THE WALL STREET JOURNAL.
WSJ.com

JOURNAL REPORTS | February 25, 2013

The Ways Art Investors Blow It

Three common mistakes novices fall prey to—and how to avoid them

By DANIEL GRANT

Adding art to your portfolio can be a lot trickier than putting it on your wall.

Journal Report

Insights from **The Experts**

Read more at **WSJ.com/WealthReport**

More in Wealth Management

- 12 Dangerous Debt Myths
- Comic-Book Investing Is a Funny Business
- 'Play Money' Accounts Let Investors Test Their Skills
- Repairing Credit and Planning for the Future
- Get Your Financial House In Order When Separating

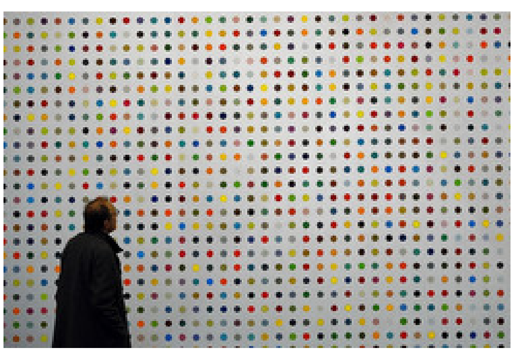
With regular investments looking uncertain these days, individuals and financial pros are snapping up artwork to diversify their holdings—and, with any luck, realize big returns.

But with more competition for desired pieces, prices are soaring ever higher and the chances of making a costly mistake are rising too. Here's a look at some of the pitfalls of art investors face and how to avoid them.

Buying What's in Vogue

Contemporary art can be alluring for investors. There's an active global market for these pieces that makes them easy to buy and sell, and prices can rise in a hurry.

But they can fall just as fast. The market relies on hype to build up certain artists, and that doesn't last. So, experts advise buyers to move very cautiously when it comes to the current big names.



AFP/Getty Images

Damien Hirst's painting, "Urea-13C," at the Gagosian Gallery in New York in January 2012

"Don't buy what everyone else is buying," advises Philip Hoffman, director of London's private-equity Fine Art Fund. "You may be too late. You may be coming into the market just as the savvy investors are bailing out."

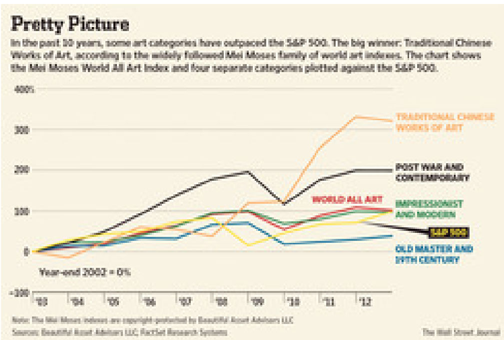
For one recent example, look at Damien Hirst, says Jeff Rabin, principal and co-founder of Artvest Partners, an independent art-advisory firm in New York. In September 2008, Sotheby's held a much-ballyhooed sale of the artist's work, with prices ranging as high as $18.6 million.

But the market for Mr. Hirst's work has cooled, and those who bought at the sale "would have, on average, paid significantly more than those works are currently commanding."

Mr. Rabin recommends that collectors "love what they're buying," because there's no guarantee of a secondary market, and they may be stuck with it.

Going for a Quick Profit

When a piece of art sets a new auction record, it can elevate gallery prices and estimates for similar works overnight. But most investment-grade artworks rise in value gradually.



"The market doesn't move up 20% to 30% per year," says Enrique E. Lieberman, president of the Art Fund Association, a membership organization of private-equity art funds. "You generally have to think in terms of a five- to 15-year plan in order to realize profits."

Even when artwork *does* soar in value rapidly, owners who go for a quick kill often find themselves disappointed—thanks to high transaction costs.

Let's say you buy a piece of art and sell it a year later for 50% more. Great profit? Not really.

If you sell it through a gallery or auction house, you'll likely have to fork over a 20% to 30% sales commission or similar fee. Then there's the money you already paid to maintain the artwork, such as storage, insurance and framing. When you factor all that in, your 50% profit has vanished.

The smarter strategy to pursue: Wait and let the art gradually appreciate, so those costs make up a smaller chunk of your profits.

"You want to amortize the high transaction costs over time," says Michael Moses, a retired New York University business professor who charts art-auction results against the Standard & Poor's index.

"You have to be a long-term investor," he says, noting that the average work of art on his index has been held for 19 to 20 years.

Going It Alone

You can study for years to develop your eye for art and your understanding of the market. But the reality is, most people don't have the time—and they need some help figuring out what to buy.

As art investing has gotten more popular, advisers have sprung up to offer guidance to would-be collectors, weighing the relative quality and importance of an artwork, researching provenance and sales history, and appraising current value.

Advisers, for instance, can help steer you away from second-rate pieces. We've all heard of Picasso, Matisse, Renoir, Warhol and the multimillion-dollar prices that their works have achieved at auction. However, not every Picasso, Matisse, Renoir and Warhol earns those prices.

"During the late 1980s and early '90s, a lot of Japanese collectors were spending millions of dollars buying second-rate Impressionist paintings that, when the Japanese economy began to decline and these collectors needed money, they couldn't easily sell," recalls Barbara Chu, partner at New York's Emigrant Bank Fine Art Finance.

Pros can also steer you away from "bargains" that aren't as good as they look.

Algur Meadows, the Texas oilman and art collector, liked buying works by famous 17th- and 18th-century Spanish artists—and thinking that he got the paintings for a steal.

However, after Meadows donated his collection to Southern Methodist University in Dallas in the 1960s, it was discovered that almost all of the works by the most important artists were fakes.

How do you identify the best experts? The art market is cyclical, and an adviser should be attuned to what's in and out.

The person should also specialize "in the area in which you are interested in collecting," says Megan Fox Kelly, an independent art adviser in New York City.

To get a full picture of the adviser's work, ask for references of past and current clients. You can also look for membership in an association, which shows the expert has gained a solid reputation among peers. Some dealers, for instance, are part of the Art Dealers Association of America, or regional gallery-owners' groups.

For independent art advisers, look for members of the Association of Professional Art Advisors. And some managers of art funds are members of the Art Fund Association and the Art Investment Council.

Mr. Grant is a writer in Amherst, Mass. He can be reached at reports@wsj.com.

A version of this article appeared February 25, 2013, on page R7 in the U.S. edition of The Wall Street Journal, with the headline: The Ways Art Investors Blow It.