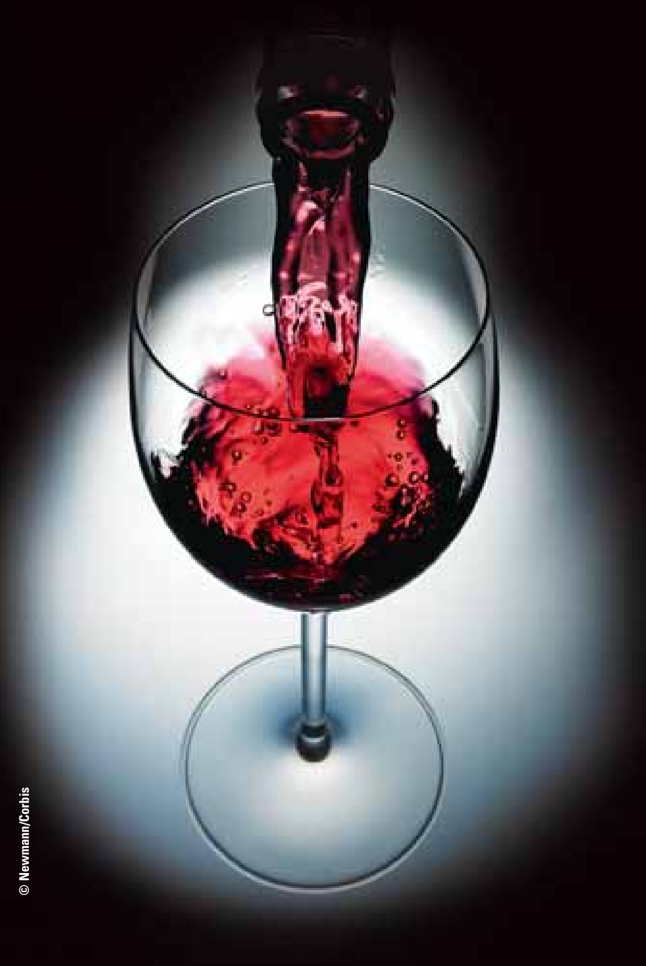
# A TRULY Liquid Asset



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**With some vintages outperforming equities while exhibiting lower volatility, is the time right for investors to take a sip?** BY ED MCCARTHY

The global market for collectible fine wines continues to heat up. The Liv-ex Fine Wine 100 Index, which tracks wine trades between merchants on the Liv-ex wine exchange in London, was up 41 percent for the one-year period through February 2011. According to Liv-ex, the index "represents the price movement of 100 of the most sought-after fine wines for which there is a strong secondary market and is calculated monthly." Bordeaux wines, considered a representative proxy for the overall market, account for most of the index, but the index also includes wines from Burgundy, the Rhone, Champagne, and Italy. Other Liv-ex indexes, which track different market segments, have also increased significantly over the same period.

The index's longer-term upward trend also has been impressive, increasing 192 percent from roughly 120 in February 2006 to its current level of 358. "The fine wine market has been in quite a long-term bull run at the moment," says Jack Hibberd, research manager with Liv-ex. "We did see a bit of a drop during the post-Lehman period, when the market did drop almost 25 percent in terms of wine value over three or four months. But since then, the market has taken back those gains and really pushed on to new heights."

There are other indications of the growing demand for fine wines. Sotheby's sold more than US$88 million of wine at its auctions in 2010, more than doubling 2009 sales and producing the highest total in the company's history.  A global shift in buyer demographics may explain the higher demand. "Our average age of the buyer has moved from around 60–65 probably to 40–45, and generally buyers were mostly in Europe and in North America," says Jamie Ritchie, CEO and president of Sotheby's Wine for the Americas and Asia. "What's happened since January 2009 is really the baton has been passed to the Asian buyers. Now they are the least price-sensitive buyers, and they have been buying probably around 80 percent of the value of the wine we've been selling worldwide."

Research supports wine's investment potential. In a March 2010 working paper published by the American Association of Wine Economists, Philippe Masset and

Jean-Philippe Weisskopf reported that from 1996 through 2009, "first growths wines from top vintages have performed better than equities while showing a lower volatility. A further and more detailed research into different investor types and wine indices fully supports this evidence and confirms that wine in a portfolio has produced higher returns and lower risks than the Russell 3000 equity index during the period of time."

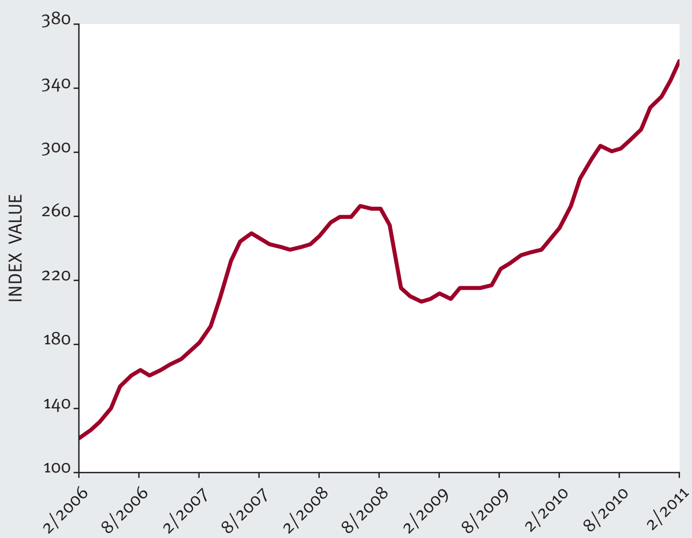
## PASSION VERSUS PROFIT

But are private-collector investors likely to see short-term price appreciation similar to the Liv-ex indexes and major auction sales? It's the classic problem facing all retail-level private collectors operating in wholesale-level dealer markets.

Timothy Clew, managing partner with the Wine Trust, a wine investment firm and wholesaler in Ridgefield, Connecticut, says private collectors face two major hurdles to profitable wine investing. The first is structural. Because of the nature of the supply chain, Clew says, collectors will never make as much money as somebody who is in the supply chain. He believes there are too many impediments for an individual (particularly in the United States)—in terms of buying the wine at the lowest possible price and then selling the wine at the highest possible price—to match what an organized fund that has trade-level access can do.

The second hurdle: Collectors often believe that their taste in wine is a reliable proxy for determining what the market will value. "We see this with people who start investing in wine for their own cellars," says Clew. "What you find with folks who are passionate about wine is what they end up collecting in their cellars is their taste buds. [They] convince themselves that they can collect their palettes and maximize returns on these things from an investment perspective, and frankly, I've never seen anybody who can do that yet."

### Liv-ex Fine Wine 100 Index




*Source*: Liv-ex.com

### Performance of Wine versus Equities and Gold
(as of March 2011)

| Index | Level | Month over Month | Year to Date | 1 Year | 5 Years |
|---|---|---|---|---|---|
| Liv-ex Fine Wine 50 | 437 | 4.4% | 9.0% | 283.1% | 60.0% |
| Liv-ex Fine Wine 100 | 358 | 3.3 | 6.3 | 191.9 | 41.1 |
| Liv-ex Claret Chip | 445 | 3.9 | 7.5 | 262.9 | 53.0 |
| Liv-ex Investables | 360 | 3.8 | 7.7 | 202.0 | 44.3 |
| FTSE 100 | 5,994 | 2.2 | 1.6 | 3.5 | 11.9 |
| S&P 500 | 1,327 | 3.2 | 5.5 | 3.6 | 20.2 |
| Gold | 867 | 4.3 | −4.7 | 170.1 | 18.0 |

*Source*: Based on data from *Liv-ex Fine Wine Market Report*.

Karl Lung, CFA, past president of the Hong Kong Society of Financial Analysts, spent 16 years in the investment industry before starting the Hong Kong Wine Academy in Kowloon in December 2009. Lung, who has made presentations on wine as an investment to financial-adviser audiences, points out several factors that collector-investors need to consider. The first is a lack of comparable regulation to that found in the major securities markets. There is no equivalent of the U.S. Securities and Exchange Commission (SEC) or Financial Industry Regulation Authority (FINRA) overseeing the wine market. The lack of liquidity is a second risk. If an investor wants to sell the wine quickly, he will have to reduce the price considerably, often by 20 percent to 30 percent or more. Wine also requires proper storage—an additional cost for larger collections—to avoid spoilage, and there are risks of fraud and breakage as well.

## BUYING IN

Nonetheless, a long-term case can be made for investing in fine wines. Ritchie notes that wine will follow economic cycles as a luxury good in the short term, but he's optimistic about the market's prospects. "In the longer term, if you have more people wanting to drink what is a fixed supply of great wines and a diminishing supply of the older vintages, then my view is that prices will inevitably have to rise over the longer term."

Those who want to focus solely on the investment aspect can consider customized wine funds or collective-investment wine portfolios with lower required investments. Among others, these include The Wine Investment Fund, the Elevation Wine Fund, and The Fine Wine Investment Fund, which is based in London. The funds' minimum investments vary; some offer the option to take distributions in cash or wine. Investing in a wine fund requires an additional level of due diligence into the fund. "I try to get more information about the wine funds, but most are not transparent," says Lung. "You really can't get much information. You look at their websites and most of them don't give any further details other than just telling

**The process of determining the *en primeur* price for a vintage is an annual rite of spring in Bordeaux, France. One of the most prestigious testing sites is the Haut Brion wine storehouse, a partial view of which is shown in this 2008 photo. "Based upon our response and the critics' responses, the pricing will begin to be set for these wines," says Chris Adams, CEO of wine merchant Sherry-Lehmann in New York City. Purchasing such wine "futures" can be a key investment strategy.**



who they are, how experienced their managers are, and what is their philosophy. Some of them post returns, but [they] are not up to the standards of typical equity funds. It is difficult to analyze their performance and make proper selections."

Wine futures, or "en primeur" purchases, are another investment strategy. These are not futures in the "publicly traded exchange" sense; they are essentially an advance order of wine (Bordeaux chateaus dominate the futures market) from a merchant. Chris Adams, CEO of wine merchant Sherry-Lehmann in New York City, describes the process of determining the futures' price as an annual rite of spring: "In the second week of April, I will go to Bordeaux and taste the 2010 vintage that has been in barrel now for a while and finished its fermentation and now is ready to be tasted. Early indications are that it was a very successful vintage, but we'll taste it and make our own judgments. Based upon our responses and the critics' responses, the pricing will begin to be set for these wines."

Customers who buy the Bordeaux futures from Sherry-Lehman and other merchants won't take physical delivery until sometime in 2012. That raises a counterparty risk and highlights the need to deal with reputable wine merchants with a history of delivery for the ordered wines. If the merchant doesn't deliver the wines, the customer owns an expensive piece of paper—about US$1,000 per bottle for the top 2009 Bordeaux chateaus—but has no wine to show for it. This happened in 2007 when London wine merchant Cellaret took futures orders but failed to pass most of the funds to the Bordeaux negociants (wholesalers). As a result, buyers lost their funds.

Moreover, building a diversified portfolio of Bordeaux futures is costly. Clew notes that ordering one case from each of the top 15 chateaus would cost about US$100,000.

"You have to work with negociants whom you trust, and you have to be able to deliver—it's as simple as that," says Adams. "Choose a merchant who has a track record because in every great vintage someone is jumping in and selling on spec. At Sherry-Lehmann we don't offer any wines until we're set with our contracts and we know what we own. We don't sell it and say, 'Well, we'll be able to buy it later,' because in a great vintage that's just not an option. These wines go so quickly that you need to secure them before you can confidently offer them."

## KEEPING PERSPECTIVE

Fine wine's cachet and potential for price appreciation make it easy to forget that the fuss is ultimately about fermented juice from crushed grapes. Kevin Zraly, founder of the Windows on the World Wine School and author of *Windows on the World Complete Wine Course*, notes that 90 percent of all the wines made in the world today are meant to be consumed within one year. Zraly has taught his wine course to more than 20,000 students over 40 years, but he doesn't consider himself a wine investor in the traditional sense, even though he has been collecting for 30 years. "Personally, I have never invested in wine to sell," he says. "Yes, I've invested in wine, but I also use about 30–40 percent of my wine cellar in my wine school."

*Ed McCarthy is a freelance finance writer in Pascoag, Rhode Island.*