not reasons not to own art... just reasons not to own art if investment returns are your only motivation.

From a behavioural point of view, what emotional blind spots should an investor be aware of when investing in art, and tangible assets in general?
Art can be appealing – you see something you like, and you want to own it. This is amplified by the theatre, glamour and allure of the art world: all these things conspire to increase emotional aspects of decision making, making you less likely to stick to sensible evaluations of what you can afford, or what the piece is really worth. This is particularly true in an auction, an environment carefully crafted to heighten competition and buyers' emotional states. Many find themselves, often unknowingly, victim to the Winner's curse: the winner of the bidding contest has, by definition, paid more than anyone else thinks the piece is worth, and is therefore cursed to hope that fashion makes others willing to pay more in the future.