Wine is the new liquid currency

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Every dark cloud has a silver lining. Similarly, the economic slowdown taught us a few valuable lessons. First: diversification in your investment portfolio is critical. Second: low volatility is actually hard to find. Third: any asset that ticks the previous two boxes generally has unexciting returns. True?

Think again.

There is one asset though, which is an exception. It has a low correlation to the standard trifecta of equities, debt and gold, it's proven to be recession-proof and the returns are often spectacular. Ladies and gentlemen, raise a toast to fine wine.

Fine wines have been in production for centuries and actively traded for the last 400 years. Christie's had its first fine wine auction in 1776. Last year there were more than 200 such auctions netting over $200 million. The fine wine market itself is worth $2-3 billion annually. There is even a global electronic exchange (www.Liv-ex.com) accounting for 80% of trades that is quoted on Bloomberg daily.

Only 1% of the world's wines are investible. Such fine wines last between 50-100 years getting better over time, are from the top Chateaux in the world, are made in tiny quantities. They are highly sought after and have exceptionally high ratings from industry reviewers (similar to Standard and Poor's or Moody's ratings!). 90% of these fine wines originate from Bordeaux, and are primarily red wine.

Several economic studies (Mahesh Kumar's the most famous, Masset & Weisskopf the most recent) have shown that over the last 30 years an investment in fine wines outperformed equities, bonds and even gold and survived every recession. In no three-year rolling period has fine wine ever lost money. The correlation between wine and equities is less than 0.03 ie negligible, making it the perfect portfolio hedge. Also, the volatility in the return profile is far lower than traditional assets.

Let's take some examples. In the five-year period to June this year, an investment in the top fine wines yielded 29% per annum. A similar investment in the Sensex would have returned 18% and in the NASDAQ less than 1% per annum.

If we factor out the recent bullish recovery, the facts are more startling. In the two-year period January 2007-2009, taking the worst of the sub-prime, an investment in the BSE would have lost 18% per annum and the NASDAQ would have lost 23% per annum. In this same period an investment in the top fine wines still yielded 10% per annum.

So why are these returns so high? It is well known that the best wines in the world are rare luxury collectibles. Lafite Rothschild, Latour, Petrus, Margaux, Mouton Rothschild and Haut-Brion are some of the most famous examples. These are the Maybachs and Hussains of the wine world. They are produced in very limited quantities, production being restricted by law and terrain. Chateau Latour only produced 9,600 cases of wine in the 2003 vintage. The demand on the other hand is global and growing. The fine wine market was traditionally dominated by the European, American and Japanese markets. In the last 10 years however Russia, Eastern Europe, Asia and now, spectacularly, the Chinese have caught on. China alone now accounts for over 30% of the fine wine market. In a two-day auction in Hong Kong this spring, $19.5 million worth of fine wine was purchased.