

THE INVESTMENT STRATEGIES OF ART FUNDS



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PLAGIARISM

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ABSTRACT

This thesis study, titled “The Investment Strategies of Art Funds”, examines the conditions that laid the groundwork for art funds in particular, their formation and development processes, and subsequently analyses the properties of art funds as a type of investment fund, and their structure and diversity, ultimately closely examining their investment strategies in detail through examples. Although artworks have been known to be valuable for centuries, the classification and acceptance of artworks as an asset class is a newer phenomenon that occurred in the last century. The operating mechanisms unique to the art markets evolved within the limits of the potential provided by the developing technology as financialization began to dominate all fields. This evolution brought the worlds of art and finance together in new practices. As changing economic conditions impacted different geographic regions simultaneously, creating fluctuations in markets, investors sought safe investments due to increasing economic and social anxieties. Emerging at this moment, these new art market practices became an anchor for investors, presenting them attractive opportunities. Building upon the structures of hedge and private equity funds, art funds are portfolios put together to create profit through the acquisition of artworks. The initial examples of these funds first appeared in France, the UK and the USA. Although their general principles are similar to other funds, due to the flexibilities of legal arrangements and a lack of disclosure requirements rendered them open to different implications. Largely and increasingly in developing economies, these funds provide opportunities for High-Net-Worth and Ultra-High-Net-Worth investors who want to invest in art as either as a major investment or a diversification factor in their portfolios. This study aims to examine the emergence and developmental stages of art funds through the conditions that allowed art funds to emerge at the intersection of art markets and financial markets

in the last century under the influence of capitalism and globalization, and the events that occurred over this historical process, through the socioeconomic conditions of the century. Consequently, it will examine the art markets' unique dynamics and their transformation into new forms in light of the financial markets' simultaneous evolution with technology, and the various resulting modern funds and various examples of these from various geographies, as well as the types of structuring and strategies in relation to these funds and the differences between them. Thus, this study will underline the details of the operating mechanisms of art funds to contribute to future studies in the literature.

Key words: Art fund, investment funds, art investment, investment strategy, art economy

ÖZET

“Sanat Fonlarının Yatırım Stratejileri” başlıklı yüksek lisans tez çalışması, sanat fonları özelinde, sanat piyasası dinamiklerinden hareketle 20 yy. başında bu fonlama biçimine zemin hazırlayan şartlar ve fonların oluşum, gelişim süreçlerinin devamında yatırım fonlarının bir türü olan sanat fonlarının özellikleri, yapılanma biçimleri ve çeşitliliğinin analiz edilmesini ve sanat fonlarının yatırım stratejilerinin tespit edilerek örnekler üzerinden detaylı incelenmesini kapsamaktadır. Sanat eserlerinin değerli olduğu yüzyıllardır bilinse de sanatın bir varlık sınıfı olarak tanımlanması ve kabullenilmesi son yüzyıl içinde gerçekleşen yeni bir olgudur. Sanat piyasalarının kendine has işleyiş mekanizmaları, finansallaşmanın tüm alanlarda egemen olmaya başlaması ile birlikte gelişen teknolojinin sağladığı olanaklar ölçüsünde evrilerek sanat ve finans dünyalarını yeni pratiklerde buluşturmuştur. Değişen ekonomik şartların küresel ölçekte farklı coğrafyaları bir arada etkilemesi ile dalgalanmaya başlayan değişken piyasalarda yatırımcılar, artan ekonomik ve sosyal kaygılar nedeniyle sığınacak güvenli yatırımlar ararken ortaya çıkan bu yeni pratikler cazip fırsatlar sunarak çıpa vazifesi görmüştür. Temelini risk ve özel sermaye fonlarının yapılarından alan sanat fonları sanat eserleri edinimi yoluyla kar sağlamak için oluşturulmuş portföylerdir. Fransa, İngiltere ve Amerika’da ilk örnekleri görülen bu fonlar genel prensipleri bakımından benzerlik gösterse de hukuksal düzenlemelerin esnekliği ve kamuya açıklama zorunluluklarının bulunmaması nedeniyle farklı uygulamalara açıktır. Gelişen ekonomilerde giderek artan bir yoğunlukta majör olarak veya portföylerinde bir çeşitlendirme unsuru olarak sanata yatırım yapmak isteyen HNW ve UHNW yatırımcılar için fırsatlar sağlamaktadır. Bu çalışma ile kapitalizm ve küreselleşme etkisi altındaki son yüzyılda sanat piyasası ile finans piyasasının kesişim kümesi olarak ortaya çıkan sanat fonlarının

oluşumunu hazırlayan şartlar, tarihsel süreç içindeki olaylara bağlı olarak sanat yatırım fonlarının doğuşu ve gelişim aşamaları son yüzyılın sosyoekonomik şartları altında incelenerek, sanat piyasasının kendine has dinamiklerinin finans piyasasının teknoloji ile eşzamanlı gelişimi ışığında yeni formlara dönüşmesi ve bu süreçlerin sonunda ortaya çıkan çağdaş fonların farklı coğrafyalardaki örnekleri, yapılandırma ve strateji çeşitleri, stratejiler arasındaki farkların ortaya konulması ile sanat fonlarının işleyiş mekanizmalarının detaylarına dikkat çekilerek bundan sonra literatürde yapılacak çalışmalara katkı sağlamak hedeflenmiştir.

Anahtar kelimeler: Sanat fonu, yatırım fonları, sanat yatırımları, yatırım stratejisi, sanat ekonomisi

To my family



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CHAPTER 1. INTRODUCTION

In the 20th century, the increasingly wide-spread acceptance of art as a financial asset added financial appeal next to its qualities of aesthetical value and social benefit. The art market thus began to quickly grow with participation from developing economies. According to the Art Basel and UBS Global Art Market Report (Art Basel &UBS, 2022, p.23) in 2021, the international art market volume has reached a size of \$65.1 billion. The downturn that occurred as a result of the Covid pandemic was compensated for with the 29% growth compared to 2020, surpassing the 2019 figures by 1% (Art Basel &UBS, 2022, p.14). The art market is a growing center of attention due to not only its volume but also the added values with tabloid glamor, prestige, and respectability it provides. The products of the art market have become a target for various reasons for the upper classes who have become increasingly wealthier due to uneven wealth distribution even further exacerbated by global capitalism. Evolving under the influence of globalization and financialization, the practices of the market gave birth to art funds as a point of intersection for art and finance.

This study encompasses the emergence of art funds around the world, their development, the birth of modern funds after 1980 and their contemporary dynamics and investment strategies, in comparison with examples from Europe and the United States.

Since it is necessary to know the dynamics of the art market to comprehend art funds, this study first analyses the market dynamics, historical process, and the factors that influence its development. It will then examine the factors that laid the groundwork for the emergence of art funds within the market, as well as their inception and evolution

processes in the 20th century. After a detailed examination of examples from history, this study will investigate art funds as they exist in the current day and examine its legal and structural specifications. Investment strategies and the administrative strategies which will allow them to reach the desired success will then be examined from a broad perspective alongside two striking case studies following some essential information about the structure of art funds to create a better understanding of the technical aspects.

Books, periodicals, articles, master's theses and doctoral dissertations, as well as online resources will be examined for the literature review and the resulting data will direct this study.

In the first chapter, the subject, purpose, scope and method of the thesis will be revealed, and the subjects to be discussed in each chapter and the sub-titles to be examined under them will be revealed, and the framework of the thesis will be drawn.

In the second chapter, this study will go over the products that comprise the art market, the supply-and-demand balance, and mention the unique economic properties of the market and the factors that create the value of an artwork. It will examine the actors that exist within the art market – collectors, auction houses, galleries, dealers – and establish the outline of their interrelations before investigating how the art market was shaped through history and analyzing the subjects of commercialization, globalization, and financialization as factors that affected its development.

In the third chapter, the influencing factors in the process that led to the birth of art funds, and the historical evolution of these funds which have appeared in the turn of the 20th century but only transformed into their current form in its last quarter will be established. The French “*Peau de L'Ours*”, which is commonly accepted as the first example, as well as the first officially recognized art fund in history, the “*British Rail*

Pension Fund”, encompassing the periods from their establishment through their dissolution will be examined. Consequently, the emergence of modern funds, which are shaped by the market conditions that continuously evolve in accordance with technological and financial conditions will be explained.

In the fourth chapter, the legal and structural framework for art funds and fund types within the standards determined by the Capital Markets Board of Turkey and the U.S. Securities and Exchange Commission, which regulate the capital markets in Turkey and the U.S., respectively will be established. We will propound the variety of fund structures through certain funds currently unavailable in Turkey to lay the conceptual foundation for the case studies in the next chapter.

In the fifth chapter, we will examine investment strategies for funds, the risk relationship, potential conflicts of interest, and administrative strategies to achieve sustainable success. We will analyze the administrative, structural and financial status of funds through two different fund examples operated in America, providing detailed information about both investment strategies and the sector itself.

In the sixth chapter, the weaknesses and threats in the sector through examples of art funds from across the globe, analyzing the steps necessary to strengthen the market and the potential opportunities in the market in line with and the trends in the fields of art and finance will be examined.

Through this study:

We aim to investigate art funds’ point of origin, the factors that influenced the art funds which had emerged in Europe then spread to the U.S. and later the world over in the axis of developing economies and their historical background. We will then examine the developments and transformations of the art market under the influence of

globalization and international financialization, as well as the strategies that drive art funds as a type of investment for the wealthy classes – who prefer art funds as a sophisticated investment for their unbridled growth of wealth as a result of capitalism which accelerated at the same time when art became accepted as an asset class – and the underlying dynamics of the legal, structural, and administrative foundations of these funds.

The purpose of this study was the promotion and detailed examination of art investment funds as a prominent and contemporary method for financial funding vital for the sustainability of the arts. The potential contribution of this study vis-à-vis the adaptation of new global trends in art financing into Turkey and the formation of a new perspective on art funding in Turkey underline the importance of this study.

CHAPTER 2. THE ART MARKET

In economics, to be able to talk about the presence of a market requires that we determine the supply, demand, and the products that comprise that market. When we talk about the products of the art market, we usually think about paintings, sculptures, works on paper (watercolors, illustration etc.) photography, prints and multiples, film, video, digital art, installation and NFTs for the fine arts. Furniture, decorative products made of glass, wood, stone, metal, ceramic or fashion (costumes and jewelry) and textile work can be classified as decorative arts. Antiques, on the other hand, are usually known as collectors' items that are at least 50-100 years old and are valued due to certain exceptional attributes. These can be wine, automobiles, money, stamps, or toys, among other things and better if classified separately from the other categories (McAndrew, 2010, Chapter 1). The main attribute of art market products is that they are heterogenous in nature and irreplaceably unique (Velthuis, 2011, p.35).

Driving the demand in the art market since its inception, its consumers tend to be individual or institutional art collectors – though recently many more actors have joined them, from wealthy investors to investment funds, museums, dealers, companies, or intermediaries in key positions who act on behalf of a country (Codignola, 2015, p.83).

The value an artwork provides the consumer consists of the union of many factors – social, cultural, historical, national, academic, or tabloid. In addition to these influencing factors, contextual factors such as the artwork's provenance, its relative position among the artist's other works, the museums or galleries it was exhibited in, or the collections it was part of also influence its value. The material, size, color, subject, and condition are also important characteristics in terms of determining the

value of the artwork (Groysberg, Podolny & Keller, 2006, p.3). The suppliers who actively influence the values in the art market are the art dealers, gallery owners and the auction houses. They may arrange for other works of similar type, period or style from the same or other artists to come into the open, thus influencing the work's value (Groysberg, et al. 2006, p.4).

The value of an artwork may take shape based on the buyer's taste or their motivation as well as its place in the history of art and its importance in the art environment. Basic motivations may be the artistic and aesthetic benefit it provides, financial incentives, or social reasons. The buyers can vary from those who are looking for something that matches the color of their sofa to those looking to make a precious addition to their collection or to purchase art to gain intellectual accumulation or to reach a certain social status. According to the early-20th-century economist Thorstein Veblen, artworks are a matter of conspicuous consumption and thus can improve the status of their owners within their society or their social circles. A buyer acting on decorative purposes has a higher possibility of buying a piece that is reproducible, and a novice collector's tastes may be shaped by the dealers' skills of persuasion or the other products on the market. The market competition is based not on the price but being able to create a perception of long-term artistic and economic value for the artwork in the collector's head, influencing and reshaping their tastes (Velthuis, 2011, pp.33-35). Novice buyers' tendency to follow in the steps of other collectors and trend towards famous names to lower their research and knowledge costs and to decrease risk can trigger a collective "superstar phenomenon" in the market (McAndrew, 2010, Chapter 1).

It's obvious that the art market is far from efficient, with markedly different mechanisms compared to traditional markets. The market conditions of those known as

an “imperfect market” in economics are valid here. The absence of price standardization and transparency, low liquidity, insufficient market information, inelastic demand and the lack of a long-term trade volume are its most significant reasons (Groysberg, et al. 2006, p.5). Its fractured and opaque structure, and the subjective approaches in product valuation result in information asymmetry, which causes high transaction costs. These conditions increase the need for art experts who can act as market makers and gatekeeper (McAndrew, 2010, Chapter 1).

In this opaque market, even the simplest act, like finding out what collector or dealer is in possession of an artwork is a whole affair. The lack of money flow for commercial or investment purposes outside traditional buying and selling characterizes the market with low liquidity. Art is considered a largely low-liquidity asset as the market has a limited infrastructure for sales opportunities. High demand does not always necessarily mean an artwork is salable. You cannot make a sales transaction with the press of a key as one can at the stock exchange (Horowitz, 2011, p.170). The high cost of information and the lack of liquidity are the obstacles that prevent the easy trade of artworks. It’s hard to find and match the supply with the demand, which causes high transaction costs. Insurance and storage costs also crucially cut into potential returns. Additionally, the threat of forgery makes the detailed and costly monitoring of provenance essential (Velthuis & Coslor, 2012, p.482).

Another attribute which could be called inefficient market information and mind is the absence of sustainable, systematic and transparent sources of data for market investors and decision-makers, causing them to resort to acting on rumors and unconfirmed information. This structure, shaped around verbal communication and close relationships, tends to be very effective for those at its center, but very ineffective for those on the outside (Groysberg, et al. 2006, p.4). This gives the insiders an

advantage over the outsiders, giving them opportunities for arbitrage by acting on important information. Asymmetrical information and the disordered character of the art market can create opportunities for arbitrage, which is attractive to some investors, but the resulting uncertainty has a deterring effect on others (Velthuis & Coslor, 2012, p.482).

The art market involves credence goods and runs on trust. The pricing of these goods is not objective and personal but is done based on the credibility of the experts' savvy as part of the collective evaluation process of the market. As the French sociologist Pierre Bourdieu states (1996), this is a market built upon the production of belief. Artists, curators, museums, collectors, dealers, and art critics are all involved together in the generation of this symbolic capital, which is only as effective as their long-term devotion to the art world, vast cultural knowledge, and personal charisma. As Bourdieu underlines (1993), the more its participants send signs of a non-profit-seeking stance and value the art itself, the more they contribute to the accumulation of this symbolic capital. However, according to Bourdieu, symbolic capital can turn into economic capital in the long run – for example, a dealer who become prominent because of their art-focused right decisions will become successful and profit by trading on these right decisions in the long run (Velthuis, 2011, p.37).

An important observation regarding supply in the art market is the limited amount of supply. An artist's production is bound to be subject to limitations regarding time and effort, and thus, their production within a specific period of time is limited. In the case of the artist's death, the number of their works becomes fixed. Therefore, the art market economy is supply driven. (McAndrew, 2010, Chapter 1) Additionally, only a certain number of artworks will be in circulation and on sale, and sometimes a group of artworks will be purchased or donated out of circulation. This is called "the museum

effect” (Horowitz, 2011, p.170). In this case, the limited number of artworks will result in an inelastic supply. (Groysberg, et al. 2006, p.5) If the artwork the customer wants to buy belongs is unique by virtue of belonging to a certain medium, period or subject, the supply curve becomes a vertical line with zero elasticity. These are the economic factors that explains the astronomical prices that come out of some auctions. In these cases, the art market takes the appearance of a great market made up of a congregation of monopolies. (Velthuis, 2011, p.35)

The art market is crucially different from all other asset classes. The daily volume of transactions present in other markets simply does not exist in the art market. The density of annual volumes occurs on the dates when auctions are held, which take place at regular intervals. The largest two auction houses, Sotheby's and Christie's, hold their main auctions for modern and contemporary art only biennially, during the auction weeks in the months of November and May. Annual art fairs like Art Basel, The European Fine Art Fair (TEFAF), Art Cologne or Frieze are the other type of occasion where dealers and customers at the higher levels meet in person and large amounts of market trade takes place. Individual sales can theoretically happen at any time, but in practice, these sales have also been observed to concentrate at auction dates and during fairs. The lack of continuous trade also stems from the artworks being retained for long periods. The status of art as less an investment good and more a collection asset is rooted in the high transaction costs and the negative connotations associated with the repeated sale of a single work in a short amount of time in the art world. A stock that is traded at The New York Stock Exchange will change hands at least once a year on average. In contrast, studies state that the average duration that a great artwork sold at an auction will be retained by one owner is 28 years (Mei & Moses, 2002, p.6). This means that artworks created by a specific artist or done in a specific style will rarely be

transacted upon. In addition, long retention periods also limit the available basic data necessary for market evaluation. (Velthuis & Coslor, 2012, p. 481) Sales in the art market essentially tend to be distress sales, also known as the three Ds: happening only upon cases of death, divorce, and debt. (McAndrew, 2010, Chapter 1)

The art market is difficult to evaluate as private sales are unrecorded. There essentially isn't such a thing as an art market – the art market isn't a single, homogenous structure. It consists of different structures, made up of clusters of different markets, all developing at their own pace (McAndrew, 2010, Chapter 1). The art market is a name given to the sum of many unique and independent sub-markets that usually on different courses of action, generally categorized by genres, mediums, artists, etc. Each section of the market has its own dynamics. Each of them has its own artists, experts, academics, passionate collectors, dealers, and even auction houses. Each product is unique and each of its owners are considered to have a monopoly on that artwork (Tucker, Hlawischka & Pierne, 1995, p.17). Considering the sectors with different price fluctuations and risks, it's easier to understand why art is a good investment. The market being invested into has over a hundred sub-markets with different risks, returns and business sense each of their own. While the data regarding the whole of the market are important as a general guide, they may prove insufficient to make investment decisions in specific fields.

2.1 Art Market Actors

The art market has many actors, each with their own relative importance and point of view. The artists hold the production of supply and they can make the sale of the goods they produce to a buyer either personally or through an intermediary: a gallery or a dealer. The market wherein the artists or the galleries that represent them make direct sales to the buyers is known as the primary market. The market where an

artwork previously sold is sold again to another buyer through a gallery, dealer, or auction house is known as the secondary market. For a large portion of contemporary artworks, there is no secondary market as dealers or auction houses might not want to sell those. Their pricing can be extremely nebulous and inconsistent – changes in artistic trends and tastes can result in a sharp decline in demand for certain styles. In other words, both the potential rewards and the potential risks here are very high. (Velthuis & Coslor, 2012, p.481) The suppliers of the secondary market are usually private collectors and public bodies. Art funds add another hoop to this supply chain and can be perceived as a potential threat by traditional suppliers who maintain monopolistic positions at certain points. (Groysberg, et al. 2006, p.4) The possibility of reaching data regarding the primary market is very slim, therefore this type of market data is usually considered to not exist in cultural economics. The data in most studies is based on auction figures from the secondary market. (Velthuis, 2011, p.38)

Intermediaries – dealers & galleries, and auction houses are the most important actors of the secondary market, and they carry out the task of matching the supply to the demand. Christie's and Sotheby's are the two colossal auction monopolies which have existed in the international art market since 18th century and continue to operate at east and west through their growing number of branches corresponding with their increasing volume of work. Dealers might sometimes acquire the products they sell under consignment, paying for them upon their successful sale, or they might pay for the artworks up front to keep them in stock, aiming to sell them at a profit. The historically unrivaled customers of auction houses, dealers now have to compete with institutional or individual collectors who could be considered retail customers. The income for auction houses consists of the commissions they get from the buyers and the sellers during the sales. The buyer's premium is paid in addition to the sale price

and is also known as the “hammer price” in reference to the hammer that strikes upon a successful sale at an auction. This premium is an amount between 10 and 20%. The seller’s commission, on the other hand, can vary depending on the seller and the volume of the trade. (McAndrew, 2010, Chapter 1) Auction houses generally demand seller’s commission up to 10% of the sales price but generally the lowest sales prices are asked for the highest rates. (Xiang, 2018, p.1714) There have also been changes in the practices of auction houses across history. For example, important customers are often presented with a reserve price. In these cases, when a sale is done, the amount above the reserve is divided between the seller and the auction house, and if the work is not sold, the auction house purchases the artwork from the seller for the reserve price (Velthuis, 2011, p.39).

Galleries work towards long-term relationships between collectors and artists. They protect these relationships against those who would seek to make speculative profit. Inflated or crashing prices at an auction can hurt the artist and the galleries. When a collector wants to unload a piece, returning it to the gallery and the work changing hands through them is an important step with regard to price stability and the protection of the artist. Multiple works of an artist suddenly appearing in the market can point to weakness and cause a steep decline in prices. To avoid these cases, galleries desire to place their artworks in good collectors’ collections and thus tend to retain the right to a first veto for sales. Though largely verbal and built on trust, these relationships can also be put into writing. These measures are generally enough to prevent speculation, as collectors do not want to harm their long-term relationships with the dealers for the sake of arbitrage. Those who violate these gentlemanly rules are blacklisted among dealers, preventing any sales to these people. (Horowitz, 2011, p.176)

These behaviors prevent short-term profit for intermediaries but generate a large amount of trust from the collectors with regard to prices and product quality. A gallery can support an artist for a lifetime, raising their prices in a stable and consistent manner to pursue sustainable pricing policies. In contrast, auction houses seek fast and profitable transactions. Auctions hinder the galleries' monopolistic price control mechanisms and means of stock control. Although they may buy back the artworks of their own artists to maintain price and stock control, this isn't always possible.

Velthuis states that the art market operates on mutual gestures and gifts beyond the cash flow the collectors create for hedonistic means (Velthuis, 2013, p.76). For example, the dealers' financial support of artists, the artists gifting their works to dealers, a collector making purchases to support a gallery or an artist, or the dealers assuming ethical and financial roles are all part of this system. Therefore, the generation of correct pricing is a complex mechanism that doesn't merely depend on economic data. One must also consider the social responsibilities. Sociologist Viviana Zelizer (2000) defines these groups as "circuits of commerce", and states that their behaviors can be directed not only by maximizing profit but also by motivations like status, respectability, power, attention, etc. The members of these circuits have to make their decision not only through the information they acquire in daily economic life but also by interpreting the behaviors of the community wherein they maintain their commercial relationships. Although these behaviors may not be universally sensible, they may be significant within the community in which they exist and thus able to shape certain behaviors. These conditions are also transferable for the art market – any economic decisions made there will also be determined through their social dynamics. The relationships within this artist-dealer-collector trinity tend to be quite personal and closed. (Horowitz, 2011, p.175)

The increase of financial elites' capital and their interest in alternative investments and lifestyle opportunities have been a propulsive force in the formation of the base of buyers necessary for the development of the art market. Economists call this the "income elasticity of demand" – as the income level increases, the demand for luxury goods and non-essential products like artworks arises at an amount higher than the income level. The High Net Worth (HNW) and Ultra High Net Worth (UHNW) accredited investors who have begun to emerge at a large volume in the recent years and how they spend their money has been a determining factor for the art market (Horowitz, 2011, p.161). The U.S. Securities and Exchange Commission (SEC) (2022) defines accredited investors as "individuals whose personal net worth (or net worth with their spouse or partner) is over \$1 million, as well as organizations, institutions, or partnerships who have earned over \$200,000 annually for the last two years and have a net worth over \$5 million". HNW represents those with a net worth of over \$1 million, while UHNW represents investors with a net worth of over \$30 million (Eckstein&Willette, 2010, Chapter 6). According to the Capgemini World Wealth Report (Capgemini, 2022), the number of HNW individuals at a global basis increased by 7.8% in 2021, reaching 22.37 million with 1.7 million new individuals. The global population of HNWI's are dominated by four markets which are the USA, China, Germany and Japan. (see Figure 1)

High Net-Worth Individuals Worldwide

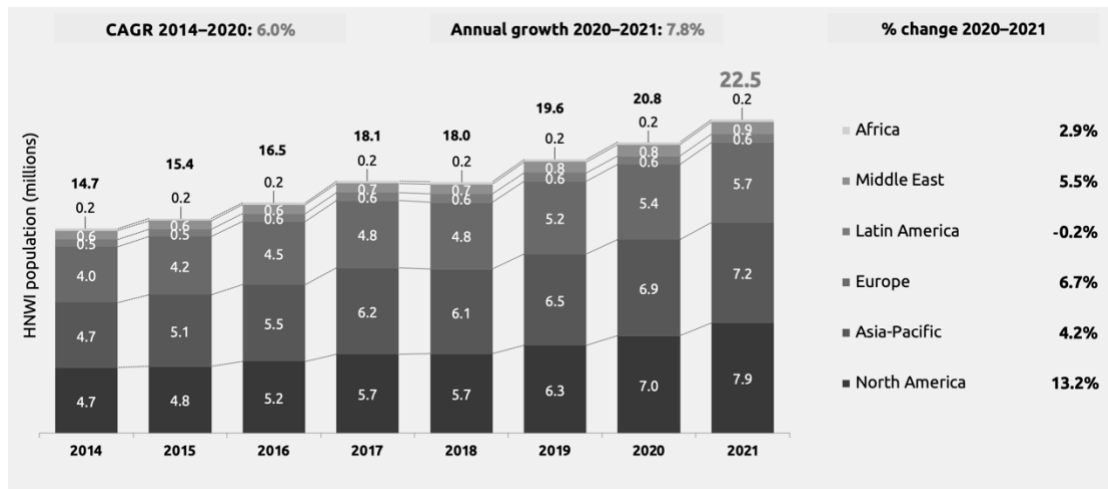


Figure 1. Kaynak: Capgemini Research Institute for Financial Services Analysis. (2022) Due to rounding, percentage calculations may not match.

Meanwhile, the number of UHNW individuals with a net worth of over \$30 million has reached 220,100. Total net worth increased by 8% (\$6.4 trillion) compared to the previous year. In the report, the largest contributing factor to this increase is stated to be “bull markets”, markets where a large portion of security prices are rising. Although dynamics vary depending on the region and country; securities markets, financial policies, and economic and social factors are the root causes of the expansion of these groups.

2.2 The History of The Art Market

A look at the modern history of the art market, which is shaped by economic power and wealth distribution, shows us that its geographical hot spots change over time, while institutions with deep roots remain present and influential. According to numerous historians, the period starting with the Industrial Revolution saw art become a more commonly traded good, with the emergence of the new middle class and their newfound wealth being the propulsive force that laid the groundwork for the current

day art market. In the 18th century, we witness England and France emerge as the big players, while Italy becomes a good supplier for wealthy Europeans. This is followed by the foundation of the first great auction houses, Christie's and Sotheby's, in the latter half of the 18th century, in the fast-expanding English market. This period sees the geographical center of art moving from Paris to London, while later economic and political developments as well as the devaluation of the French Franc triggering changes in power, with America and England markets rising into prominence. A stagnant period (known as a "bear market") for the American markets in the 1920-30s caused American buyers to come into prominence in the global markets. Joseph Duveen, an important London art dealer of the period, once stated that Europe had plenty of art and America had plenty of money – and thus a lot of works of the Old Masters were traded (McAndrew, 2010, Chapter 1). The trade volume of Paris in the 1950-60s moved over to New York and London with the new tax regulations regarding art sales, easier means of movement for art due to the elimination of currency limitations, and the increase of the upper classes' wealth and economic power. (Lacey, 1998, s.145) Art trade was previously done by a minority with vast knowledge and expertise and were market savvy. The changing economic conditions attracted the "retail" customers who wanted a safeguard against inflation. This resulted in the emergence of super-galleries that were established to meet this demand and operated in many cities. Even in periods of economic downturn, such as the 1973 petrol crisis, artworks continued to be traded by collectors as well as investors and speculators. (McAndrew, 2010, Chapter 1)

The differences between the two great capitals of art began to become more noticeable in the 1970s. New York became known for Contemporary Art, the Impressionists, and the Post-Impressionists, while London became a center for the Old

Masters, as well as 18th century English and French art and antiques from Asia. By the 1980s, however, many art institutions had entered the market and art trade had become known to be popular and profitable. After the 1960s, the art market entered another period of increase trend. This period is commonly known as the “art market boom”. The flow of financial resources from Wall Street, as well as the rise of the Japanese Yen, and the intense marketing activity from auction houses are the known triggers of the boom (Coslor, & Spaenjers, 2016, p.17). Not even the 1987 "Black Monday" in the stock markets could buck this trend. (Velthuis, 2012, p. 39-40) Historically high figures were recorded at the auctions in New York, which largely sold modern and contemporary art. For example, an auction held by Christie's in 1990 saw the sale of Van Gogh's "*Portrait of Dr. Gachet*", which sold for the record price of \$82.5 million. This was a period where returns from the stock markets decreased, and the art market was further energized by the efforts of the speculators, becoming extremely valuable. Tax incentives and the new purchasing power of the Yen brought in a lot of Japanese investors interested in Impressionist and Post-Impressionist art, which only further stoked the flames. In 1990, the Bank of Japan decided to sharply increase their interest rates, causing many speculative players to pull out of the market and bursting the bubble. (McAndrew, 2010, Chapter 1) The average 44% decrease in auction prices of individual artworks between July 1990 – July 1992 is an indicator of this downturn as well as numberless galleries in New York, London, Cologne, Zurich etc. withdrawn from the market. (Velthuis, 2008, p.306)

The 2000s brought with it dazzling growth for the international art market. The main reason for the dealers and auction houses' sales of fine arts, decorative arts and antiques comprised a market volume of over \$65 billion in 2007 – the highest peak in the history of the market. The effects of the stable growth in the fine art market,

especially in the contemporary art, impressionism and modern art categories is prominent in this regard. Contemporary art in 2007 saw rapid growth, securing the largest share in market value. (see Figure 2)

Auction Market in Contemporary Art

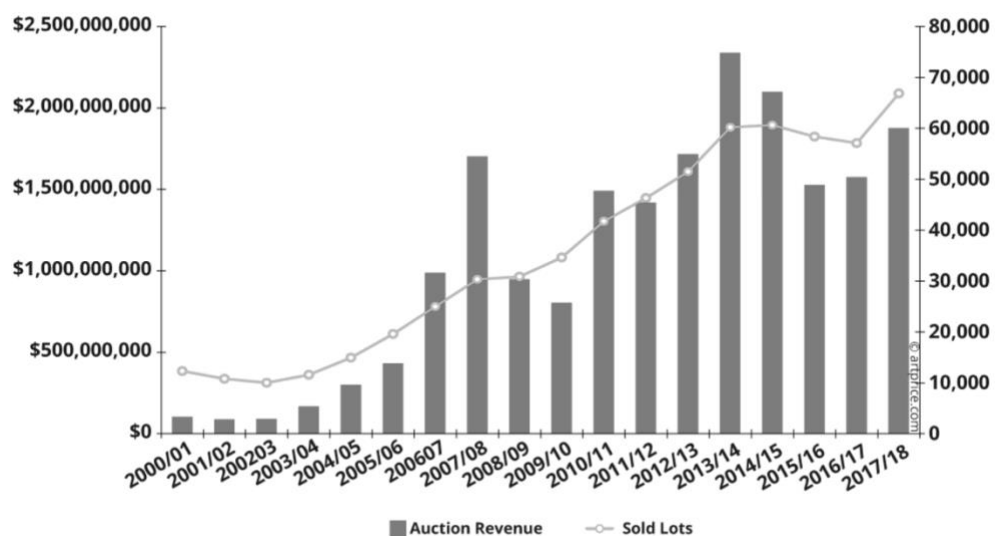


Figure 2. Source: artprice.com (2022).

In 2007 Christie's contemporary art sales totaled a volume of \$ 1,5 billion which is %75 more than the last year's figures. Sotheby's sales doubled to \$1,3 billion which turned contemporary art as the maximum gross sales category ever for the firm. The rising trend in the market resulted in the extraordinary increase in the number of galleries. Contemporary art also played a determining role during the depression in 2008. Although the market saw a downturn, the figures after 2006 have remained higher than the previous. The financial crisis in 2008 triggered by the downfall of American real estate market is not necessarily related to the collapse in the art market, the

economists have never been able to prove such a relation so, it can be stated that an inevitable downturn shall be expected independent of the existence of a crisis if the prices are overvalued. (Velthuis, 2008, pp.305-306)

Although the sum of all sales can give us a general idea, the better information can be derived by studying the sub-markets. Another important subject not found in the sales figures is the quality of the goods sold. Changing population figures, developing economies and wealth distribution are important figures that shape the art market. For example, the increase in population and wealth in China, as well as an increase in contemporary art resulted in a 11,000% growth in the contemporary art market in China (McAndrew, 2010, Chapter 1). It is therefore better to act on region and type specific data while evaluating the art market. Behind the dramatic growth of the market in the 2000s, just as the Japanese were the triggers of the growth in the 80s, new collectors from the Middle East, Mexico, Russia, Brazil, and Asian countries were influential. The main difference of these buyers is that they prefer not only art capitals such as London and New York, but also their own regions to purchase art. Another main factor of the boom is that starting from the initial years of the millennium, money was cheap. Low interest rates provided investors to have strong appetite for investment which resulted in inflated prices for all assets including art. (Velthuis, 2008, pp.306-307)

It may not be easy to identify the reflections of the global crisis, which was effective in 2009, on the art market. For example, while high quality goods still maintained reasonable prices at high amounts, comparatively lower quality goods had a harder time finding buyers. It is not easy to foresee the effects of economic stagnation on the art market as it is affected by two factors moving in opposite directions: the wealth effect on consumption and the investor substitution effect. (McAndrew, 2010, Chapter 1) The wealth effect can be described as the demand for and the consumption

of luxury goods increasing to a higher level than that nation's wealth increase during boom periods, elasticizing the demand curve. Therefore, on the flip side, a global recession will cause decreases in wealth and discretionary income, thus resulting in an even lower amount of luxury goods consumption. However, the art market's substitution effect for other investment types can also render it more appealing during a recession. As the art market has low or negative correlation with many other sectors, it might become an attractive low-risk investment alternative for the purposes of portfolio diversification.

As an emerging market NFTs, a new product that appeared as a reflection of recent digital technological applications such as Cryptocurrency, Bitcoin, Ethereum, and blockchain, is a phenomenon in art sector that dates back to 2014, but has gained increasing popularity in the last few years with skyrocketing prices and fluctuations in the market. According to the data NonFungible.com provided, \$2.6 billion of the \$18 billion NFT market in 2021 is related to art. In 2020, 75% of the total sales value of art-related NFTs, which is discussed as a new type of art, was realized in the primary market, and in 2021, 73% of the total sales value was realized in re-sales. Distinguishing from products in the art market as being liquid and continuously tradable, NFTs are seen as an attractive product for speculative buyers, and the average trading time has been determined to be approximately one month, in great contrast with the waiting times in the art market, which can reach 25-30 years. (Art Basel & UBS, 2022) The NFT transaction volume in the first nine months of 2022 has collapsed over 90% to \$466 million according to data provided by Bitay which indicates the volatility of the market.

2.3 Factors That Influence the Development of the Art Market

According to the 2022 Art Basel and UBS Global Art Market Report (Art Basel & UBS, 2022), the sales figures in 2021 compensated for the downturn during the Covid-19 pandemic, leading to 29% growth compared to 2020. The global sales figures of the art and antiques market reached \$65.1 billion. (see Figure 3)

Sales in the Global Art Market 2009-2021

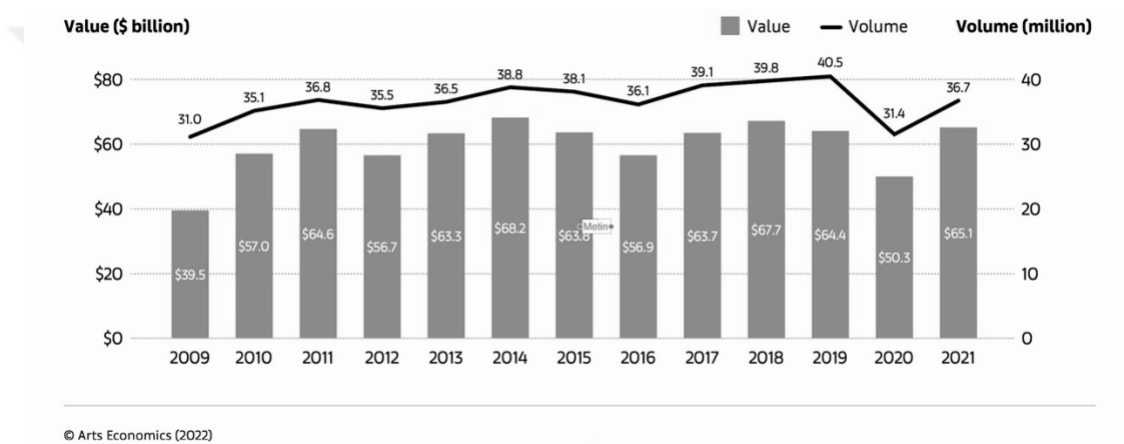


Figure 3. Source: Art Basel & UBS (2022).

The art market strongly recovered in 2021 after the recession which lasted a decade and America maintained its domination in the market with a 43% market share, followed by a rapidly growing China, pushing the UK to the 3rd place. Meanwhile, the French market had a growth of 50%, the most remarkable development of his own in the last decade. (see Figure 4)

Global Market Shares (Top Three Countries)

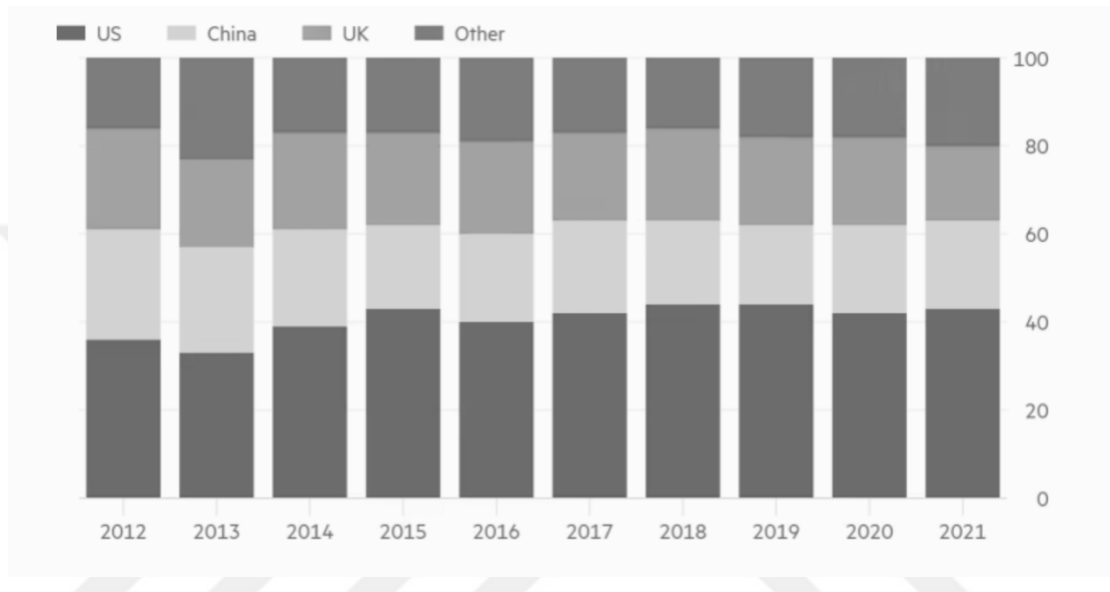


Figure 4. Source: Arts Economics (2022).

The figures in question make it evident why art as a global market appeal to investors despite its geographical points of density. The internet usage and the developing FinTech applications in the recent years has lowered the opaqueness of the market, which has begun transforming into a financial trade platform, with financial interests beginning to surpass aesthetic or historical value for an ever-increasing number of individual or corporate investors who are trading more and more with a growing number of artworks.

According to Adam, the root causes for this recent increase in art consumption are the influence of emerging economies, the nature and polarization of wealth, the

increasing interest in art as an investment, the parallels by association between art and fashion with luxury and fame, the effects of globalization, and the internet (Adam, 2014, p.10). The new millennium has been a period where digital technologies have played a huge role in many fields including the art market. It is important to study the dynamics of this era of the first ever online art fairs, where the traditional buyer-seller relationship has begun to reshape as offers and bids are made over digital platforms, and ultra-wealthy collectors are beginning to direct the values and the workings of the market as well as the artists' careers. Today, digital technologies have led to the diversification of traditional sales channels through galleries and auction houses. The combination of e-commerce, which has risen with digitalization, with the conditions created by the COVID-19 pandemic, has led to a significant increase in online art sales in 2020 and beyond. While the online sales figures of the art and antiques market were \$6 billion in 2019, the volume doubled to \$12.4 billion in 2020, and continued its upward trend with a size of \$13.3 billion in 2021. In 2021, 20% of the products in the art market were sold through online channels. Global retail e-commerce sales grew by 26% in 2020 and by 16% in 2021, reaching \$4.9 trillion, and it is expected that the market volume for 2025 will reach \$7.4 trillion, accounting for 24% of total sales. (Art Basel & UBS, 2022) These data indicate that the importance of online sales channels for the art market will gradually increase.

According to Velthuis, the emergence of this new regime which has shaped the art markets is rooted in these phenomena: commercialization, globalization, and financialization. (Velthuis, 2012, p.18)

2.3.1 Commercialization

The many important developments of the new millennium resulted in changes for the art market and position of the artist. Artists, collectors and intermediary

organizations began to display more profit-oriented approaches as a result of the conditions caused by neoliberal policies, privatization, and cultural erosion. As artists who began to find previously unseen and unexpected levels of financial success found themselves at the top of the market while the gap between them and the majority of artists who are simply trying to make a living increased. According to the Sunday Times' Rich List in 2009, Damien Hirst is the 238th wealthiest person in the UK with a net worth of £235 million GBP – the first time in history where an artist is able to have more financial assets than prominent collectors. The financial potential the new century opened up for artists is promising, especially compared to their colleagues in the previous periods. For example, Hirst's income is higher than the sum of the incomes of Picasso, Dali, and Warhol when they were the same age (43). Such striking factors increased the appeal of the art market, resulting in a dramatic increase in the number of artists (Horowitz, 2011, p.5-6). This process created a growing split from creative and artistic purposes, resulting in artists who can almost mass produce artworks with an army of workers in their workshops ready to execute their ideas. Career success for artists was no longer associated with their artistic output but their media presence. Thus, their marketing efforts took the spotlight from their artistic endeavors. Mainstream media's frequent use of the contemporary art scene fed into the hubristic artistic lifestyle transformed it into a new popular culture obsession, launching certain artists such as Jeff Koons, Takashi Murakami, and Damien Hirst into Hollywood-style celebrity.

According to Horowitz, the relationship between art and money evolved into a new union during this period: "a new kind of union at once glamorous, provocative, and banal." This resulted in art, despite its ability to reach a wider audience compared to before, turning into a product that served the elites more than the public good as the

market's excesses ran the gamut from VIP events, galas, parties in honor of artists, collectors and institutions, held in exclusive, closed venues, to corporate partnerships with art, design and architecture. (Horowitz, 2011, p.5-6)

The artworks produced as a result of this change betray more pronounced commercial concerns. A typical example of this is the type of work commonly called "Art Fair Art". Works that are easily noticeable, and quickly consumable and digestible like fast-food, that use iconic or provocative imagery or extensions of popular culture, have begun to overtake the market in the new millennium. (Velthuis, 2012, p.19) These homogenous artworks that find form depending on the market tastes have become a symbol of commercialization.

This period also saw the consumers becoming more profit-oriented like the artists. Approaching art as an investment vehicle or a status symbol, this customer profile aims to compensate for their lack of cultural wealth with monetary wealth, thus self-differentiating from the traditional collector profile who made purchases with a passion for art. These new buyers who have seen a sharp increase in wealth with their quick profits from the financial markets or the luxury goods industries strongly need art consultancy services. In what the French sociologist Lucien Karpik calls the *economics of singularity*, with markets consisting of products of unrivaled uniqueness, opaqueness becomes an issue not only of an absence of information but also of how to most effectively use the present information in the decision-making process. Through information acquired from reliable sources, choices become preferences. The factors that influence this decision-making mechanism are communication networks, titles, various experts collectively known as cicerones (art critics, curators, etc.), rankings and sales-marketing concentrations. (Healy et al., 2011, p.788-789) Also valid for the art

market, the influence of these dynamics has been observed increasingly frequently in the recent years.

However, the buyers of this new profile might also make quick and speculative short-term sales that do not really fit within the art market practices. Because they aren't completely present in the art world, they prefer to work with auction houses. (Velthuis, 2012, p.20) This clientele is frowned upon by art galleries who seek long-term returns for their artists. The primary art market, wherein money alone isn't enough and long waiting lists and personal relationships are more important and where galleries can exercise their personal preferences to place their artists' works in important collections (Velthuis& Coslor, 2012, p.474) and see long-term value generation policies, does not look kindly upon speculative activity. Collectors who sell the artworks they have purchased too early are given the moniker of "COIN" (collectors only in name). (Frye, 2018, p.114)

Meanwhile, against incredibly high sales figures in the contemporary art market, auction houses have focused on contemporary art at an unprecedented level. The supply, which is limited in other segments of the market, is almost at a surplus in contemporary art, yet it is paradoxically met with much higher prices by the market. (Codignola, 2015, p.87) As trading in this segment with endless supply and much steeper price hikes compared to the other categories brings in a lot of profit, auction houses have begun to seek access to the primary market, too, by purchasing galleries. Damien Hirst, who in 2008 made a direct sale through Sotheby's is the first artist to break the traditional rules in this sense. Sales being done through auction houses, art fairs and over the internet can have effects that weaken its social ties and eliminate its cultural interactions, thus commodifying art and reducing its symbolic value, which is considered sacred (Velthuis, 2012, p.21-22).

Though known for their commercial practices for centuries, art market dealers had to resort to more enterprising strategies in this increasingly more competitive environment, while also enjoying the legitimacy and justification they've earned with their commercial stances after years of critical scrutiny and making plans to carry their sales networks to an international scale. The developments in technology in the last millennium and the widespread use of the internet, together with the obligations created by the pandemic conditions, directed the suppliers to online sales channels. As a result, in the face of this change in the world, the art market has also updated its sales channels in line with the conditions of the age, preferred to offer online services and expanded the scope of its sales networks.

2.3.2 Globalization

Globalization is a concept that came into prominence in the 21st century and denotes the increasing mutual integration of markets and the collaboration between different organizations from different geographies around the world (Codignola, 2015, p.86). As emerging economies began to participate in it, the art market, which for centuries had been under western hegemony, has set sail towards new horizons. After the 1990s, strong and developing economies such as Brazil, Russia, India, China and South Africa (BRICS), or the United Arab Emirates have reshaped the geographical distribution of the market completely. These large markets have been effective in the art market's trade volume growth, allowing for great auction companies to enter these markets and operating their international commerce in various regions around the world such as India, China, Russia, and Latin America. These companies have opened their advisory boards to prominent collectors from developing countries like India, Hong Kong, and Turkey. This is a common globalization strategy which allowed them to adapt to cultural differences. (Codignola, 2015, p.88) According to the Artprice Global

art market in H1 (2022) report, Christie's and Sotheby's own 38% percent of the global work volume in the fine art category.

As a result of these processes, art fairs have also transformed into gigantic organizations for large scale commerce where supply and demand meet, where information is disseminated and shared, new movements are established, and new business opportunities are born. Apart from traditional fairs such as Hong Kong, New Delhi, Sao Paulo, Abu Dhabi, these art fairs are held in many places around the world, through which many locally known artists have found renown globally. The list of the top 100 prominent contemporary artists changing more in the favor of developing economies especially China in the last 20 years is an indicator of this process.

The Internet is the greatest power that bring nations together on a global platform and allow for the collection of information and its dissemination. It minimizes the information asymmetry in the art market, is effective in the buying process, overrides the traditionally accepted methods between the buyer and the seller, and homogenizes communication through its use of English, which is the most common trade language in the world. It thus quietly permeates through country borders and influences global consumer behaviors. (Codignola, 2015, p.90)

2.3.3 Financialization

The market conditions regarding production and consumption, which are valid in Capitalist societies, have also affected the art market. Artworks have become consumer and investment goods that take shape based on market conditions and the existing demand. Economics has attempted to define the new function of the art product through economic methods and approaches. As a sub-branch of cultural economics, art economics is concerned with the developments in this field. Studying the

transformation process of the function of art in parallel to the transformation processes of economic and social systems is necessary to understand the financialization of art.

These stages that lead to the financialization of art can be linked to the commodification and corporatization of art. In his infamous book *Das Kapital* (1867), Karl Marx analyzes the concept of a commodity under the section of capitalism. A commodity, which denotes commercial goods produced to be sold, is defined by Marx as any object that meets the needs of a person and has transactional value. The concept of commodification is the production of these goods or services for purposes other than its own benefit and their trade through the market. It leads to commercialization, which, in this case, is the production of art products as a commodity in order to generate income in return for labor (Özdem, 2020, p.21). according to the principles of microeconomics, the demand for a product is inversely proportional with its sale price. However, this rule works the opposite way for art products which are categorized as Veblen goods in economics. That is to say, the demand increases with the sales price. the reason for this is the fact that Veblen goods are viewed as symbols of status, respectability, and prestige. (Velthuis, 2013, p.104) The increase in production to meet the demand as a result of the market dynamics leads to the corporatization of art (Özdem, 2020, p.21). The text written by the curators of the 1989 Whitney Biennial seems to almost summarize the situation: “Capitalism has overtaken contemporary art, quantifying and reducing it to the status of a commodity. Ours is a system adrift in mortgaged goods and obsessed with accumulation...” (Velthuis, 2012, p.42)

The centralization of capital throughout the development process of capitalism resulted in the founding of big national and international corporations. Art, which once used to be under the monopoly of the aristocracy, the church, or the wealthy classes, began to increasingly become an area of interest and consumption for societies whose

welfare and education levels have been increasing as a result of economic and social changes that have occurred around the world. The increasing demand in art, when combined with the desire of capital owners to use arts to increase the status of their companies, to increase their respectability, and at the same time to use it has a tool for marketing and advertising has resulted in the corporatization of art. The art studios of certain famous artists where they employ hundreds of workers, like large scale companies, makes up the art world side of the corporatization of art, while prominent holding companies publicly exhibiting their artworks in order to generate cultural capital and finding museums to exhibit their collections comprises the capital side of this process (Özdem, 2020, pp.21-22).

As globalization affected the whole world after 1980, and as financial capital got ahead of production capital, art also began to take part in our increasingly financialized lives, transforming more and more into a speculative investment commodity. Art related organizations, institutions, and events such as museums, biennials becoming more and more owned by global corporations and financial institutions as a result of the privatization of culture and art plays a great role in this transformation. (Artun, 2015, para. 30-31)

To understand the transformation of the artwork from a commodity into an investment asset and traded as a financial asset, we must first study the concept of financialization. Financialization, in general terms, is the name given in economics to profits being made largely through the means of financial activity rather than the production and commerce of goods and services. Paulre (2008) defines financialization as *“the increase of the functions of financial markets, financial actors, and financial institutions within international and domestic economies”*. According to Hilferding, who coined the concept of finance capitalism, this concept is a new phase of capitalism

and defines the transition of capital accumulation from industrial capitalists to financial institutions, banks and fund managers (Tellalbaş, 2012, p.15). This transition disrupts the dynamics of free markets competition and leads to monopolistic constructs, seeking new targets in globalizing markets.

The widespread and closely related changes witnessed since the 1960s in the global economy have made the financialization of arts possible. Better corporate returns, the increasing value of the stock market and other such resources have made it possible for large scale infrastructure investments to be made in the art market. Factors like the increase in wealth inequality, the sharply top-heavy distribution of the income spectrum, have made it possible for new art investors to join the market. The wave of privatization which has four stalls public subsidies inspired art institutions and artists for common causes. This point we have reached through the superiority of finance, which provides new means of thinking and doing, has led to an influx of money in previously unseen amounts from previously unseen places. These resources have inspired the inception of more creative ideas with regard to turning capital into work (Horowitz, 2011, p.7). as New York became the new capital of art as a result of the changing international balances throughout history, the USA's rise as a superpower, and the domination of capitalism have greatly influenced the art world and the relationship between art and capitalism has led to the art market entering the financial markets.

The structural issues of the art market have been partially eliminated through standardization, scientification, and professionalization which have developed through the process of financialization. Market information being much more comprehensive and accessible in this new period has led to people being much savvier regarding the advantages of art as an investment. The market, which used to consist of the artist, the art connoisseur/investor, and occasionally the dealer, had to welcome many new

professional actors, like academic economists, retirement funds, auction data providers, art market research companies, arts evaluation experts, legal services, insurance companies, and accountant. The coherent efforts of these new actors have in turn made the art market more transparent and predictable overtime. (Velthuis & Coslor, 2012, p.475)

Developing new applications with regard to financialization, banks have developed the field of art banking as part of the private banking system. Private banking institutions have begun to include artworks in investment portfolios for asset owners along with other traditional investment vehicles such as stocks, bonds, precious minerals or real estate. In order to provide a new way of financing for the collectors, credit for artworks was defined as a new type of debt in private banking practices. Beginning to work with organization which would provide the necessary art consultancy regarding their art investments, banks have created partnerships that bring financial capital and art capital together. As an example, Akbank Private Banking and Yapı Kredi Private Banking have started working with monopolistic and globally operational auction companies which have been active for over two centuries, Sotheby's and Christie's, respectively. (Artun, 2015, para. 33)

However, the acceptance of art as a financial asset is a very controversial subject. there are those both in the art world and the world of finance, who, for reasons that arise from the perspectives brought on by their respective sectors, reject the evaluation of art as a financial asset. Although those in the art world approve of artworks as a potential means of investment, and believe that the financialization of art is against the very nature of art, and that it conflicts with the unique, emotional, and creative qualities of art. On the other hand, the financial sector's perspective is that the art market consists of heterogeneous products, which do not have the qualities of

liquidity and transparency, and do not have standards—it is thus a market with a number of structural issues. Some, going even further, believe that artworks are nothing but investments, as per Zelizer’s “Nothing But” view. (Velthuis & Coslor, 2012, p.473)

According to Zelizer, (2000) the art world circuit within the socioeconomic system views art as a unique, immeasurable, cultural or aesthetic object and in an attempt to protected from financial or commercial interests, views it as largely uncommercial and generally invaluable. For the finance world circuit, however, the art world with little intrinsic economic value outside of the time spent on production and the material costs, is a candidate for great symbolic and economic dividends. The members of the financial world attempt to transform arts into a class of assets that requires standardization, measurability, and quantification. (Velthuis& Coslor, 2012, p.473) Apart from the capital profits the finance world circuit also aims to profits in cultural capital. It is here that the two sides of a conflict of interests attempting to maximize benefits emerge, which Zelizer calls the “hostile worlds”: the art world and the finance world. (Horowitz, 2011, p.175)

Ultimately, the development of financial markets and the professionalization caused by the advancing technologies has led to a more standardized and regulated process of financialization of art, thereby legitimizing it. (Velthuis, 2012, p.28) In the current day, we have reached such a point that large international and national banks and financial institutions’ websites feature artworks as a financial asset, and many banks provide art investment and financing services, as well as art consulting services as part of their private banking or investment banking programs. Artworks have become a part of many financial services like portfolio diversification, mortgaging, assurances, investments, and leasing (Velthuis, 2012, p.26). In the current day, artworks have begun to become known for their financial identities over their aesthetic value.

CHAPTER 3. THE FORMATION OF ART FUNDS IN THE HISTORICAL PROCESS

In a speech in March 1968 at the MoMA Conference, Leo Steinberg stated that *“Art is no longer as we think; it is, in the broadest terms, cash money / Even at its newest ends, all art has been reduced to familiar values. / In another decade, we will have bonds in the shape of paintings in our safe boxes.”* (Artun A., 2015, para. 29), underlining the changing function of art while simultaneously foreseeing the financialization of the art market. Parallel to the evolving political and socioeconomic conjunctures, the changing practices in technology and finance in the last century have revealed art funds as an application that brings together the worlds of art and finance.

3.1 The Factors That Led to The Emergence of Art Funds

In order to be able to evaluate the conditions which birthed art funds, we must first analyze the changing balance of power after the Second World War and the conditions created by financialization as a result of the development of capitalism in a globalizing world. A review of the recent years of global capitalism shows us that the most striking changes have happened in the field of finance. According to Krippner (2004), financialization is profits and capital accumulation largely made through financial transactions rather than the production and commerce of commodities. As financial transactions grew in scale and significance within economics, the size and the profitability of the financial sector increased, leading to non-financial companies transferring their investments into financial assets. (Durmuş, 2010, p.15) Once companies' balance sheets began to exhibit more profits through financial instruments than through production and commerce, financialization began to dominate all sectors as an economic reality of the global world.

The financialization of art is a phenomenon that took place in the second half of the 20th century. Under this influence, the art market has also gone through a three-stage process and become financialized. The foundation of art funds and their development consists of three critical stages (Velthuis & Coslor, 2012, p.475). The first stage is the period between 1960 and 1980 when the conditions necessary for the formation of art funds first emerged and the first ever art funds began being founded. We will review the stage after 1980, wherein the first examples of art funds had to be restructured as a result of the conditions of the period, in two separate parts under the “The Birth of Contemporary Funds” section.

The first stage, consisting of the 1960-80 period, the art market was characterized by relatively limited information and limited access to that information. Thus, it was largely shaped by a limited number of pioneers who acted on a passion for arts or an adventurous investment spirit rather than detailed information. During this initial period, the development that could be called a turning point is the emergence of the art index, which was an instrument that could be used as a measurement for investment in the art market. Publishing a graphic organized like a stock market index, The Times of London rendered arts comparable to the stock market for the first time in 1967. This way, a perspective akin to approaching a stock became part of the evaluation process of an artwork, thus pioneering a staggering increase in the value of art. (Velthuis & Coslor, 2012, p.475)

There are two obvious reasons why this process started in the 1960s. The first is the economists frequently emphasizing the high sales figures during this period, leading to a lot of public discourse about the subject as a result of the media attention around these figures. The period saw art being featured in popular publications like Fortune and the New York Times as a field of investment. The second reason is the

decreasing appeal of traditional investment methods due to the economical conjuncture of those years, which made the art market attractive to the investors who sought alternative investments. Art provided an alternative investment opportunity against high inflation, which was a critical issue for the period. Thus, it's attracted attention from not only amateur art connoisseur buyers but also from retirement funds, and high-worth professionals who were savvy and experienced with financial markets. As anxieties rose as a result of inflation, art began to be seen as a safe harbor, and art investments as an idea became increasingly more prominent. (Velthuis & Coslor, 2012, pp.472-473)

As artworks became measurable as an attractive asset class within the available socioeconomic conditions despite their heterogeneous character, and them being expressible in numbers as well as through symbols comparable to other investment categories, kicked off the efforts regarding the formation of art investment funds in parallel to art banking at this point in the process of the financialization of art (Velthuis & Coslor, 2012, p.472-473). Within this process of financialization in addition to many smaller scale organizations and groups, well-rooted auction companies Sotheby's and Christie's also founded art hedges, beginning to sell their stocks to a clientele of retirement funds, banks, and prominent investors. As a result, as predicted, art became a type of stock. Indirectness within the art-money relationship was eliminated and a mechanism within the financial system that directly equalized the two was established. (Artun, 2015, para. 34)

3.2 The First Examples of Art Funds

In contrast to many newer financial instruments, art had already been considered a movable asset for many centuries. In the 17th century, the Marquis de Coulanges opined that “paintings are as valuable as gold,” pointing to an awareness about the

monetary value of arts even in those years. (Velthuis & Coslor, 2012, p.472) Art historian David Solkin stated that there had been instances in the 18th century England of artworks being commonly used as capital investment. In his book about the foundation of modern art markets, Peter Watson notes that Baron Friedrich von Grimm was of the opinion that buying paintings for the purpose of resale was an excellent form of investment. (Horowitz, 2011, p.152) In the mid of the 19th century emergence of the first commercial fine art galleries in London provided a new way to buy art works other than buying directly from the artist, auction or at annual academic exhibitions. (Fletcher, 2011, p.139) In the 19th century the banking family of the Rothschilds allegedly began buying artworks as a means of diversification in order to lower the risk of their portfolio. A third of their wealth was invested in stocks, authored in real estate, and the rest was divided between jewelry, art, and cash money. (Ferguson, 1998, cited in Velthuis & Coslor, 2012)

Although all of these ideas and experiences formed the roots of the art market, the identity of art investors becoming what it is in the current day took until the 20th century. At the end of the 19th century, the bourgeois-capitalist investor profile had still been buying artworks for the purpose of social prestige rather than financial gain (Horowitz, 2011, p. 152). In the first half of the 20th century, few people were aware of the connection between finance and art and could see the appeal of art as a financial anchor. More often, price hikes tended to form the public agenda regarding art.

Art being viewed as an investment vehicle and attempts at art funds are a notion that belongs to the last century. At its simplest form, an art fund is an investment fund that aims to generate positive returns through the purchase and sales of artworks. Although through the historical process these funds took various different forms from

unofficial groups to corporate investors and private investment companies, their principles are standard: buying low and selling high. (Frye, 2018, p. 115)

At the start of the 20th century the French financier and art connoisseur Andre Level, who could be considered a pioneer in art funds, started an enterprise. His investment club, founded in Paris in 1904, used its pool of capital consisting of 250 francs of investment from each of its 13 investors to purchase modern artworks. The members of the club included three brothers and a cousin of Level—and according to Matisse, the club consisted of Level’s poker friends. Only Level was authorized to make purchasing suggestions, which were only taken into action if they were accepted by a majority. The artworks purchased for the fund could be displayed in the houses of its members. According to the agreements they had made among themselves the fund would dissolve after 10 years, and the investors would receive 3.5% percent annual interest and their own share of the 60% of the sales premiums. One half of the remaining 40% would go to Level, and the rest would go to the artist. Level named the fund “Peau de L’Ours” (The Bearskin), which was a reference to a fable named “The Bear and the Two Companions” by La Fontaine. The subject of the fable is a pair of friends who promise the fur of a bear for sale before having hunted it. During the hunt, they would fail to catch a bear and decide to never make promises before successfully hunting a bear again. In short, the fable tells us to never be sure of success until we achieve it. (Frye, 2018, p.117)

Considered the first investment fund in modern art, the Peau de L’Ours managed the necessary funding for the purchase of 100 artworks in a period of 10 years. Among the artworks in the portfolio of the fund were certain works of young artists of the period such as Picasso and Matisse. (Velthuis & Coslor, 2012, p.472) Others included in the collection were 20th century artists such as Vincent Van Gogh, Paul Gauguin, Odilon

Redon, Constantin Guys, Maurice Denis and Albert Marquet. Level generally purchased artworks from the artists of the period who were having financial problems, and avoided galleries, which helped them keep the costs of these purchases low. Especially in the initial years of the fund, he managed to seal what could be considered some great bargains. The collection as a whole was liquidated in 1914 in Paris at the Hotel Drouot, with a sale figure of 100,000 francs. The average sales figures for the artworks were approximately four times as much as their original purchase prices (Fitzgerald, 1995, cited in Velthuis & Coslor, 2012). Among the more notable artworks in this sale was Picasso's 1905 painting named *Saltimbanques*. In 1908, the painting cost 1000 francs and its sale was only settled on after a two-week waiting period with a 300-franc deposit. The painting then sold for a figure of 12,500 francs. The artists were probably further incentivized into these low-priced purchases with the 20% share they would get after a successful sale. Additionally, artists of the period believed it was important for them to have "droit de suite", the resale royalty rights, and the fund provided them with this right at least for the first sale. However, the fund started a trend in the market by itself increasing demand. In other words, it was a victim of its own success. By 1910 the fund could not afford to buy new and significant artworks. (Frye, 2018, p.118-119)

Attempts similar to this successful example could not gain traction due to the First World War, the Great Depression, and the Second World War which followed. It took until the 1970s for the world to recover from these back-to-back global disasters and for art investment activities to gain speed. According to Gerald Reitlinger, who conducted a study between the years of 1961 and 1970 about the art sales between the years of 1700 and 1961 and published it with the title "The Economics of Taste" that

enriched an unrivaled amount of quantitative contribution to the literature, until the mid-1950s, art had lost its appeal as an investment (Horowitz, 2011, p.153).

The 1960s are a period where art was beginning to once again become considered a means of investment. The subject was published on magazine covers, articles, analysis studies, which underlined the value of art as an investment during periods of financial and political crises due to its intrinsic value and undebatable role as a reserve. By the late 1960s small scale amateur art investors as well as professional large-scale investors such as retirement funds began to act and begin following experienced, finance savvy experts in order to benefit from their savings. Smaller scale, unregistered, unofficial investment groups began to form, which can still be encountered in the art market in both the West and in developing art markets such as India and China. These roughly correspond to the private investment clubs that exist in the stock markets. (Harrington, 2008, cited in Velthuis & Coslor, 2012)

The year 1973 saw two major achievements for the auction sector. The first was the Sotheby's becoming the first ever international art auction house through the sales it has conducted in Hong Kong. This signaled that the markets which had largely been centered in the West was about to be subject to change. The second achievement was Sotheby's liquidation of Robert and Ethel Scull's collection in New York, marking the first independent auction of contemporary artworks from a private collection in 1973. According to Velthuis, this auction marks the point where a line was drawn between the old and the new art worlds, where the old players who had little expectation of profit and were moderated by a passion for art began to be replaced by more aggressive players who acted on financial instincts with the purpose of investment and status, and where the pricing of artworks turned aggressive. These events are significant in

showing the profitability of contemporary art and the changing dynamics of the market. (Horowitz, 2011, p.10)

In 1968, a group of English and American investors founded one of the first art investment funds, titled the Sovereign-American Arts Corporation. Its portfolio included pieces of art from around the world from the last two centuries and the fund's consultants included former museum directors. Before becoming public in 1969 at the New York Stock Exchange, the portfolio of the funds consisted of 70 artworks including some works from Kandinsky and Giacometti. On the first day the fund was listed in the Stock Exchange the price of its stocks went from \$6 to \$25, achieving a successful initial public offering. In the following years, similar attempts took place in the USA, Belgium, Switzerland, Luxembourg, and Germany, usually with the support of each nation's respective banks. These securitization efforts, some of which were open to retail investors, and some which were only open to high net-worth individuals, provided liquidity for the art investment market. In addition to creating opportunities for diversification, the use of experts' recommendations, and the elimination of the bothersome issues of storage and security, thus becoming an appealing investment vehicle. Founded in 1970 by the banker Baron Leon Lambert in Luxembourg with a \$5 million investment, the Artemis fund, in addition to the Modarco (Modern Art Collection, S.A.) fund which was founded in 1971 by industrialist Ephraim Ilin in Panama with an investment of \$3 million, were the largest-scale investments of the period and were founded for entirely commercial purposes. Artemis, which likened its own function to art investment banking, turned from a fund into a public dealership in its first year and continued like that until its dissolution in 2006. Meanwhile, Modarco made a loss in the years of 1974 and 75, after which it merged with the fine arts dealer Knoedler in 1977. Other similar enterprises from these years ended with similar results.

By the end of the 1970s none of these enterprises had been able to continue operating in their original forms. (Horowitz, 2011, p.153) Additionally, in 1971, the Times-Sotheby Index was suspended upon a request from the Sotheby's director Peter Wilson to prevent a possible crash. This resulted in the stock prices of the Sovereign American Arts Corporation to drop to half of its initial public offering price only a year after its public offering, which only further reinforced the negative perception people had regarding the market. (Velthuis & Coslor, 2012, p.476)

By the time the stock market had recovered at the end of the 1970s and other alternative investments were put to use, the public interest in the financial aspects of art decreased for a few years. A news article that was featured on the front page of the New York Times in 1985 was seemingly a short summary of this period: “No Survivors from The Arts Investment Fund Trend That Followed the Art Boom of the 1970s”. Although this was a sign of weakness regarding the historical track record of art investment funds, it also pointed to a turning point. Art funds were about to enter a sharp rise. (Velthuis & Coslor, 2012, p.476)

3.2.1 British Rail Pension Fund

The most prominent fund to survive the 1970s was the British Rail Pension Fund (BRPF). With its corporate credentials, it is one of the few successful investments that are accepted as one of the first art funds. Using a strategy that was widespread in England during the period, the British Rail Pension Fund created an art portfolio consisting of arts and antiques in order to protect themselves against inflation. It was founded as a refuge against the double digits inflation figures that was triggered by the oil crisis led by OPEC in 1973. (Eckstein & Willette 2010, Chapter 6) The idea was that just like precious metals could provide financial protection against the English currency and the stock markets and the commercial real estate market which had all

taken a hit due to the crisis, so too could art. The fund had a 25-year term to maturity established by its visionary director Christopher Lewin, who, in reference to the economist Reitlinger, stated that many categories of art should be considered a long-term investment, as supplies would not increase with the demand. (Horowitz, 2011, p.154)

Between the years of 1974 and 1980, the fund invested in various asset types such as paintings, sculptures, antique furniture, bronze objects, and jewelry; adding 2400 artworks into its portfolio with an investment of approximately 40 million British pounds which equaled a 3% of its total worth. A third of this portfolio was dedicated to the Old Masters, and an amount no higher than 10% of the portfolio was dedicated to the impressionists, thus establishing the long-term investment strategy for the fund. In the 1980s as the fund had reached a sufficient amount of diversity and inflation had begun to decrease, it stopped purchasing artworks. (Horowitz, 2011, p.154)

Initially shaping its investment decisions through the professional consultancy services provided to them by Sotheby's, the BRPF later began to act on the advice from other prominent organizations in the sector. The purchases made by the fund had a quality high enough to be considered standardized, it was, therefore, able to compete with museums who existed in the same sector of the market as the fund. (Cannon-Brookes, 1993, p.406) The fund largely made its purchases through auctions, or in other words, the secondary market. Its collection consisted of a wide variety of artworks from various time periods and geographies such as the paintings of Old Masters and their drawings and prints, Impressionist paintings, a selection of ceramics books and manuscripts from China, decorative artworks from the 19th century Japan, British silver, antiques, as well as Medieval and Renaissance period art. (Frye, 2018, p.121) The directors of the fund chose to make the selection for the collection that was in as

wide a spectrum as possible so as to be able to provide the maximum amount of protection against fluctuations due to market conditions and changes in trends and tastes. With this in mind the directors achieved the desired diversity under 7 main categories that fell within their resources. In 1980, when they stopped making purchases, the seven collections in question corresponded to the 76% of the total value of the fund. The Old Master paintings (18.8%); the Old Master drawings (11.1%); the Impressionists (10.2%); Chinese artworks (10.2%); books and manuscripts 10.0%); the antiques (8.3%); the Medieval and Renaissance period (6.9%). The remaining 24% consisted of immature selections that hadn't yet been completed and could be enriched. However, the administration decided against it. (see Figure 5)

BRPF Portfolio Composition

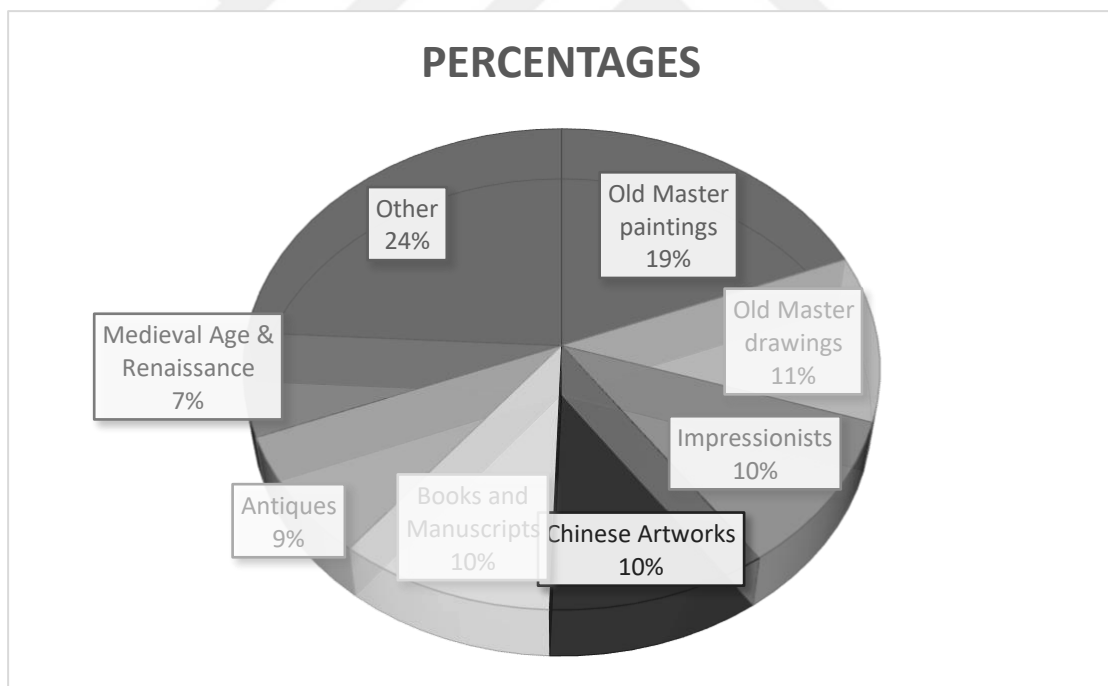


Figure 5. Source: Eckstein and Associates (2009).

The fund administration had a lot of faith in the financial synergy created by balanced collections with a multifaceted structure that was carefully composed for

esthetic and financial purposes. However, they also believed that these pieces being together would have a much larger added value than if they were all separate. Even if they came across a piece that fits the collection or a singular opportunity, in both cases the biggest concern for the fund was that the artwork be the best and most high quality artwork possible in the market. However, we can also see that they showed sensitivity towards the prices they would have to pay and avoided purchasing from single owner collections in the market if it could be helped in order to avoid paying high premiums. Although the collection was divided into seven main categories in line with their resources, and each of these categories contained many different subcategories within, the funds collection did not include contemporary artworks as the contemporary art market involved high risk and high volatility. (Eckstein & Willette, 2010, Chapter 6)

When the BRPF's decided to invest in art in late-1974, it had a total worth of £1 billion GBP, which equal to about \$2.4 billion. A decision was made that's a maximum of 6% of the funds yearly cash flow would be directed into arts investment which equal to around £3 million annually. However, by 1978 the fund had spent £27 million, which was well over the purchase limit. a new decision was made to limit the art investment spending to £40 million, which they reached by the 1980s. At this point, when they had ended their art purchases, the ratio of the retirement fund's art investments compared to its total worth was around 2.9%. (Eckstein & Willette, 2010, Chapter 6)

By 1987, the fund had begun to start selling the artworks as their art investments had achieved the optimum yield and alternative investment fields had become more appealing. As part of their decision to sell, the costs regarding the maintenance and conservation of such a collection and its constant repricing also played a large role. Throughout 1988 approximately 1000 artworks were sold off at three times their cost

in average. In 1989 the fund made a sensational sale of their impressionist artworks, which had caused £3.4 million, for an amount of £34.9 million, netting them a 21.3% portion of their annual income. Ironically, despite their long-term sales strategy, the fund made their most profitable sales within a very short period. In 1989, the funds managed a 15.4% cash influx from their sale of the Chinese porcelains, while their sale of the Old Masters in 1996 came at a loss of 0.4%. Taking an average of the various profits acquired from various fields in various times, by the year 2000 when the whole collection had been liquidated, the total some of the funds returns from 1974 to 1999 was calculated to be 11.3%, which equal to an annual return of 4% after adjusting for inflation. (Horowitz, 2011, p.155) According to certain commentators such as Blake (2003), the BRPF's investment of only 2% of their funds had provided them the reputation of being one of the biggest art patrons in Europe. (Coslor & Spaenjers, 2016, p.14)

After all the sales had been completed, the figures showed that the fund had made a profit of £168 million. The main goal of the fund had never been to achieve any returns higher than stocks might bring, they only aimed to beat the inflation. The end result meant that the fund had not only achieved its basic goal but also proved that a good selection consisting of mainstream art collections could be much more than an anchor against the inflation in the long run. Among the sectors the fund had invested in that had managed to overperform compared to stocks were the Impressionists and the Chinese ceramics and porcelains. Behind the extraordinary performance of the Impressionists was the unpredictable rise in popularity in the 1980s, as well as the careful selection of the artworks that were purchased, and their sale being done at a uniquely lucky time period. (Eckstein & Willette, 2010, Chapter 6)

Although the BRPF, as an important early example of art funds, to have been founded in order to beat the inflation and had seemingly reached its goal, it also had some not as exciting aspects. First of all, the total profits it had yielded compared to mainstream stocks which had been active in the same time period proved to be a lower amount. The fund was also subjected to enough criticism to attract a large amount of public attention and create a request for a parliamentary question during its late period. The public opinion about the fund was that if the retirement fund had invested the £40 million in the Post Office Savings Account, they would have achieved better returns. (Cannon-Brookes, 1993, p.407)

Another issue was the fact that the impressionist paintings had been put on sale during an unprecedentedly fortunate boom period for the sector, and a similar situation reoccurring for similar investors was very low. And their back-to-back decisions to sell in various segments, which had been partially because of the public pressure about art being an unsuitable type of investment for a retirement fund, partially because of a new perspective brought on due to changes in the funds administration in 1987, and partially for the purposes of lowering current expenditures, really had coincided with a boom period for the market. The sales began in 1987, and by April of 1989 the sale of the Impressionists achieved unprecedented success, followed by the art market crash in 1990, which led to the suspension of their sales, which didn't start back up until 1994. The fund failed to profit from many of their collection sales in various fields and even faced losses in certain cases -- the only large scale profits for the fund had been the sale of the Impressionists. Despite being in possession of a large number of artworks, the artworks whose sales generated profit had been a small number of very high-value artworks. Only 25 Impressionist paintings made-up a 25% of the fund's asset value. (Frye, 2018, pp.121-122)

Another issue stemmed from the fact that all investment decisions had to be made by an art subcommittee, which created formalities and delays, as well as liquidity issues, which occasionally led to them missing good opportunities. Additionally, Sotheby's, which had been a strategic partner and collection consultant for the fund only provided the minimum amount of discounts for the buyer premiums and seller commissions. The transaction costs being between 5 to 7% of the prices was another factor that lowered the profitability of the fund. There have also been assertions that the auction house pawned off the low quality artworks, which they themselves owned and for which they provided advance payments and assurances, to the fund. Conflicts of interest is an important issue with regard to the management of artwork funds. (Horowitz, 2011, p.155) While the BRPF worked with Sotheby's to receive arts expertise consultancy services, after evaluating the advice from these experts they used an independent company through which they made their ultimate decisions to make a purchase. This intermediary company also had their own art experts who had been tasked with responsibilities such as leading the consulting panels organized by Sotheby's, as well as evaluating purchase suggestions and coming up with sales strategies. Therefore, this company acted as a buffer between the fund and the auction house which aim to prevent any potential conflicts of interest. The fund made their purchases based on the recommendations from Sotheby's, largely through dealers and collectors as well as other auction houses that operated in different locations such as England, New York, Hong Kong, and Monaco. By partnering with an institution whose responsibility is to consult for not to the buyers but to the sellers, the fund also started this course regarding potential conflicts of interest. (Eckstein & Willette, 2010, Chapter 6)

Another item that decreased the return for the investments was the insurance costs. The BRPF managed to save on insurance and other similar expenses through the method of lending to private collections and museums while also adding important records into the provenance. However, they also had to deal with the maintenance costs all countless artworks that waited in storage. Artworks that were too sensitive or required special conditions for their storage were left outside this scope. (Horowitz, 2011, p.155) Once the funds completed their purchases, the insurance payments and the curation costs became the largest items of expenditure for the fund and to eliminate these expenditures the fund lent various artworks from its collection to places in England and to countries overseas. Throughout the 1980s, around 30 to 40% of the total collection had been in the list of artworks that were on loan. Only the artworks that attracted less interest or were under the risk of being damaged due to they're more sensitive in nature were kept in more secure and controlled storage spaces. Through these loans the fund hoped to not only decrease the storage and insurance costs but also to increase the potential value of the artworks that would be displayed in international museums and exhibitions. (Eckstein & Willette, 2010, Chapter 6)

It could be said that certain artworks in the portfolio were much more valuable than others and were more often sold for profit. In the 1980s, it was estimated that only 50 of the 2400 pieces in the portfolio were valued at £250,000 or higher, and the total value of these artworks amounted to approximately over one third of the total value of the portfolio. The list included artworks that were among what was called the “Top 100”, which consisted of artworks with a value of £120,000 or higher, or rare examples of their mediums. These artworks were estimated to comprise one half of the total value of the portfolio. The returns from the sales of these artworks were much higher compared to the sales of less valuable artworks. (Eckstein & Willette, 2010, Chapter 6)

According to Eckstein, who had served as an art consultant for BRPF and ABN Amro, the lessons to take from this case was that, only the funds who manage to keep a small number of artworks of very high quality in their portfolio – so as to maintain a high general investment performance level while maintaining a low overhead – would be the ones to succeed. Certainly, an administrative structure that maintains a fine balance between finance and art is extremely important. In many fund attempts launched after the BRPF, the desired results could not be achieved because of inadequate expertise regarding either finance or art, and a lack of experience regarding the unique dynamics of the art market. (Eckstein & Willette, 2010, Chapter 6)

3.3 The Birth of Contemporary Funds

Following the stages of the emergence of art funds and their popularization followed by a period of low public interest, the second wave of arts investment efforts happened at the end of the 1980s and the early 1990s. During this stage, which we can call the second period, a big reason for this increase in public attention was the increase of transparency due to the emergence of suppliers who provided the markets with systemic data. Institutions like Reuters or Bloomberg began to provide systemic data regarding auction prices for potential investors in addition to the analyses they provided for traditional investment assets. (Velthuis & Coslor, 2012, p.476) The Information Society greatly contributed to the financial markets by bringing transparency regarding numerous asset fields. (Knorr & Brugger, 2002, p.917)

The art bubble which formed due to the flow of financial resources from Wall Street, as well as the rise of the Japanese Yen, and the intense marketing activity from auction houses of the 1980s, lead the art market boom brought on by overly exuberant and at times corrupt speculative trends, and it proved to be an inspiration for art market profits to be examined in academic literature. Contributing to this, in addition to the

steep price hikes, were the addition of new art institutions and new geographies as well as the increasing popularity of celebrity artists. The establishment of Sotheby's financial services department in 1988, and the BRPF's sales attracted great attention to the economic value of art. (Horowitz, 2011, p.3) Another sign of the increased academic attention in the subject was the founding of the Journal of Cultural Economics in 1973, which held its first conference in 1979. Additionally, realizing the significance of the absence of data in this field in light of the BRPF investment in art, Sotheby's signed an agreement with the statistician Jeremy Eckstein in 1979 to provide art market data, creating new and different dynamics for the field. After completing his task of providing data for the fund, Eckstein remained a point of interest for many who are interested in art investment and art market economics. (Coslor, & Spaenjers, 2016, p.14-15) Eckstein is a concrete example of the increased interest in the field, as well as of how economists become involved with these processes. The "Sotheby's Index" was a study where data from 13 different art markets were combined into a "market basket" and based on the contemporary valuation of a portfolio which had been valued at \$100 in September 1975. (Tucker, Hlawischka & Pierne, 1995, p.18)

Real-time and time series data analysis tools and graphs brought the advantages of the information society to the art market just as it did to the world of finance. As a result, uncertainties, such as not knowing where and for how much an artwork had been bought or sold, greatly decreased compared to the period before the 1980s. Thanks to systematic and objective information providers like ADEC/ArtPrice or Artnet, facilitated the calculation of the potential investment value of art. Consequently, the role of instinct diminished, making way for a larger role for information in decision-making for investments. These services brought relative democratization and rationalization to the art market. Through this process, information became more

comprehensive and accessible at a lower cost, preventing the asymmetrical spread of information, which diminished the importance of insider information acquired through personal contacts. What's more additional information about the work such as material, imprint, provenance has been provided, contributing to the institutionalization of certain standards in the valuation of art. However, we also cannot state that the flow of data became completely democratized and rational. Non-systematic information, such as the trends in the art world, changes in artistic tastes, rumors and hearsay, etc., can influence the value of an artist's work. For example, an artist's career plans or insider information that amounts to future plans, such as a museum retrospective, can still be acquired through personal networks, interactions, and conversations with the members of the art world. Of course, niche markets that can control sales and prices for those who hold this type of information may also exist, and it must be stressed that there are no regulations regarding insider trading in the art market. (Velthuis & Coslor, 2012, p.477)

At this stage of the financialization process of the art market, which could be viewed as the second period for art funds, the growing number of information sources led to a second wave of attempts to create art funds. As international banks, such as Citigroup, became involved with the process, the sector became more professional – with wealthy customers of these banks recognizing their art collections as a part of their financial investment portfolios, and the banks themselves beginning to offer art consultancy services as a private banking customer management tool (Citibank, 1995, p.38) Although art consultancy is a service that many banks continue to offer, the decrease of inflation and the 1990 art market crash led to some endeavors, such as BNP Paribas's art investment fund, to lose great amounts, causing another period of diminishing public interest in fund based investment (Velthuis & Coslor, 2012, p.477).

In summary, post- BRPF art investment ventures also fell short. Following the 1980s bubble, Chase Manhattan Bank demanded a \$300 million investment in order to create a closed-end art fund out of their retirement funds, but failed to gather the necessary capital, ultimately shelving the project. The Banque Nationale de Paris (BNP) formed two art funds with two allotments of \$22 million between 1989-1991, but by the time they auctioned the artworks in 1998 and 1999, they had taken over \$8 million in losses. The rigidity of its administrative structure is one of the reasons pointed out for the failure of the fund. Founded in 1998, the British Taylor Jardine Ltd. is another example of these failed ventures. Resorting to leasing the artworks they purchased to corporations, the company aimed for an average annual return of around 10-15% with their portfolio of 1900 artworks. However, they failed to reach their desired number of leases, taking a loss of £6.4 million when the fund was liquidated in 2003. (Horowitz, 2011, p.156)

The third transformative wave happened through structured finance. A group of newly founded art fund investments found a new guise as a private equity rather than publicly traded investment funds. And art, in its new packaging, was presented as an essential element of a diversified portfolio by the world of finance. The art market, in light of better information about itself and new ideas in finance made a big splash. Characterized as “Mimetic isomorphism,” this third wave saw the art investment community embrace the organizational plans and the role models of the financial world, which generated legitimacy. For example, new art funds adopted their payment structures largely from private equity funds. Managed assets were subject to an annual administrative fee of 2%, as well as a 20% performance fee from the fund’s annual yield. Potential investors who could take part in this order consisted of individual investors who met the high minimum net worth criteria (which vary depending on

regional and national regulations), and financial institutions like retirement funds, with each investor generally being evaluated and picked by the administrative board of the private company that organized the fund. As private equity funds are not public, exact costs and yields cannot be independently verified, meaning that they are not obligated to publish their data (Velthuis & Coslor, pp.477-478).

This stage of the financialization of art, which we may call the third period, continued with the scientification of art investment and with the founding of market research companies who analyzed prices and other market trends to report their findings through comparison criteria, confidence surveys, and market outlook reports. The market tools that these companies provide, such as analytical analyses, representative graphs, and the market rhetoric of the financial world, acted as borders that bridged the two worlds. Much like accounting records of the past, these tools provided retroactive systematic data to carry out the task of informing the audiences, while performing the rhetorical role of persuading them about the soundness of investing in art. For example, indexes such as the index prepared by the art consultancy company Art Market Research are then circulated to the investment community at large by the prominent data provider and trade platform Bloomberg. Consequently, art is further incentivized and legitimized as an investment asset in these investment communities reached through local platforms. (Velthuis & Coslor, 2012, p.478)

The strength of the market post-2000s and the ever-increasing artwork prices reinforced the perception of art as a profitable financial investment. However, the most important factors that reinforced the market were the increased theoretical reliability of art investment, the development of an alternative investment industry, and the increased amount of diversity in the structured solutions offered by art funds. Studies that supported the merits of art as an alternative investment were featured more prominently

in the literature with the onset of the millennium. For example, the Fernwood Art Fund enlisted the Ph.D. economist Robert Gough as its chief economist and published many financially sophisticated trade documents with academic references to back the subject. The fund has also been a sponsor for the organization of many seminars on the subject of “Art: An Alternative Asset Class” since 2004, in which they also participated. Among the participants of these organizations were prominent names of the sector, such as Daniella Luxembourg from ArtVest, Mary Hoeveler from Citibank, and economists Michael Moses and Rachel Campbell. (Horowitz, 2011, p.157) Moses, an academic who has taught at universities like The Stern School of Business, and the NYU, published a study with Mei in 2002 which showed that the average annual yield of artworks bought and sold between the years of 1875 and 2000 and created a benchmark for alternative investments. (Mei&Moses, 2002, p.1657) (see Figure 6)

Mei & Moses Art Index vs. S&P 500

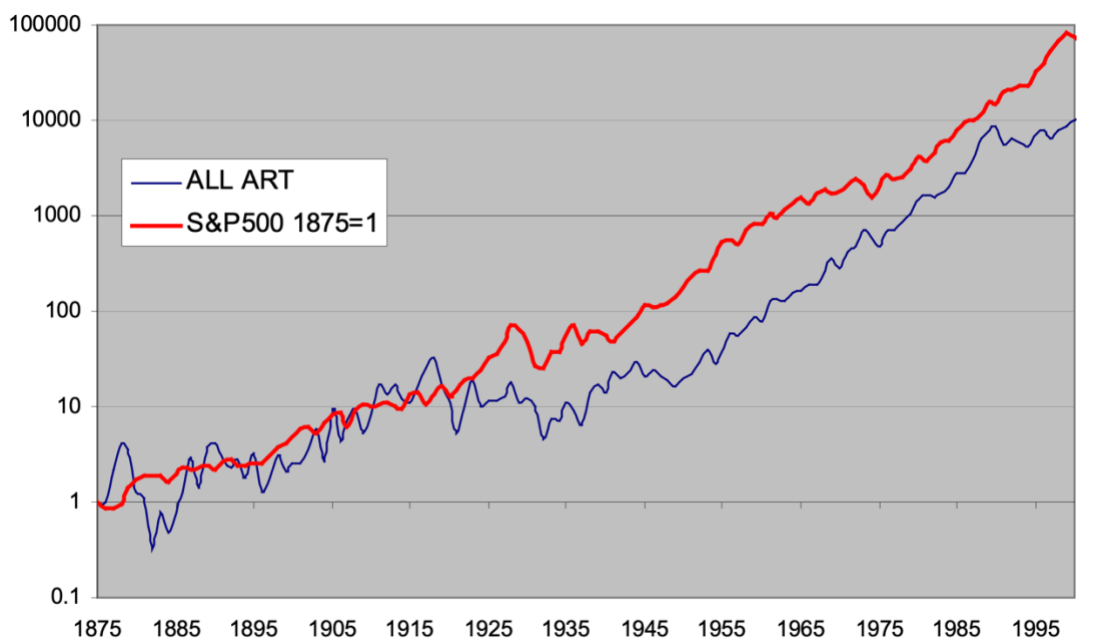


Figure 6. Source:

<https://webstatic.stern.nyu.edu/om/faculty/moses/FineArt/year2000update2.pdf>

Mei & Moses created a database over the buying and selling prices of the art works sold by Sotheby's and Christie's in the American market between 1950-2000 by recording the data of repetitive sales, which can reach even six repetitions. The returns of the art index had been higher than that of bonds, but lower than stocks, and that they exhibited lower correlation and volatility compared to the financial assets in question. As seen in the example, the Mei & Moses art index provides a comparison with the Standard & Poor index, which consists of the 500 largest companies in America. The opportunity to compare with alternative investments has paved the way for art as a financial asset. The academic conclusion of the study was the official acceptance of art as a profitable and low-risk element of a financial portfolio.

CHAPTER 4. ART FUNDS

In order to have a better understanding about the technical and structural features of the art funds, we will first examine what is an investment fund, then analyze the fund types and emphasize the four types of funds by which art funds have inspired and finally we will explain and discuss the dynamics of the art funds.

4.1 What Is an Investment Fund?

Investment funds are a type of collective investment undertaking, which is a capital market institution. According to the Capital Markets Board of Turkey) (SPK, 2022), they are portfolios that are formed by investors through various financial instruments with the purpose of generating value from money and capital markets and are managed by professional managers who closely monitor those markets. To understand an investment fund, we must first explain what a portfolio is. A portfolio, in broad terms, is the whole of the assets owned by a person or an institution. Investment funds manage portfolios that consist of capital market tools such as shares and bonds, and assets like precious ores, in exchange for the money collected from the account owners. On an individual basis, the investors become partners in the fund portfolio by receiving a share that corresponds to a share of the portfolio owned by the fund. The investors are entitled to a share of the income and partial ownership of the portfolio corresponding with the percentage of the investment fund shares they've purchased. The goal is to acquire the optimum amount of yield that can be acquired through the publicly traded assets and various capital market tools, while remaining faithful to the risk choice and yield expectations of the investor as well as the general strategy of the investment fund.

Collective investment undertakings are divided into two categories depending on their legal structures: investment trusts and investment funds. If the undertaking is founded by a discrete and individual legal entity, it is defined as an investment trust. If it is founded by a legal entity around a contract, it is called an investment fund. Even though the two are similar in purpose and economic function, their operating principles and the services they provide to their investors differentiate investment funds and investment trusts. The basic principles of collective investment undertakings are the formation of the portfolio through publicly collected capital (collective capital), the management of the portfolio on the basis of risk dispersion, and the management of the portfolio by experts. The sole subject of activity of investment trusts is the management of the portfolio which was formed with publicly collected money. It is a model that involves a share ownership relationship with the investor and is established under an S.A. corporation. Investment funds, on the other hand, correspond to an estate that was also formed with the money collected from account owners but does not have legal personhood. (Ertan, 2013, p.134) Legally the main difference between the two undertakings is that an investment trust is corporation-based, while an investment fund is contract-based.

Investment fund portfolios contain various assets depending on their investment strategies. These assets can be various investment instruments such as stocks, government or private sector debt instruments, gold and other precious ores, foreign securities, futures contracts, etc. Funds that trade in Turkey, are divided into categories depending on the types of assets with which they build their portfolios, as established by the Capital Markets Board of Turkey (CMB). There are many types of funds including money market funds, that instrument funds, variable funds, stock funds, fund

basket funds, precious metal funds, mixed funds, hedge funds, participation funds, capital-guaranteed funds, capital protection-oriented funds, etc. (SPK, 2022)

Through these funds the investors can, in principle, acquire yield through three means. They can acquire a share of the profits or the yield of interest from the tangible assets which are the investment vehicles of the fund. However, this amount is only reflected after subtracting the costs from the value of the fund's portfolio, also known as dividend payments. The assets owned by the fund could also increase in value, which, once sold by the fund, generate capital earnings. The capital earnings acquired as a result of the sales following a price increase are reflected onto the portfolio value of the fund, which is known as capital gains distribution. Another method is holding the assets owned by the fund despite the increase in the value. After subtracting the overhead costs this increased value will increase the prices of its shares, thus increasing the total value of the fund. This is also known as an increased net asset value. The investors acquire their profits or losses by selling their shares. (Securities, US, 2022)

Reasons for investors to prefer investment funds may be the professional management, the risk minimization potential created by the diversification of the portfolio, easy liquidation, being able to take part in large scale investments via small savings, opportunities to invest in different instruments provided by the fund diversity, the ability to invest in international tools which are hard to access for individual investors, and tax incentives provided with certain funds, among other advantages.

The legislation in Turkey dictates that the authority to establish a fund and their management belong to portfolio management companies. Even if the founders are not in charge of the management of the portfolio, they are responsible for the management, representation, and safekeeping in a manner that protects the rights of the shareholders

on the basis of the principles of risk dispersion and fiduciary ownership. Investment funds can also be managed by the founder or another portfolio management company selected by the founder (which must be certified by the CMB with a portfolio management authorization certificate) that provides the service in exchange for a portfolio management fee as part of a specific contract. Portfolio management refers to activities that include buying and selling assets for a portfolio within the framework of legislation and prospectus (a document issued for the purpose of informing the public regarding the issuance or public offering of capital market instruments), as well as conducting research and analyzes that form the basis for decision-making and the collection of the assets' returns. (SPK, 2022)

4.2 Fund Types

In order to understand the structure of art funds, it is first necessary to study the structure and types of funds. Different legislative regulations and different names for the corresponding funds are used depending on the country. The U.S. Securities and Exchange Commission) divides investment companies into three categories under the U.S. federal securities laws; Open-end funds (mutual funds and exchange-traded funds (ETF)s), closed-end funds and unit investment trusts (UITs). (SEC, 2022) Although each has its own characteristics, mutual funds are essentially considered “open-ended”, which gives the investor the freedom to sell their shares at any time. Being "redeemable", they allow the investor to sell to the fund or to the broker acting on behalf of the fund on net assets. Closed-end funds, on the other hand, are generally non-redeemable and can only be sold at market set prices for other investors in secondary markets. Existing in many varieties such as stock funds, index funds, bond funds, exchange-traded funds, etc., each type of investment company differs even within those categories. However, it is best to keep in mind the differences between the basic

principles of closed and open-ended funds. These were established in a congressional legislation to regulate mutual funds, titled the Investment Company Act of 1940.

According to the CMB, which makes the regulations in Turkey, collective investment undertakings (CIU), which invest in transferable securities, are divided into two categories: "Investment Funds" and "Investment Trusts". "Real estate investment trusts" and "Venture capital investment trusts", whose portfolios consist of non-transferable securities, are only accepted as an intermediary model within the purview of CIUs. An example of contract based CIUs is investment funds in Turkey. Investment funds offer open-ended investment options. CIUs established in accordance with trust law exist in examples in Anglo-Saxon models, called a unit trust or a unit investment trust in the U.S., but have no correspondents in the Turkish system. Corporate, open-ended CIUs are also absent in Turkey, although they do exist as mutual funds in the U.S.A. Corporate closed-ended CIUs exist as investment trusts in Turkey, and are concerned with the operation of a portfolio and have a limited number of partners (Okat, 2000, pp.7-14)

Investment funds' operation structures may vary depending on investors or the investing companies. To analyze the funds under a few types, we can mention hedge funds, mutual funds, private equity funds, and venture capital funds. Hedge funds are private investments offered to accredited investors and have a leverage function as well as high risk and high potential returns. Mutual funds are structured and public funds, suitable for daily trading. Private equity funds invest directly in companies, evaluate opportunities for mergers and acquisitions (M&A), and operate through an investment plan to acquire the entire company or its main share. Venture capital funds, on the other hand, are funds that invest in start-ups with high potential and are distinguished from

angel investors who use their personal savings by being both larger in scale and operating as a fund as well as under stricter procedures. (SEC, 2022)

Like art funds, hedge funds have emerged in recent years. The first hedge fund was founded in 1949 by Alfred Winslow Jones. These are a groundbreaking enterprise in hedging against investment bets, and actually aim to obtain arbitrage through expectations. Through tactics such as strategic trades, short selling, or leveraging, they exploit incorrect pricing in the market and create opportunities that do not have any legal correspondence in traditional investment. (Horowitz, 2011, p.162) The trading volume of hedge funds is incomparably higher than their market share, and they provide leverage. For example, during periods known as the Bull Market, which is named after the metaphor of the bull lifting everything with its horns, where the market is in an upward trend and the investors are about to buy, hedge funds can provide leverage with ratios up to 30-to-1. These funds can have an impact on global financial markets. In this sense, art funds can exhibit similar characteristics. Since most are managed outside financial capitals, they can seem disproportionate to global trade from the markets they inhabit. Their trading volumes may actually be much smaller than they seem due to being off target or termination of the funds. (Horowitz, 2011, p.164)

Although, hypothetically, they promise profitability, it is difficult to translate hedge fund performance into data as they are exempt from SEC records, reports and legislation. While successful ones are documented, less successful or unsuccessful ones go unrecorded. In the literature, this is called the “survivorship bias”, and it causes hedge funds’ index of returns to be perceived 2-3% higher. Another common factor that can distort our perception is the “backfill bias”. Funds that are new to the index can have an inflating effect on it. When we make similar numerical evaluations about art funds, such factors will prove crucial, and we will question whether a realistic

assessment of the market as a whole exists. (Horowitz, 2011, p.164) Art funds have benefited from the growing popularity of not just hedge funds, but also of alternative mutual funds such as real estate investment funds and private equity funds. Many art funds exhibit a hybrid structure similar to these funds. (Horowitz, 2011, p.162)

4.3 Art Funds

An art fund, much like other investment funds, is an open-ended and structured investment vehicle for the purpose of financial gain. Art funds are usually private investment funds dedicated to making profit through the acquisition and sale of artworks. They are managed by a professional investment management company or a consulting firm who receive a management fee as well as a portion of the returns provided by the fund. (ARTFA, 2013) Although art funds vary significantly regarding criteria such as their portfolio content, size, investment focus and investment strategies, they mostly exhibit the same principles as traditional investment funds, except for having art assets as investment assets in their portfolio. Investing in art through an investment fund is a very practical method for those who do not wish to own an artwork itself with motivations that a collector might have, such as prestige or the work's aesthetic value. Art funds provide advantages such as access to high-quality works, diversification at a level usually inaccessible via individual means, and active asset management (Eckstein & Willette, 2010, Chapter 6) The basis for the increasing demand for art investment vehicles may be the fact that art investment is a valuable component of the portfolio diversification, i.e. the fact that it has a low correlation with other asset classes as shown in some studies, and that its returns may be higher compared to the stock market when market trends reverse, that the investment maintains its value in high-inflationary conditions where purchasing power is diminishing, that market environments wherein UHNW investors are growing in number have the

potential for large price hikes, and that the big gains in some sub-groups of the art market (such as the 308% price index boom in the post-war art segment after 2008), which reinforce the appeal of art as an investment in the public eye. (Xiang, 2018, p.1701)

Art funds, which largely emerge in developed art scenes, differ completely from other investment vehicles in terms of structure. Although these funds, wherein art is the main asset, exhibit great similarities to financial asset funds in terms of structure, one must consider that a completely different type of special expertise is required to manage them. The presence of art assets, which are quite opposite in nature to the rational and objective concepts associated with finance, creates quite a conflict. Another name given to art funds is passion investments, which has its roots in the 2007 World Wealth Report by Cap Gemini & Merrill Lynch. (Horowitz, 2011, p.330) Characterized as non-transparent, lacking in regulatory authority, made up of subjective value, inadequate in the price discovery mechanism, and illiquid in its conditions, the art market may provide great opportunities for experienced art professionals as well as pose great risks. Art funds have many supporters as they can lead to huge arbitrage opportunities, as well as detractors who see art as the riskiest asset class and criticize it by underlining its investment loss potential. (ARTFA, 2013)

Although art investment has shifted from private commissions to corporate finance regarding the matter of art patronage, it remains an option under the monopoly of the very wealthy class. Although art investment, which involves processes that requires private communication networks and enough wealth to finance dealers, has begun to adopt the lower cost and barrier opportunities brought on by technology, the basic logic still relies on the capital invested in a work by the investor. And because each artwork carries its own idiosyncratic risks, a well-diversified portfolio requires a

large number of works, which in turn requires great purchasing power. In addition, art investments, which are more difficult to liquidate when desired, will appeal less to investors whose assets belong to a more restricted group due as it is unable to meet the need for liquid funds when necessary. This leads to the art market taking shape at the hands of small cadre of elite investors before it can fully reach its cultural and economic potential. Art investment vehicles offer a potential exit as a solution for these constraints within their framework. They exist to combine their investors' resources and profit from the financial benefits of art without having to own the works individually. Art funds, which are a type of art investment vehicle, involve the process of purchasing a group of artworks and storing them until their maturity date, only distributing the profit to the investors at the end of this period. Other than cases where they are leased, the artworks are usually kept out of sight for 5-7 years. However, issues such as illiquidity, in-accessibility, and low returns, in addition to high participation rates of up to \$1 million made necessary by the way these funds are structured, still limit participation in this market to the very wealthy class. Also important is the fact the art funds market's estimated fairly small share in the art market as a whole. Art funds are a small portion in the \$64 billion art market, and has only shrunk from its peak value of \$2.1 billion in 2012 to \$836 million in the current day. (Xiang, 2018, pp.1702-1704)

Art indexes are another type of art investment vehicle and provide the less affluent group of investors with the opportunity to invest in art with a logic similar to the stock market. It is based on the trade of shares that reflect the value of the artwork collections owned by the companies that are traded in the index. Like the stock market, these indexes create the opportunity for shareholders to easily sell their shares with no high barriers for entry, and they provide investors with the opportunity to trade in "art

management companies'" shares. Their most fundamental difference to art funds is that the companies in the index are managed internally while art funds are managed externally. These companies also manage funds other than art funds and benefit from economies of scope and scale where common resources are used. Art indexes, however, have separate management teams. Indexes that have been attempted in the U.S., Europe and Asia in recent years experienced various difficulties, not only regarding issues like regulatory approval and not attracting enough investors, but also problems caused by speculation. When two artworks traded on "The Tianjin Art Exchange" in China jumped seventeen times their original purchase price within three months, the investors' panicked activities caused fear that the index might collapse. Trading had to be suspended and the Chinese government issued a new legal regulation in 2011. (Xiang, 2018, pp.1706-1708)

Art investment funds established in the current day are generally structured like private equity or hedge funds, and thus differ from historical examples which featured union or private partnership structures. These funds aim to securitize the purchase and sale of art in proportion to their shares in the fund to accredited individual and institutional investors. They may be confused with private investment partnerships, which can lead to misunderstandings. Private investment trusts are formed by investors who pool their resources to invest in art or other assets and are closed to outside investors. (Plummer, Principal and Rabin, 2012, para.3)

Most art funds are planned as closed-ended investment vehicles with a duration of five to ten years. Unlike stocks or investment funds which have more liquid markets, art funds allow investors to buy up to a certain point whereupon the fund closes. Shareholder investments are, in a way, locked into fund and can only change hands at

certain intervals determined beforehand. These intervals can be quarterly, annual or the period from the launch to the closing date of the fund. Investors usually contribute up to \$250,000, with a minimum of \$100,000. The fund management company will deduct 2% of the invested capital for annual operating expenses based on overhead and operational expenses. In addition, a 20% performance fee is charged on top of the earnings. Art investment funds provide limited access to information about their performance because, similar to hedge funds and private equities, many art investment funds are unregulated and do not have public disclosure requirements. (Horowitz, 2011, p.2)

Art funds have expenses like the storage, insurance and maintenance of the works in their portfolios, which leads to negative cash flow. Consequently, it takes a certain period of time for art funds to turn a profit. The cost of retaining an artwork can vary between 1-5% of its value per annum. The way to turn negative cash flow into positive is through leasing. Additionally, investors are provided a "redemption right" in certain circumstances as an option to relieve the illiquid art market, but this must be executed carefully. Some examples offer the investor the right to redeem at a rate of 5-10% each year. However, creating resources in an illiquid market can also cause the fund's performance and stability to deteriorate. (Xiang, 2018, pp.1715-1716)

Art funds' capital and investment return targets may vary depending on their purpose, financing, and management styles. While funds such as Fernwood or the Fine Art Fund aim to create a volume of millions of dollars, many other funds aim for a volume of \$15-50 million. Performance targets also vary, such as returns of 10-15% on annual net prices. When the capital required to form the fund is collected, the process

of purchasing artworks begins. For example, on a ten-year fund, the investments are usually done between the first and the fourth years, while divestments usually happen between the third and the tenth years. Some funds want to expand their capital base through quick trades early on and can use these earnings on future purchases. After a certain obligatory point, usually in the third or fourth year, the fund begins to wait with its current stock and seek opportunities to make optimal sales. (Horowitz, 2011, p.149)

Funds usually make their purchases in the secondary market. This actually means they bypass reasonable investment opportunities that have appreciation potential in the primary market, accessing only half of the whole market. However, this is mostly a result of the primary market's cold outlook on art funds because of the difference between the artist-oriented approach of the galleries, which seeks the long-term career plans of their artists, and the profit-oriented approach of art fund managers who want to reach peak pricing at the end of a certain period. This may cause galleries to prefer giving art investment vehicles their less marketable works. (Xiang, 2018, pp.1711-1712) In turn, art investment vehicles can develop ways to involve the primary market to the advantage of both parties. For example, through special agreements, galleries that are given shares can both considering their long-term earnings to volunteer giving up their favorite artworks and also have a chance to intervene in possible price fluctuations by retaining the first right to veto sales and a time-limited option to purchase at the first sale price plus a certain amount of interest. This option protects both the artist and the fund as the gallery will buy the artwork if it loses value. If the artwork increases in value, unless there is an artificial value increase, the sale of the artwork would also be desirable for the gallery, who will also benefit from the fund's profit. (Xiang, 2018, pp.1731-1733)

Upon examination, it is possible to divide the current structural forms utilized by funds into four groups: (Eckstein & Willette, 2010, Chapter 6)

- 1) The pooled-fund approach, which is used by some private banks who buy art with an eye to investment potential on behalf of HNW clients
- 2) The art expert as adviser approach, which offer investors the guidance of an art expert in order for them to pool their money and acquire a selection of investment-quality art, with emphasis here on the nature and quality of advice offered by the expert
- 3) Fund of funds structure, which includes separate art funds in one structure
- 4) Art hedge fund, which hedges against a potential market downturn using derivative securities

Although their target markets are mostly countries such as the U.S. and the U.K., most art funds operate from outside the United States, the United Kingdom or continental Europe. There are many examples recorded in offshore locations such as the Cayman Islands, Channel Islands, British Virgin Islands, Bermuda, and Luxembourg. These countries help funds optimize their returns with their investor-friendly regulations and attractive tax incentives. For example, the United States' 28% tax rate on capital gains from art and collection products, a high figure compared to the 15% tax on capital gains from real estate and securities, can be nullified through the British Virgin Islands. This regulation increases the efficiency of the fund and provides options such as reinvesting the remaining resources or paying them to shareholders as dividends. (Horowitz, 2011, p.149)

Many funds utilize a multi-tiered management structure. At the top is the senior management or investment committee, consisting of the fund's founders, senior investment experts and respected consultants. This structure, which usually boasts a strong financial or auction history, determines the scope and the vision for the fund, and raises capital, conducts situational analysis and adjustments, and provides first-hand information to the investors, the media, the art market and the financial market. Commercial activities are generally carried out by a group of expertly positioned external art buyers. This team usually consists of people who are in-the-know and have connections in the industry, such as gallerists, private sellers, former experts of auction houses. Those in this team can work on a commission separate from working management staff who are salaried. Art consultants can mediate the connection between buyers and the management. Academics, critics and art experts can also contribute to the trade of an artwork by providing objective information and opinions about it. (Horowitz, 2011, p.150) Undoubtedly, the fact that economists have clearly translated the theoretical benefits of art investment into a comprehensible economic jargon has also contributed greatly to the development of art funds. This clarity played a groundbreaking role in opening up the art market to the world of modern and global finance, from which it had been distant. This process legitimized art as a dynamic alternative asset class. (Horowitz, 2011, pp.157-159)

CHAPTER 5. THE INVESTMENT STRATEGIES OF ART FUNDS

Art is a good, rising alternative for investors with capital who are seeking a safe asset-backed investment. With strengths such as low volatility, high durability, and risk-adjusted investment ratios, it is an asset class that should be featured in any diversified asset allocation strategy in a balanced portfolio alongside other investment vehicles. Art investment is a goal-oriented and intuitive process that involves buying artworks cheap and selling them the highest premium point while keeping the processing, transportation, storage and insurance costs to a minimum. This purpose is based on two suppositions. Firstly, art as an asset class is not affiliated with international stock markets, which means that its prices act independently of traditional investment products such as stocks and bonds. Secondly, art market is strongly inefficient, has opaque prices, low liquidity, and a high amount of informational asymmetry. In accordance with these suppositions, the distinguishing feature of the art fund from other speculators must be the strategic reveal of the ostensible uncorrelated benefit to profit from the lack of efficiency. Gathering a high volume of financial and artistic assets under the same umbrella can ensure this. During periods of economic turbulence and in high inflation environments, art prices may also rise and create value for the investor. Even only maintaining its existing value can be advantageous over investments like stocks or bonds. Because the global art market is fragmented and hybridized, the collapse in one country may not affect others. These provide opportunities for arbitrage for well-structured global funds. Financial crises can provide opportunities for savvy investors to build a stock of low-cost works of art. (Horowitz, 2011, pp.147-148)

5.1 Strategies

Art funds generally implement three main investment strategies. The first can be called a "diversified" strategy, where the investments are spread across different geographical regions and market segments. There is a selection of portfolios from the Old Masters to the Impressionists and contemporary art. The second is a vertical integration and can be called the "region-specific" strategy, where all sorts of artworks are acquired from the selected region. For example, with this strategy, the portfolio of a fund of Chinese art might feature artworks from old porcelain to antiques to the works of living contemporary artists. The third strategy applies what is known as an "opportunistic" tactic, wherein the fund tries to achieve profitability by taking advantage of incorrect pricing using informational asymmetry in the market. Most funds are built upon one of these three strategies or a hybrid model. (Horowitz, 2011, p.151) Although on paper each fund aims to select and feature works on a basis of high quality and low cost in their portfolio, in real life, the purchasing options of a fund might be out of their control and based on luck. If there are too many players in the same segment, this will cause funds to act to their own detriment due to rising costs. An alternative is to look for different opportunities that are more niche, such as emerging economies or different specific fields. (Eckstein & Willette, 2010, Chapter 6) Another critical issue is that in fund structures where internal dynamics consist of too many procedures, there may be problems in making timely trade decisions, which causes good opportunities to be missed as the markets move very quickly. The unity of cash and authority is a factor that creates success in the art industry. (Diamond, 2016, p.33)

According to The Art Fund Association (ARTFA) (2013), the investment strategies that art funds can implement are:

1. The Buy & Hold Strategy: A strategy based on the appreciation of the fund's assets over time, which is already a common strategy for many funds.

2. The Geographic Arbitrage Strategy: A strategy that aims to benefit from different pricing that may occur between the works of certain artists in different geographies.

3. The Artwork Driven Strategy: A strategy that aims to profit from factors such as the provenance, condition, or title of the artwork that directly affect its exact price.

4. The Regional Art Strategy: A strategy of focusing on making art investments in a certain geographical region (e.g., Chinese or Indian Art)

5. The Period Strategy: A strategy of focusing on making art investments from a historical period (e.g., Modern, Impressionist, or Contemporary Art)

6. The Emerging Artists Strategy: A strategy based on investing in artists who are still early in their careers and whose works have the potential to quickly become valuable.

7. The Intrinsic Value Strategy: A strategy based on the purchase of artworks that are perceived to be selling at prices far below their real or potential value, at advantageous prices.

8. The Leveraging Strategy: A strategy that involves borrowing from the art fund's portfolio and using these funds to obtain additional artworks that are expected to yield more returns than the borrowing costs during the lending period.

9. The Distressed Art Strategy: A strategy focusing on purchasing artworks at large discounts from collectors who are experiencing bankruptcy, debt, cash flow problems, etc.

10.The Co-ownership Strategy: A tactic that involves the purchase of artworks in partnership with third-party investors to share the risk of a particular investment and to further diversify the portfolio.

11.The Showcasing Strategy: A tactic to increase the value of the artworks in the fund's portfolio by featuring them in prominent museums' organizations such as exhibitions and events.

12.The Bulk Buy Strategy: An approach based on lowering the price and transaction costs with large volume asset purchases.

13. The Medium Strategy: An investment strategy focusing on a single medium in line, for example photography, with the expertise of the fund manager.

The risks and returns for each strategy may be different, so when evaluating a fund's success, it is better to analyze it according to these two variables: Most fund managers use more than one of these strategies at the same time to create a profitable process. The main factors to be considered when determining the strategy are the limitedness of the number of artworks that meet the investment criteria in the field in which the fund will operate and the amount of capital resources that can be procured while the fund still has advantages in the field area before the competitors take action and balance the market.

Art funds have many advantages for individual investors that can ensure that some risks are mitigated. The key benefits are as follows: (Eckstein & Willette, 2010, Chapter 6)

Artworks in a portfolio diversified across sectors have a low correlation with each other. With their larger amount of resources, funds have a high bargaining power and can

provide advantages that individual investors cannot. They can provide cost-reducing benefits in terms of trade costs, storage, insurance, etc. Making correct and timely investments is a skill that requires expertise and the fund can provide the individual investors with expertise in such subject that are very difficult to master on one's own. Through their connections, art funds can find valuable artworks that are fresh or rare in the market, and they can contact collectors and institutions to bypass dealers and auction houses. For those investors who are passionate about art, a fund can sometimes even provide the opportunity to borrow the works of art for a limited period and enjoy them personally in their own homes. Some funds have the connections to arrange lending of the fund's art to major museums or exhibitions, thereby raising its profile in the international art market and enhancing its investment value. Art funds are often structured to provide investors with tax incentives. Art funds usually acquire works of art over a period of years and therefore can take advantage of potential price fluctuations and avoid art that they consider overpriced.

Naturally, these benefits only apply on the condition that the management of the fund is in competent hands and the trade decisions are guided by experienced, independent and objective expert advisors. Problems for the fund may arise if there is a conflict between the presence of the advisors in the art market in different roles and the expectations of the investors. Well-structured funds take measures to prevent such conflicts of interest with thorough analysis. As art is not an investment that can be easily liquidated, issues that may arise due to the market conditions at the expiry date of the fund can also lead to risks. It is vital to also employ measures against these issues.

The managerial strategies that should be implemented to ensure the consistency and success of the art fund and to prevent potential conflicts of interest are: (Eckstein & Willette, 2010, Chapter 6) The remuneration of consultants in a way that aligns their

interests with those of the investors, the development of an achievable investment objective in terms of the sourcing and acquisition policy, offering attractive prospective returns higher than the historical returns achieved by the same category of art, devising a realistic exit strategy that can function even in an illiquid market conditions, designing a holding strategy that offers the potential of true value-added content above the projected underlying growth in market value, determining an optimal financial structure, whether open or closed-ended, with consideration of the implications of the assets' interim and indicative valuations, without "mark-to-market" pricing, intensely marketing the fund in order to overcome the questions in investors' minds against the opacity of art as an asset class, as it is traded in an inefficient marketplace that is absent of regulations, about which there is asymmetry of information.

5.2 Case Studies

These case studies aim to analyze the processes of two American art funds that are remarkable in the art funds market, starting from their founding stage and centered on their investment strategies.

5.2.1 Fernwood Investment Fund

The information obtained for the case study "*Fernwood Art Investments: Leading in an Imperfect Marketplace*" done by Harvard Business School (2006) provides detailed information about the internal structure of the fund and its decision-making processes. The study was an undoubtedly valuable contribution to the literature regarding art funds, which are not required to publicly disclose information.

Bruce Taub believed that art would develop as an alternative asset class with an appealing return potential and risk management benefits that would be uncorrelated to other investment vehicles, and consequently started the initiative to establish the art

fund in 2003. Taub, who had served as the senior director of international private customer services at Merrill Lynch during his 23-year career and came from a family of art collectors, described the motivation that led his career plan to setting up an art fund as the combination of his own financial background with the deep interest he and his wife had in arts, which resulted in his desire to be part of the art community. He supported his wife's passion for art by establishing a non-profit foundation that supports art collecting to inspire the next generation of collectors and launched the foundation simultaneously with the fund so they could serve a common purpose. (Groysberg et al., 2006, p.6)

Aware of the difficulties regarding placing an investment-oriented business next to art-based business models where the aesthetic and emotional components of art are front and center, Taub hired his team by balancing art and finance well to develop a reliable and sustainable operational model. The person who would lead the team to serve as a bridge between the worlds of art and finance would be Michael Plummer. Plummer was a professional with 15 years of experience and expertise in art management and marketing at Sotheby's. He had spent his last few years working on ArtBase, the first business model of its kind, a start-up he founded that provided information services related to art as an asset class for the world of art and investors. Thus, he was aware of the chronic problems in the sector. When they reached a consensus at his meeting with Taub on how to overcome these issues, he assumed the role of presidency of the fund and the task of determining its artistic road map. (Groysberg et al., 2006, p.7)

The fund launched its activities across three different offices with eight employees. It formed many strategic partnerships and benefited from the knowledge and consultancy of these contracted professionals. Each of them being a valuable expert

in their respective fields, the impossibility of these people to leave their positions and for a full-time job at the fund made this approach possible for the fund to both work with these people and benefit from their network, while also saving on costs and providing sustainability. However, the fact that the team was spread across its Boston, New York and Miami offices and kept different schedules created some intrinsic operational issues regarding the fund's priorities and coordination. These operational challenges were exacerbated by the limited ability of the organization's art and finance units in speaking a common language. For example, before their first press conference, the adaptation problems of two different worlds came to a head as the financial language used in the presentation had to be edited so that the art community could understand it. (Groysberg et al., 2006, pp.7-8)

An examination of the profiles of the executives at Fernwood reveals that each had remarkable educational and professional backgrounds. Art Marketing Managers were Patrick Cooney and Rachel Kaminsky, and the Senior Vice President of Marketing was Jennifer Winn. Winn had previously been the Director of Strategic Marketing for the New York-based Art Capital Group, which produced creative marketing solutions in fields such as artwork leasing and exhibitions for museums and dealers and had completed his master's degree in Art History at Columbia University. She had also collaborated with senior professionals in the field of strategic business development at Sotheby's. Cooney was an art historian who had founded Citibank's art consultancy services program in 1979. After 15 years of experience at Citibank, he worked with private collectors for a period before joining Christie's in 1994 as Senior VP and head of international customer services. He continued his academic studies while providing art consultancy to collectors, financial institutions, and insurance companies through Fine Arts Advisory Services, which he had founded in 1998. Kaminsky had spent 11

years at Christie's New York branch as the head of the Old Masters paintings division and then became director at leading galleries and art dealership firms. Prior to his appointment as the fund's VP of Business Development and Strategy, Todd Millat studied at Oxford and Yale, after which he worked in the field of financial asset management at McKinsey and is a partner at CCC Alliance, a global consortium of wealthy families. Both assistants of the team are Harvard Business School MBA graduates. (Groysberg et al., 2006, p.21)

Fernwood found that the old methods of the art market had been evolving over time, as sales made through auctions and dealers gradually began to give way to the internet and that dealers had reduced their stocks and would seek out works according to collectors' wishes like broker agencies, and that the profit margins had been narrowing as buyers diversified their sales channels, and predicted that art could create opportunities as good as other traditional investments under the changing market conditions. Academic studies on art investment, the merits of which should be evaluated on a basis of estimated risk and return, have presented data showing that the overall risk of a portfolio decreases if art assets are added to it. Other studies have shown that there is no significant correlation between art market and capital market returns. (Groysberg et al., 2006, p.8) It also bears mentioning that economists' various approaches to art generally do not reach a consensus.

The Modern Portfolio Theory (MPT) forms a model that maximizes profit through the combination of various assets in the economy. The model, put forth by Harry Markowitz in 1952, supposes that if the average yield, variance, and covariances of individual investment assets can be quantified, the investor may be able to create an efficient portfolio to optimize their returns. The key here is the covariance, which is the coefficient that reveals the interaction of assets with the market and between

themselves. According to the Capital Asset Pricing Model (CAPM), which provides a model for asset equilibrium pricing, which was developed as a result of numerous revisions and studies on MPT, the yields of individual assets are not too important when composing an investment portfolio. The important factor is the relationship between the return provided by the individual asset and the yield provided by all the assets together. Consequently, while it was previously thought that investors who are more aggressive, which is to say, more open to high-risk should focus on investment products with higher volatility, these theories resulted in a more complex process through what is called a market basket – the diversification of investment vehicles that have different correlations. (Horowitz, 2011, p.158)

This theoretical information is often used to legitimize art funds. For example, Fernwood emphasized in their marketing materials that art investment fell under the same broad financial umbrella as other investment assets. In their retroactive calculations from the end of 2003 and covering the preceding 25-year period, Fernwood stated that their optimal portfolio consisting of 35% in stocks, 45% in bonds and 20% in art was shown to yield more than 10-year bonds, and furthermore this optimal portfolio being the lowest-risk model among other investment asset combinations. (see Figure 7)

Efficient Frontier Analysis

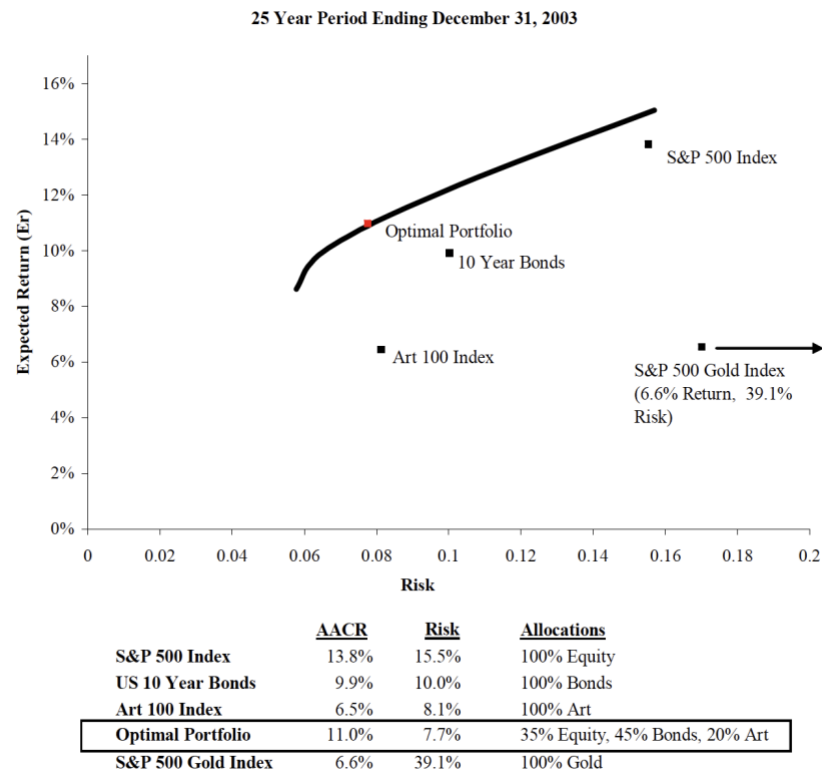


Figure 7. Source: Fernwood Art Investments Company Documents. All return series are based on monthly data. Risk is defined as annualized standard deviation of returns. Art 100 Index data represents the central 80% price bracket from Art Market Research.

Models that consisted of 100% stocks or bonds in the study were shown to be more disadvantageous in terms of risk-return. Stating that the low and sometimes even negative correlation of art with other asset classes is the key point that determines the results of the model, Fernwood underlined that the efficiency of a portfolio can be noticeably increased through the inclusion of fine arts. (Horowitz, 2011, pp.157-159)

Among the detractors who emerged in the previous periods was William Baumol, an economist at Princeton University, who authored the sensational text titled "Unnatural Value: Or Art Investment as Floating Crap Game" in 1986, a prominent

example of this kind. In his study examining the resale of 640 paintings traded between the years of 1952 and 1961, Baumol asserted that making a good art investment is akin to a gamble, and that the opportunity cost of retaining the artworks is up to 2% compared to government bonds. He stated that investors cannot make a profit with any degree of reliability as art assets' pricing is random and their trends are unpredictable, not unlike the random walk theory regarding the stock market. Another such scholar was Goetzmann, who concluded that the returns on art investment is somewhere between those of bonds and stocks, but that art is the most volatile among them, damaging the appeal of art investment with his work. His conclusion was that art was not a superior investment product, but was a weak vehicle for portfolio diversification. The chief shortcoming of these studies is their data being derived from only auction pricing. Sales made in the dealer market are not included in these studies, and obtaining numerical data about them, or to access information specific to customers and sellers, or to determine the interaction between these figures and the auction market is not entirely possible to due to the opaqueness of the art market. Another shortcoming is that the artworks examined in these studies are all of paintings. These studies, conducted by Baumol, Goetzmann, Mei and Moses, and Campbell are all like this – the data they present are from a fairly small subset of the market as a whole. Especially considering the entirety of the international art market, their data is revealed to be a very thin and selective slice of the whole cake. (Horowitz, 2011, pp.166-167)

According to Taub, the spread of global capitalism, and the resulting to the securitization and even the democratization (for the lack of a better term) of illiquid investment categories, has become an accelerating trend in favor of the growing number of investor groups. The benefit, initially derived by the small and privileged in-group, then shifts to the sophisticated investor, followed by the investor in the retail market.

Stocks and bonds' journey over the course of the past century has provided individual investors with the opportunity to invest in smaller and smaller amounts. Structures established as fund-of-funds in the art market have created this potential by opening the non-traditional investment types of hedge funds and private equity investments to small investors' access. Taub predicted that art markets would develop in a similar fashion to benefit small investors. (Horowitz, 2011, p.160) When he established the art fund, he stated his vision regarding the democratization of the art investment with these words: "One day even my secretary will have art shares in her pension plan account." (Groysberg et al., 2006, p.1)

According to a case study published by Harvard Business School, Fernwood had three comparable fund models in its sector to pattern its fund structure after: the private equity fund model, the real estate fund model, and the hedge fund model. The private equity fund model is simply a business plan that aims to buy shares in companies in which it sees potential and to sell them in the future for a profit. They are formed to purchase shares from private companies that underperform or have growth potential, which they aim to sell for a profit when they increase in value. The goal, then, is to profit from the valuation of the asset, like art funds. Private equity funds and art funds, both of which implement strategies to increase the value of the companies they acquire, are compatible in terms of their main objectives. The common fundamental goal for both structures is the valuation of the assets in their possession. Just as art funds find investors through strategic methods, private equity funds raise capital by sourcing it from institutions or family companies. Unlike portfolio management, however, private equity investment styles are often systems that operate in the form of individual transactions and usually make payments to investors at the end of a 10-year period. Compared to alternative fund models, they are structured in a way where legislations

are more flexible. Valuations are done on a basis of prices upon purchase, not with market prices. (see Figure 8)

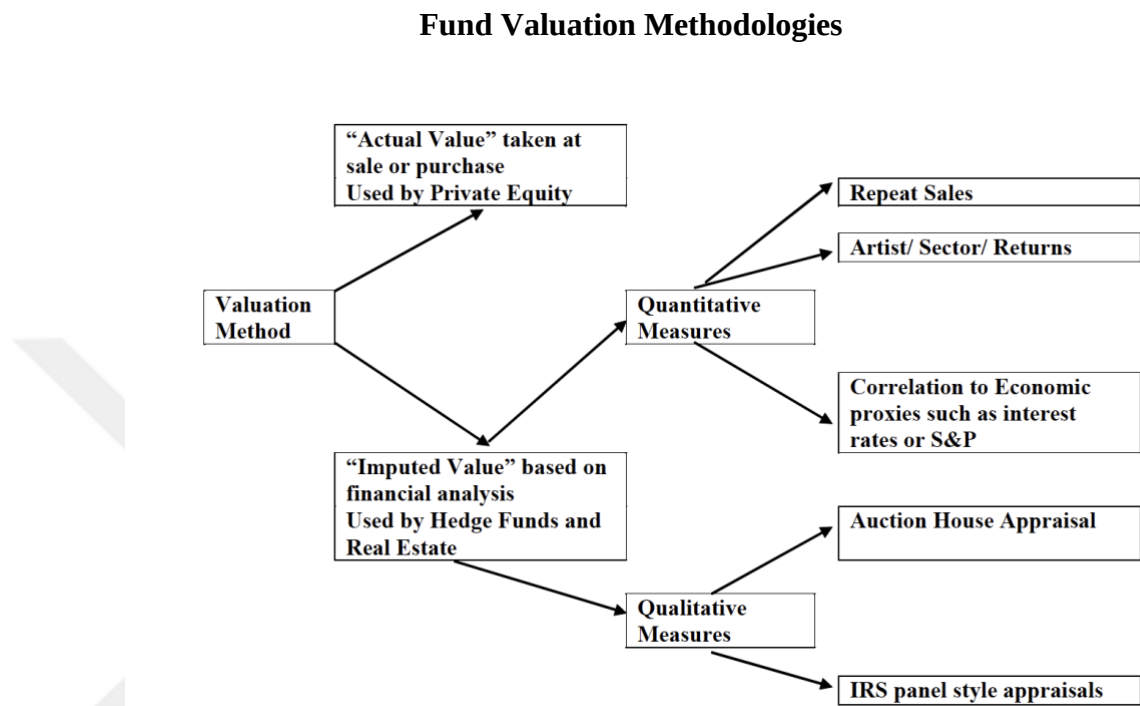


Figure 8. Source: Fernwood Art Investments Company Documents

An art fund's use of this model will provide ease and certainty regarding the valuation of its portfolio. On the other hand, the fund's targeted valuations in market prices will not reflect in the data, and the 2% management fee that constitutes the fund's income will remain low, and convincing new sophisticated investors who do not see the valuation in the figures will prove difficult.

Another model, real estate investment trusts (REITs) – a type of mutual fund that invests in real estate – reveals that the real estate market is also not an efficient market. However, this market was democratized long before the art market and turned

its previously indivisible and illiquid products into a form available to millions, which resulted in a great influx of resources into the market. Todd Millay, a former consultant to Fernwood, stated that art is on the same trajectory as the development of the real estate sector over the past few decades. Real estate investment trusts had existed since the end of the 19th century but were only brought to life by the real estate investment trust law that was introduced in the 1960s. The legislation revitalized these funds by allowing investors the opportunity to buy shares from a pooled property group and rendering them exempt from corporate tax within certain criteria. The common element between these funds, which have grown in size over the years with due to various legal regulations, and art funds is that they both offer investors investment opportunities with capital expenditures that would not be possible for an individual. (Horowitz, 2011, p.162) Art funds also seek to successfully securitize a concentrated investment. The process of an “imputed value” used in the real estate sector offers an analogue for art funds that is inconvenient to execute but attractive with regard to its returns. Though it is debatable whether real estate funds, which are legislatively stricter in structure compared to private equity funds, are more advantageous vis-à-vis comparisons with artworks regarding the assets in their portfolios.

The third option, hedge funds, provided Fernwood with a hybrid model – a compromise between the other two options. It combined private equity funds’ advantages in distribution channels with the valuation methodology applied by real estate funds. Ultimately, this proved to be the choice for Fernwood. Among the methods to reach qualified investors who could invest in a hedge fund, the opportunity to access both institutional and retail investors provided by hedge funds was a priority for Fernwood. Picking this door would also present a chance to market to super-HNW investors in person. In terms of its ease of promotion for the fund, the hedge fund’s

much more boutique environment made it possible to sell and market with less effort and cost than the other options. Although small in numbers, the professionals in this sector boasted high quality and high wages, which was also compatible with Fernwood's organizational structure. However, the short-term rapid returns which hedge fund investors are accustomed would not be possible for the illiquid art market, and sharing fund management data or trade registry records, which the investors expect, was not a done with art funds. (Groysberg et al., 2006, p.12)

Fernwood's eight-step managerial sustainable investment strategy to achieve optimum investment returns was as follows: (Horowitz, 2011, p.150)

1. Determine overall allocation
2. Assess liquidity and cash deployment
3. Employ investment analysis expertise
4. Identify and source potential opportunities
5. Perform due diligence and negotiation
6. Determine portfolio suitability
7. Execute transactions
8. Continually reassess cash and exposure

These steps aimed to apply fluid active management to optimize investment returns.
(see Figure 9)

Fernwood Strategy

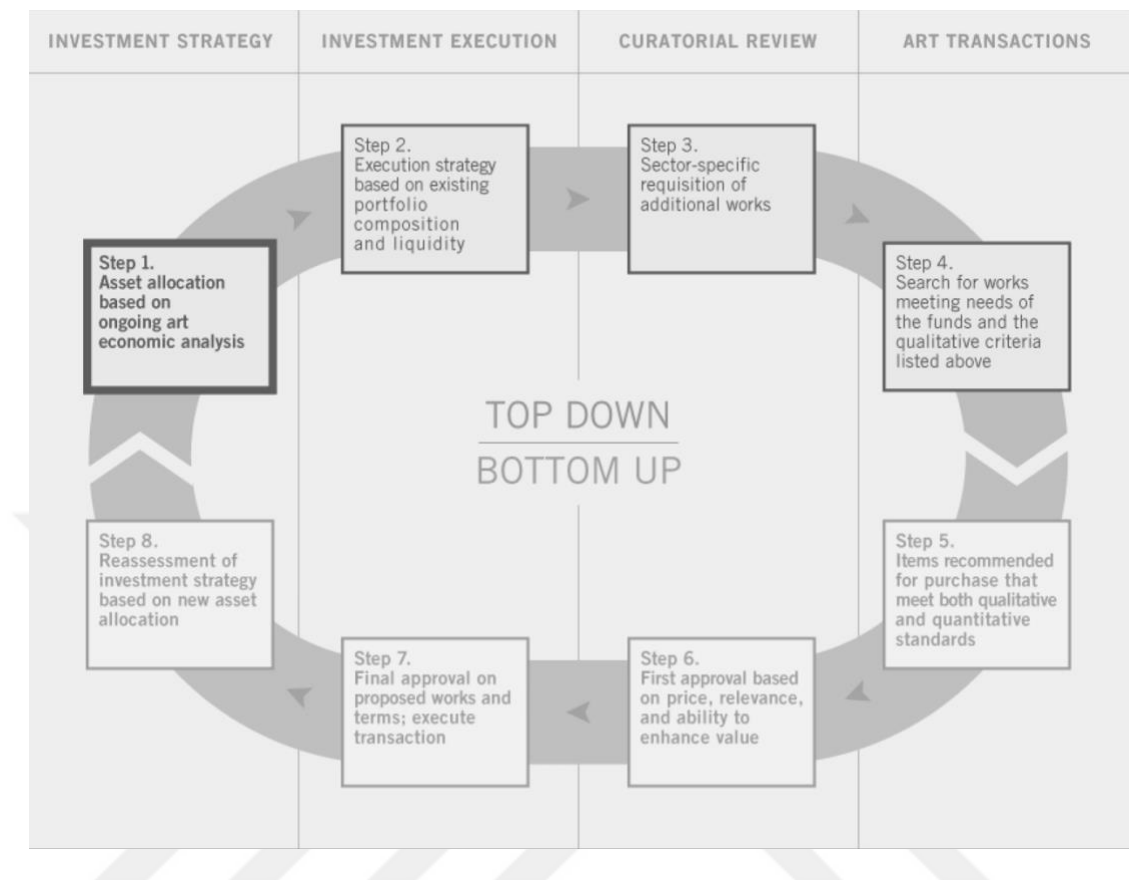


Figure 9. Source: Fernwood Art Investments Company Documents

Fernwood planned to offer services for dynamic art financing and collection management like its industry competitors. The intention was to provide the following: “Quantitative Econometric Research and Analysis,” “Market Intelligence Gathering,” “Collective Behavior Analysis,” and “Economic Analysis and Forecasting”. According to Horowitz, had they been able to implement these services effectively, Fernwood could have been a leader in the industry. (Horowitz, 2011, p.160)

Believing in the power of art as an investment, Taub funneled his \$150 million investment target into two primary art funds: the Sector Allocation Fund, wherein the portfolio was divided into eight genres such as Old Masters and Emerging Masters as

a diversification strategy, and the Opportunity Fund, which, as the name implies, offered higher-risk but immediately valuable opportunities. (Horowitz, 2011, p.144)

The eight genres in which the Sector Allocation Fund invested were:
(Groysberg et al., 2006, p.22)

- 1) The Old Masters: A portfolio of artworks from European artists who were active between 1300 and 1800, and which includes a selection from the Renaissance, Baroque and Rococo periods from Italy, Spain, Germany, The Netherlands, France, and England. (Boticelli, Bellini, Durer, Cranach, Titian, Carracci, Velasquez, Breughel, Rubens, etc.)
- 2) European Masters: Represents the works of European artists of the late 18th and 19th centuries, where art historical movements such as Neo-Classicism, Romanticism, Orientalism, Symbolism and Realism emerged. (Goya, David, Bouguereau, Tissot, Ingres, Millet, Corot, Courbet, Delacroix, Leighton etc.)
- 3) Impressionist Masters: A selection of French artists from the period between 1860-1915, including Neo-Impressionist, Post-Impressionist and Symbolist styles. (Degas, Renoir, Monet, Manet, Pissarro, Sisley, Rodin, Rousseau, Vuillard, Van Gogh, etc.)
- 4) American Masters: Artworks from the late 19th and early 20th century American artists in the genres of portraiture, history and nature. (Sargent, Hassam, Chase, Bierstadt, Church, Remington, Innes, Homer, Eakins, Sloan, etc.)
- 5) Modern Masters: Artworks that can be associated with the Cubism, Surrealism, Expressionism and Bauhaus movements in the period between the beginning of the 19th century and 1945, categorized after

the Museum of Modern Art (MoMA) and similar institutions. (Picasso, Braque, Léger, Duchamp, Kandinsky, Klée, Chagall, Ernst, Magritte, Miro etc.)

- 6) Contemporary Masters: A selection of prominent artworks from the years of 1945-1969, reflecting the movements of Abstract Expressionism and Monochrome Painting. (de Kooning, Pollock, Klein, Rothko, Kline, Louis, Calder, Fontana, Smith, Johns, Martin, etc.)
- 7) Post-Modern Masters: A portfolio of works by prominent artists from the last three decades of the 20th century, that is, in the period after 1970. (Warhol, Lichtenstein, Rivers, Stella, Judd, Serra, Le Witt, Marden, Nauman, Flavin, etc.)
- 8) Emerging Masters: A high risk/return category whose potential and value were likely to vary. (Sherman, Goldin, Gursky, Holzer, Boetti, Koons, Struth, Ruff, Serrano, Hirst, Schnabel)

The fund, which operated out of its New York and Boston offices with approximately 20 white-collar employees, and served people from auctioneers to sales representatives, economists to art critics is closed in 2006. Its executives made no explanations regarding its abrupt shut-down in June without any announcement, but Michael Plummer, the COO, had expressed concerns about the funds' founder, Taub, regarding financial stability and whether he had had the resources to manage the funds. He had also stressed that even though the world had changed, an in-group still ran the art world and, consequently, there was a lack of capital. And as signaled in these statements, it didn't take long for the facts to come to light. In February 2007, a consortium of investors who had purchased preferred shares from Fernwood filed a lawsuit against Taub on charges of embezzlement, fraud, deliberate and negligent

misrepresentation, and abuse of attorney duty, and won. Using his and his wife's social network and other people's money, Taub had integrated himself into a rare social circle, and funded his own lifestyle and social desires by controlling the funds and the information regarding that use. The capital raised was used on the parent company instead of the funds. This end to one of the prominent and profitable examples of its kind, caused considerable damage to the sector. (Horowitz, 2011, p.180)

5.2.2 The Fine Art Fund

The Fine Art Fund (FAF) was founded in 2001 by Philip Hoffman, a former executive for Christie's, and began launched its activities in 2004. It was the first fund with a minimum investment prerequisite of \$250,000. The fund's initial portfolio included 80 artworks. The fund began forming different portfolios and strategies and started concentrating on certain regions and genres as well as opportunities such as distress sales as it progressed. For instance, the banking crisis in 2008 offered unmissable opportunities for the fund at attractive prices. For example, Hoffman reported that a collector who had hesitated to consider a \$5.2 million offer in 2003 later agreed to sell for \$750,000 in 2008 based as they needed to procure an amount of cash within 48 hours. The fund adopted a method of taking advantage of other parties' distress and turning it into an investment. It closely monitored unsold lots at auctions and then made lowball offers to purchase works at rock bottom prices. Each fund typically had between 30 and 40 clients who invested between \$250,000 and \$7 million. The fund began distributing profits from its first fund to its investors in 2009 with a net annual return of about 5% in 2015 when the sales had been completed. The fund was rechristened The Fine Art Group in 2016, reintroducing itself as a new brand. In 2018, the fund's investment volume exceeded \$500 million, and it had maintained its structure consisting of eight funds. It is, ostensibly, one of the few very successful examples that

have been active for such a long period, but the profitability of the funds it manages is a complete mystery. (Frye, 2018, pp.123-124) According to Hoffman, long-term capital and resilience are the main strengths behind its success, stating in his 2017 assessment that most of funds in the sector were recent ventures, underlining that investors began to assign importance to a good and long track record, especially after the disappearance of Lehman Brothers in 2008. (Shaw, 2017)

In 2005, after having announced its art consultancy services and that it would establish a fund-of-funds, ABN AMRO terminated both ventures before a year had passed. The company spokeswoman Carolein Pors explained in a statement that their analyses of existing funds showed that the conditions were not suited to establishing a fund-of-funds. Of the 20 then-current funds they evaluated, only two, the FAF and the China Fund, were found to be viable to recommend as third-party investment vehicles for investors. A 2005 report highlighted that there was a major battle over new investors and that few other funds were achieving success. Most funds outside the FAF had to downsize their optimistic plans from their inception stage. ABN AMRO's experience and its assessment of the circumstances has undoubtedly had a negative impact on the art funds market. (Horowitz, 2011, p.180)

Hoffman, who had served as the Executive Vice President of Christie's Europe for twelve years, spent two years planning the fund and clarified its details before launching the fund in 2004. The fund, which, according to the financial press, had made its first close at \$70 million – far from its target of \$350 million – adopted a "buy & hold" strategy. (Horowitz, 2011, p.184) The plan was to make purchases for three years, followed by the sales which would start in five to seven years depending on any good opportunities that might arise. It would then completely divest in the final two years. The first portfolio was diversified through a selection of five sectors from the art

market. The fund's primary marketing strategy also overlapped with its stated investment strategy: "the enjoyment of museum-quality art works". The investors were also offered opportunities to enjoy the investment they were involved in by leasing artworks from the portfolio. The leasing price was 1.75% of the artwork's value. (Groysberg et al., 2006, p.19) The services provided by FAF include guidance on customers' personal collections, due diligence on artworks outside of the fund's own investment universe, short-term rental arrangements, loans, art financing, restoration, and co-investment opportunities. And the fund is also the chief art advisor to the private banking clients of BSI Bank and Banco Santander. (Horowitz, 2011, p.160)

Fine Art Fund I is a good example for the strategy of diversification. The fund was conceived as a diversified fund specializing in five market sectors. FAF I's portfolio consisted of the Old Masters (25-30%), Impressionists (30%), Modern (20%), Contemporary I from period 1960-85 (15-20%) and Contemporary II from period 1985-2010 (0-5%). Working with professional art consultants, the fund offered evaluation and purchase recommendations from its experts, who were well-known and respected in their sectors, to its managers and made trade decisions with their guidance. When an opportune artwork was identified, the board was consulted to purchase. However, no single artwork could cost more than 15% of the fund's committed capital, and any purchase greater than 7% required approval by the board. The minimum amount required for investment was \$250,000, plus operating expense at 2% and a performance fee of 20% after 6% hurdle. It was 10-year long closed-ended investment with two additional one-year extension options. Returns would be paid to investors after the fourth year, that is, after it was no longer purchasing artworks. With its advanced structure and ambitious business plan, FAF is a good example to examine development of art investments. (Horowitz, 2011, s.151) FAF seems to have adopted its 10-year

closed-ended fund structure from private equity funds. Its “2-and-20” fee structure was inspired by both private equity and hedge funds. (Horowitz, 2011, p.162)

It may not always be possible for art funds to realize their targeted investment strategies. For example, FAF I's target investment strategy was to compose 15-20% of the portfolio from 1960-85 period and 0-5% from post-1985. However, at the end of the fund's lifecycle, the ratios were 30-40% for the 1960-85 period and 5-10% for the post-1985 period, at which point half of the fund's portfolio consisted of emerging artists' works which had a higher potential to net cash. Since art investment is a relatively new phenomenon and investors want to see some positive data and sense trust before investing, funds tend to want to create investments that will make a splash by quickly using their assets to create positive figures in the early period. This is normal so long as it remains in line with the specified portfolio allocation parameters of the fund. However, in FAF's case, when the segment the investment had shifted into grew quickly and became profitable, FAF and many other funds of the time chose not to stick to their predetermined strategies and make changes. Sector diversification is appealing but prone to errors – with funds entering a vicious circle while trying to provide new resources through rapid returns and being subject to a higher-than-expected risk. Essentially, if they are able to provide the necessary resources, art funds can boast a high profit potential by utilizing their large capital reserves and deep market knowledge to take advantage of informational and regional asymmetries in the market. Yet the high risk they are willing to take on might underline the gap between art investment in theory and in practice. (Horowitz, 2011, p.169)

Following FAF I, the Fine Art Fund acquired three other funds, FAF II, the China Fund, the Middle East Fine Art Fund, and later formed FAF III and the Indian Fine Art Fund. FAF II, like its predecessor, had a minimum investment amount of

\$250,000. The minimum amounts for the Chinese Fund and Middle East Fund were \$100,000. FAF III was a closed-ended fund with a five-year duration that took advantage of distress sales. All Fine Art Fund ventures aimed for annual returns at 10-15% and were closed-ended investments. Middle East FAF was a partnership with the Bahrain-based Addax Bank. The remaining funds were under the management of the Fine Art Management Services. FAMS had defined a management strategy that charged a 2% annual management fee and a 20% performance fee after a 6% hurdle. In its first year of operation, FAF I yielded 54% revenue from sales, and by the end of 2009, it had maintained an average annual return of 34% on sales, while the fund's total average annual return on all sales was 30.15%. The FAF II had an average annual sales return of 29%. According to an assessment done by The China Fund's executives, the fund had a valuation of 6%. According to the evaluations done by the Middle East fund executives at the end of the 18th month, the fund had a valuation of 6%. Overall, the average profit from all FAF initiatives was 30%. (Horowitz, 2011, p.180, Table C1)

The fund completely stopped its purchases in the first half of 2009 after the crisis in 2008 and survived this period smoothly as it had completed the capital acquisition process. For other funds that were still in the funding stage, this was an unfortunate period. Many such funds were lost to time under the market conditions of this cash crisis. (Horowitz, 2011, p.186) The fund stated that lost \$40 thousand in a single sale but that all other artworks were valued higher than their cost, adding that their expectations regarding the future were far from certain and would be shaped depending on the recovery of the markets. (Horowitz, 2011, p.184) When the FAF I wrapped up its 10-year term in 2015, it yielded a return of 5% and received criticism from those who thought the figure was low. According to Hoffman, however, compared to many other funds that had gone bankrupt after 2008, FAF I's return was a respectable amount.

According to Todd Levin, the director of Levin Art Group, a New York-based art fund, groups of artworks with a period of 4-12 years provide a consistent net return of 8% to 40% per annum. Certainly, portfolio diversification contents are also subject to changes in time. Initially largely investing in the Old Masters segment, the fund later shifted to the groups of Modern and Contemporary Art during its late period. (Shaw, 2017)



CHAPTER 6. EXAMPLES OF ART FUNDS IN A GLOBAL WORLD

Art pervades through countries' borders without any linguistic or cultural restrictions, functioning as a real social adhesive in today's society. In an era where social, political and religious tensions are on the rise, contemporary art paves the way for development, innovation and inclusivity by offering humanity a "tabula rasa" with its leverage effect. In our current day, art has become more commonly produced in different disciplines and shared and reaches a wider audience than ever before. It is experienced and collected more by national and international audiences. Diversity and pluralism have increased. (Horowitz, 2011, p.9) The art and culture industry is the union of three interrelated sectors. It is located at the intersection of culture, finance, and visual arts. (Deloitte Private & ArtTactic, 2022) Its financial sector includes asset managers, private bankers, family businesses, individual investors/collectors, art and collection goods, supporters, art insurance companies and those engaged in art trading. Its visual art branch includes artists, companies that carry out art sales, digital art companies, companies that supply logistics services in the art field, art and media companies, related technology companies, the creative industries and art fairs. The cultural branch involves institutions such as state museums, private museums, corporate collectors, and public authorities. The common denominator of art investment funds is the interaction between the development and professionalization of the art industry, the pragmatic career-oriented approach in art education after 1960, the innovative marketing, finance and sales strategies implemented by galleries, auction houses, banks and art-based enterprises. (Horowitz, 2011, p.3)

It is thought that approximately 50 active art funds existed the beginning of 2009, and remarkably, the majority of which were located in India. It is not possible to

estimate their number, as art funds do not have record-keeping obligations and do not operate publicly. If we were to set aside any funds that are open to outside investors, subject to the legal regulations that govern the incentives created for qualified investors, has provided the necessary funding in accordance with its commercial strategy and has completed a sufficiently diversified portfolio distribution regarding western art, the total number of funds would be expected to drop at least by half. By 2010, the number of art investment funds, which had reached fifty, was down to twenty. (Eckstein & Willette, 2010, Chapter 6) There are many funds that have been suspended or dissolved due to difficulties related to capital collection, managerial problems, and marketing. The losses following the decline in the market include the China Fund, the Oasian's Art Fund, the Art Trading Fund, Meridian Art Partners, Dean Art Investments, ArtPlus, various funds recommended by the Société Générale Asset Management, the Art Dealers Fund, and by MutualArt. According to the Meridian's employee Littlejohn, the primary issues for funds are the liquidity and transparency problems. The investor does not want to lock his valuable capital for the long-term into a system the operation in this economic environment of which they do not exactly understand. Although funds themselves have management and auditing structures that do not allow direct access to the investor's money, and their reports come from an independent audit firm, it may take years for the sufficient demand to grow. (Horowitz, 2011, pp.184-185)

According to the Deloitte Lux. & ArtTactic Art & Finance Report 2014, the art fund market had become revitalized by 2012 and as of that same year there were around 115 art investment funds driving \$2 billion of investment. Behind this significant growth in the sector was the funds founded in China, although there are also funds among them whose focuses are not concerned with the performance of the art market. In fact, the number of funds originating in America and Europe remains at around a

stable 20. Fresh capital that enters the market is usually directed towards funds about which there is data. Of the \$ 557.9 million of total assets under management in the art fund market in the US and Europe in 2016, more than \$350 million was held by Fine Art Group. (Xiang, 2018, pp. 1717-1718) Due to its eclectic nature, it is only possible to assess the art fund market in light of the data presented. It is difficult to know the details about most small-scale funds. In addition to funds created with the purpose of profit, there are also art funds that are created towards social goals, which the investors position themselves according to these goals. According to Christian Kaspar Schwarm, the Founder of Independent Collectors and a prominent name with regard to individual collecting as stated in the 2019 report, giving the public the chance to see art that had been previously kept behind closed doors their works has become a kind of social responsibility project.

Due to limited data and the absence of information about performance, sometimes it may not even be possible to determine whether a fund is already in progress. The strongest expression of this is the fact that the website of The Art Fund Association (ARTFA), which was established in 2011 as the commercial association of art funds, was last updated in 2013 and no information or termination was made afterwards. According to the available information, some of the prominent funds are as follows: (Frye, 2018, pp.124-127)

Artfonds 21 is a venture based in Germany that launched in 2007. The fund raised a total of \$440,000 from 20 investors and invested in 50 artworks. It encourages museums to lease the works in its portfolio and sells a limited number of prints from its selection. It has established a system that gives artists a share of the profits it obtains.

Art Partners is a fund based in Tel Aviv, Israel, which was founded in 2007 and has a portfolio consisting of Post-War and Contemporary art genres. In 2013, it was

announced that investors had been provided with a return of about 50% and that a second fund was planned, but later disappeared.

The Collectors Fund was founded in 2007 in Kansas City, Missouri. The fund focused on Post-War and Contemporary art, with an investment minimum of \$100,000 as of 2010 and a capital of \$30 million raised from 100 investors as of December 2010. The site has not been updated.

Artemundi Global Fund has been operating in the Cayman Islands since 2010, the fund has composed a selection of Old Masters, as well as Modern and Modern Latin American art. It has managed to create a capital pool of \$150 million through investments where the individual minimum is \$250,000, and the corporate minimum is \$1 million. At its close in April 2015, it reported a return on investment at 17% net annually.

The Fine Art Invest Fund was launched in 2010 in Zurich, Switzerland, focusing on Contemporary Photography. The fund makes its purchases from the artists themselves, unlike most other funds. The fund, which is managed by the joint management of KMS Fine Art Group and PMG Funds Management, reached a size of \$ 17 million in 2015, but the number of its investors is unknown. The fund, which is open-ended, allows investors the right to withdraw, which is valid in quarterly periods. The annual return reported to the investors in 2015 was 33%.

Brazil Golden Art has originated in Rio de Janeiro. The fund was founded in 2011 and focused primarily on Brazilian art, but then went on to provide financing for art galleries. In 2015, it sold a selection of its portfolio at Sotheby's. It has negatively reported the return on investment since its launch.

The Day Star Fund was founded in Malta in 2012 and invests in well-known artists. The fund declared a return of 20% in 2014 after reaching a total capital structure of \$60

million in 2015, but there is no information about the aftermath and its website is inactive.

The Tiroche DeLeon Collection was founded in Israel in 2012 by collectors Serge Tiroche and Russ DeLeon. The fund was launched with the sale of 230 works. The fund focuses on artworks from developing countries. Its minimum investment amount is \$500,000. The system, which was established as a 10-year investment, completed its buys as of 2017.

Anthea is founded in 2013 and of Swiss origin, the fund operates in the field of contemporary art and has reported a 28% return on investment in 2018.

The Scheryn Art Collection was based in South Africa .The fund, founded in 2015 by South American collectors Herman Steyn and Dabing Chen, invests in Contemporary African Art. An initial capital of \$1.6 million was raised by its founders and the minimum investment amount was set at \$40,500. The Fund's target capital size is \$40.5 million, and its main objective is to support the African art. Cash or art donations are accepted to the fund, which as a structure puts social benefit before the return on investment.

For art to become a more appealing investment, it needs to be transparent and have reliable indicators, public records, and the promise of a solid portfolio in accordance with the art investment strategy like other investment assets. (Eckstein & Willette, 2010, Chapter 6) According to the "Art and Finance Report 2019" from Deloitte & ArtTactic (2020), which is one of the top four firms in the world that provide international independent auditing and management consultancy services, "trust" and "transparency" are highlighted as two key points in front of the financial growth of the art market originality. The threat and risk factors for the art market can be stated such as lack of provenance, fraud and attribution, insufficient transparency, price

manipulations and anti-competitive behaviors, inadequacy of the determining qualities about registration or originality, lack of professional qualifications in art market at international standards, money laundering, undisclosed conflicts of interest, hidden commissions, insider dealing, buyer-seller confidentiality, auction guarantees.

Returning to the FAF example, the fund, which was only able to collect less than \$100 million of the \$350 million target in the first establishment phase of 2003, may have prepared some data shared with the public with a more biased perspective as an unregulated business which is concerned with attracting new investors by providing extraordinary returns in its early periods. For example, while the returns on assets sold are shared, the current valuation of the assets in stock may not be disclosed if it is not profitable. Again, the fact that sales up to the year 2009 coincided with a unique period when the market was very high has also strengthened the fund's hand. However, in contrast, we may not see the effects of the post-2008 market collapse on the entire portfolio. Although it appears to be a successful example of art funds, the transparency problems that are likely to be experienced even in this fund provide an idea about the potential problems with the sector. Additionally, we must not forget that it took seventeen years for the post-bubble price parity in the 1980s to settle – the possibility of a fund established with a ten-year maturity to coincide with such a period is another economic risk factor to be considered. (Horowitz, 2011, p.184)

As of January 2020, the EU countries have updated their anti-money laundering regulations to include individuals or brokers trading artworks worth €10,000 or more. Research also shows that every year the number of asset managers who believe in the importance of regulations to build trust in the art market is on the rise (Deloitte & ArtTactic, 2020) According to the report, compared to others, art funds are a model in which art professionals show interest with a rate of 38% and rank second after social

responsibility design products. For collectors, it ranks first place with a rate of 33%. This analysis clearly reveals the growing interest in art funds. Derivatives and fractional investment methods (e.g., security tokens) are also other models. The development of technology will undoubtedly have a profound impact on the formation and diversification of different models. As transparency and regulations expand, so will the trust in the market.

The priority issues in the report that are significant at the intersection of art and finance are as follows:

- 1) Asset managers should re-evaluate the customer experience and new strategic perspectives in the field of art and asset management must be provided.
- 2) Cooperation between art and finance shareholders is crucial to developing common principles and standards and rebuilding of broken trust.
- 3) It is necessary to support ArtTech and meet the need for new investment models.
- 4) Socially effective investment models in the field of arts and culture should be studied.
- 5) New regulations on dirty money should be used as an opportunity for the art industry to be more transparent and reliable.

According to the report, 86% of asset managers support the inclusion of art as an investment vehicle in asset management. 83% of managers state that their motivation for this is to offer a more holistic approach to customers. A majority of investors, at 52%, on the other hand, state that their most prominent factor for investing in art works is "diversification". Art is now legitimized as a fixed financial asset that has to be

featured in a portfolio. The process of holding onto an artwork and waiting for its value to appreciate is called "The Holding Period Effect" and is profitable for art, which has correlation with asset classes that retain their value, such as gold. According to auction participants, with the "holding period effect", the artwork only becomes profitable after waiting for at least a decade. Reports state that 88% of contemporary artworks and 80% of works belonging to the Impressionist and Modern periods, when traded 10 years after their purchase, yield prices are above the purchase price and exhibit less volatility than the annual compound interest.

Systematic research shows that motivations for players on both sides of the table are increasing steadily year after year. As art funds move closer to the business models of financial services firms, it is unclear if the demand for this sort of comprehensive service will increase to meet the need for their survival. As Moses argued in 2007, the idea that those considering investing in art are doing so on their own indicates that even if HNWI and institutional investors who lack expertise in art markets grow in number, the demand may not necessarily increase. Or, even if the demand does increase, it will require serious competition to stand out among the suppliers offering these services and to be resilient in terms of labor and costs. According to the report, the global "art and collectible wealth" size estimate for 2019 was \$1.74 trillion.

If we are to touch upon the necessary revisions to ensure resilience in the face of competitive conditions in the art investment industry and the primary sector trends, we can see a shift towards developing specialization and opportunistic investment strategies. (Eckstein & Willette, 2010, Chapter 6) The developing trend of specialization, or the trend of sector allocation, as Fine Art Wealth Management calls it, is the shift of funds from general diversified portfolios to sector-specific strategies, which includes specializations specific to any genre or geographical region. To

illustrate, the WMG Photography Collection, which launched in 2007, is a London-based, £10 million fund that aims to invest in thousands of photographic prints. Vienna based Merit Art Photography, founded in 2008, is another pioneer of the trend. FAF's China, Middle East or Indian funds are similar examples. Activities in these regions are important in terms of the relevance of emerging markets in the global economy to the art economy and in terms of certain local characteristics that differ from the West. Conditions like fluctuating prices in some segments of the market, i.e., the volatility of prices and the difficulties in actively managing diversified large scale art investment portfolios, necessitate the shift towards more opportunistic investment strategies, which has led funds to seek such strategies since 2008. FAF III, which was established in 2009 with the goal of reaching a size of \$50-100 million, and ArtPlus, the London-based \$50 million volume fund with a goal of \$200 million and for which the former Sotheby's expert and BRPF consultant Jeremy Eckstein was a consultant also employ similar strategies.

According to data from the Deloitte Luxembourg and ArtTactic Art & Finance Report 2021 (2022), 58% of asset managers, 84% of art professionals and 88% of collectors are interested in direct investment in art. As for investment funds, however, these figures represent smaller groups of 25% for asset managers, 28% for collectors and 30% for art professionals. However, considering that the percentage of asset managers who preferred investment funds as a way to make art investments in 2019 was 17%, we can see that the interest in art funds has increased somewhat.

At this point, asset managers have become aware of the importance of art and collection products and approach them as a strategic component of total asset management services. In the joint declaration of the culture ministers of the G20 countries on 30 June 2021, which was a historical first, culture was depicted as the main

locomotive for sustainable socio-economic recovery after the pandemic. The intersection of art, finance, management and culture is a field that is extremely open to innovation and development and is vital for the creation of a better society. Technology, sustainability, and regulations are the main determinants of potential development processes. The dynamics in this area are global in scale and span all generations. Despite challenges such as a lack of regulations and transparency, the art and finance industry will continue to innovate and develop. (Deloitte & ArtTactic, 2022)

According to the report, the amount of asset managers, collectors and art professionals who believe that art markets need to update and modernize their business practices is thought-provoking. We could say that the art market has been slow in adapting to new business model in the recent years. Although some development signals have emerged as the COVID-19 pandemic acted as a catalyst for innovation and change, issues regarding transparency, art markets data, market manipulation, originality, provenance and ownership risks are still concerns that asset managers emphasize the most. However, there are also positive developments to consider; new regulations regarding the principles of property, and the efforts against money laundering are promising developments in terms of the art market and are dynamics that will force business practices to change. New technologies and data-driven business models are expected to reduce information asymmetry and increase transparency. If art professionals and asset managers cooperated to ensure trust and stability for the market, and asset managers correctly analyzed and communicated the conditions and priorities of their stakeholders and practices were developed in this regard, it would be beneficial for all involved.

UHNW individuals' assets related to art and collection products have been estimated to have reached \$1,448 billion as of 2020. The sector itself, which provides

services related to the safe-keeping, development and support of these products, as well as its profitability, are expected to gradually expand. This aforementioned growth will be possible through strategic partnerships and close relationships between asset managers and art professionals, as well as the proliferation of suppliers who provide services at the intersection of technology and art. Within the purview of the services that collectors want to receive are issues concerning consultancy in the form of advice, research, valuation, collection management, property planning, insurance, storage, and security problems. At a time when art-secured lending is developing, new art investment models are being introduced, and socially effective investments are increasingly being given priority in the cultural and creative industries, art's brilliance in terms of asset management is growing.

According to Capgemini World Wealth Report (2022) 71% of the HNWI have invested in digital assets globally and the ratio increases to 91% for those who are younger than 40 and have investments in digital assets. They emphasize cryptocurrencies as their favorite and exchange-traded funds (ETFs), metaverse investments are other popular investments as well. The digital assets such as NFTs, ETFs, metaverse-related products, cryptocurrencies and digital currencies are the new age products that a wealth management firm should focus on. The faster the adoption and the better the capabilities about the products and education, the more successful will the firm be. In 2022 several announcements were made for the initiatives following these trends. Amundi, which is one of the largest asset management firms in Europe published that the firm would provide his clients the opportunity to invest in directly NFTs or firms in this sector. Wave Financial and Criptonite Asset Management started an NFT fund in Switzerland for qualified investors.

Over the past decade, the scope of art and asset management services has evolved away from an investment-oriented client strategy to a more holistic perspective, providing the clients with broader services in terms of their needs and assets. While the customers' wishes and requirements vary, especially under the post-pandemic conditions, managers try to adapt to these new services which consolidate personal and professional needs of customers. What asset managers point out as an impediment to their development in this field is a lack of internal expertise. Working closely with professionals and experts in the field of art and balancing internal and external services provided will create the means to compensate for these shortcomings. Collaborations with prominent art professionals and institutions in the field, working with people who have the skills and expertise related to technology and innovation will provide the opportunities to compensate for the areas that are lacking.

The younger generation of collectors are also beginning to draw attention as the rising value for asset management. Technology-oriented art and next-generation management strategies are vital to be able to address this target audience. Technology is one of the main determinants of innovation and change in the art and asset markets. The COVID-19 pandemic has significantly increased digital adaptation and the frequency of use of digital channels. It is certain that data-supported new generation solutions and digital skills will have an impact on new generation investors. As art industry matures, opportunities that are generated through technology regarding subjects such as transparency, valuation, originality and provenance provide convenience. The initiatives spearheaded by big data and artificial intelligence function as a catalyst in the creation of analytical tools needed in matters that require art valuation, risk management and profound analysis. Developments in this area will also benefit the existing systems in terms of consolidation by entering existing asset data

into the system. Functioning as an adhesive that keeps the sectors together, technology contributes by minimizing conflicts between stakeholders and paves the way for development in the sectors. If we were to summarize the rich and complex structure of the art and finance ecosystem and the facts that will effect change, the trends in art and finance should be emphasized.

The trends in art can be stated as: globalization, democratization, and cultural diplomacy; trust, transparency, regulation, and professionalization; art and technology, digitalization, virtualization, tokenization; the new economic reality for public cultural institutions, the moderate power of culture, the economic driving force, the cultural heritage of the world; creative industries, cultural citizenships, culture and smart cities. The trends in finance can be mentioned such as: the expansion of the UHNWI class, a new generation and a holistic approach; financialization, and art as a new type of capital; risk control, collection management and asset protection; tax and real estate assistance, philanthropy, and sustainability; art-secured lending, social impact investment, and partial ownership models. (Deloitte & ArtTactic, 2022) There will always be great opportunities in the growing art market on a global scale for art funds that understand well the structure of the sector and can apt to changes.

CHAPTER 7. CONCLUSION

This thesis study reveals the dynamics of the art market in order to examine art funds as an investment vehicle, and establishes the unique characteristics of this market. This analysis showed that the market actually consists of many sub-markets rather than a singular, large one, and has various limitations in the economic sense. Art market products have different characteristics that do not directly correspond to the supply-demand balances in traditional economic models. After analyzing the dynamics and historical processes that resulted in the emergence of art funds, which are a type of investment fund, this study then provided the necessary background to examine the technical details of art funds, analyzing the components that make up investment funds such as the portfolio, valuation, fixed terms, etc. Potential misunderstandings were prevented by drawing clear boundaries between different fund types that exhibit structures and even different names domestically and internationally. Underlining the analogues of fund practices and art funds that correspond to each other, we examined the objectives of art funds, their managerial and operational structures, maturity and return targets, as well as financial and management strategies used to achieve their goals; their difficulties and failures in light of the ever-changing technological advances, and their possible risks, in addition to various methods to overcome these, and the opportunities and threats that may be encountered in the art market, both theoretically and practically through examples.

The first chapter of this study presented *the subject, purpose, scope and method of the thesis*. The subjects in each chapter and the sub-titles to be examined under them are revealed, and the framework of the thesis is drawn.

The second chapter of this study examined *the phenomenon of the art market and its actors, history, and the main factors shaping the market in the big picture, as well as the subjects of commercialization, globalization and financialization*. The art market as a mechanism exhibits different dynamics compared to traditional markets and operates on a system of unwritten rules. In economics, it would be a so-called "imperfect market": an "inefficient" market characterized by an absence of price standardization or transparency, and insufficient market information, low liquidity, discontinuous transactions, and an inelastic supply. Its fragmented and opaque structure causes informational asymmetry, and the difficulties regarding matching the supply and the demand create high transaction costs, which add to the increased overhead due to insurance and storage costs, the threat of counterfeiting, etc. The art market's unregulated nature and informational asymmetry can create arbitrage opportunities for investors, which can also have a deterrent effect. The factors that determine the value of an artwork are a combination of many social, cultural, historical, national, academic or tabloid factors, as well as contextual factors such as the relative position of the work in the artist's oeuvre, museums or galleries in which it was exhibited, the collections they are part of, and characteristic features such as its material, size, color, subject, condition, etc. Basic motivations for purchase may be an artistic and aesthetic benefit, financial incentives or social reasons. According to Veblen, art is an object of "conspicuous consumption" and can increase its owners' status in society or within their social circles. The competition in the art market, which involves credence goods and operates on trust, is based less on price and more on creating the perception of long-

term artistic and economic value of the product in the mind of the collector by influencing and reshaping their tastes. The pricing of these products is not objective or individual but rather depends on the credibility of the experts who have a say in the market process of collective evaluation. Another important economic finding about the art market is the limited supply. The art market does not have the daily trading volume encountered in other markets. long retention periods also limit the available basic data necessary for market evaluation. Art market is difficult to measure since private sales are not recorded. In fact, there is no such thing as an art market: The art market is not a homogeneous single structure, but clusters of structures that consist of different markets, and each developing at their own pace. The art market is a general name given to the sum of independent and often different and unique sub-markets that are separated according to their genre, artists, etc. and each segment has unique dynamics. Accessing data for the primary market is very rarely possible, and thus, this type of market data is usually considered to not exist in cultural economics. The data in most studies is based on auctions that take place in the secondary market. The increase of financial elites' capital and their interest in alternative investments and lifestyle opportunities have been a propulsive force in the formation of the base of buyers necessary for the development of the art market. Economists call this the "income elasticity of demand" – as the income level increases, the demand for luxury goods and non-essential products like artworks arises at an amount higher than the income level. The High Net Worth (HNW) and Ultra High Net Worth (UHNW) accredited investors who have begun to emerge at a large volume in the recent years and how they spend their money has been a determining factor for the art market. The root causes for this recent increase in art consumption are the influence of emerging economies, the nature and polarization of wealth, the increasing interest in art as an investment, the parallels by association

between art and fashion with luxury and fame, the effects of globalization, and the internet. The internet usage and the developing FinTech applications in the recent years has lowered the opaqueness of the market, which has begun transforming into a financial trade platform. The emergence of these conditions is rooted in three phenomena: commercialization, globalization, and financialization. In the current day, artworks have begun to become known for their financial identities over their aesthetic value.

The third chapter examined *the emergence of art funds in the historical process, the factors that led to their emergence, the first attempts at art funds, and the British Rail Pension Fund, which is the first accepted institutional example of an art fund in history, and lastly, the formation of contemporary funds.* Peau de L'Ours, an investment club founded at the beginning of the 20th century, is commonly considered pioneering venture for art funds. The fund provided the capital necessary for the purchase of around 100 artworks in a 10-year period, and when its portfolio, whose collection included works from the period's emerging artists like Picasso and Matisse, was liquidated in Paris in 1914, the average sales price of the artworks had gone up four-fold compared to the original purchase prices. The changing balance of power after the Second World War and the conditions created by financialization as a result of the development of capitalism in a globalizing world laid the necessary groundwork for the formation of art funds. Financialization has affected the art markets in three stages. In its first stage, consisting of the 1960-80 period, the development that could be called a turning point was the emergence of the art index, which was an instrument that could be used as a measurement for investment in the art market. The first art fund officially accepted due to its corporate credentials, was the British Rail Pension Fund, which had created an art portfolio consisting of arts and antiques in order to protect themselves against inflation

– a strategy that was common in the UK at the time. Between 1974 and 1980, the fund invested in various asset types such as paintings, sculptures, antique furniture, bronze objects, and jewelry; adding 2400 artworks into its portfolio with an investment of approximately 40 million British pounds which equaled a 3% of its total worth. By 2000, when the whole collection had been liquidated, the total sum of the fund's returns from 1974 to 1999 was 11.3%, which equaled to an annual return of 4% after adjusting for inflation. The fund turned a profit of £168 million when all sales were completed, was in possession of numerous artworks, although the ones that generated profit were the few very high-value artworks. The fund, whose main purpose was not to generate returns on stocks but only to fend off inflation, did achieve its primary goal, which proved that a well selected collection of mainstream art can do much more than be an anchor during inflation. Despite this, it couldn't evade heavy public criticism.

In the late 1980s and early 1990s, the emergence of suppliers that provided systemic data to the market such as Reuters or Bloomberg, was one of the contributions of the information society to financial markets that brought transparency to financial markets. The resulting wave of second-period art investment initiatives brought inspiration for the academic literary study of the art market and its returns. New art institutions and new geographies also entered the market, and famous artists became increasingly more popular. These services have made the art market relatively democratized and rationalized. Structured financing was the transformative wave of the post-1990 third period and resulted in the birth of contemporary funds. Newly established art fund investments were given a new appearance as private equity instead of exchange-traded investment funds. This new structuring introduced art as an important element of any diversified financial portfolio, bringing legitimacy as a financial instrument. The bull market of the 2000s and the ever-increasing prices of art

reinforced the perception that art as a profitable financial investment. The increase in the theoretical reliability of art investment, the development of the alternative investment industry and the increase in the variety of structured solutions being offered by art funds were factors that reinforced the market. Studies in the literature like Mei & Moses art index confirming the merits of art as an alternative investment resulted in the acceptance of art as a profitable and low-risk element of a financial portfolio.

The fourth chapter examined *the concept of investment funds, the types of funds that may have varying structures and names depending on their country's legal system and, art funds in order to lay the groundwork for the later structural analysis of art funds*. Art funds, like other investment funds, are private and open to investors for the purpose of financial gain. They are structured and dedicated to making profits through the acquisition and divestment of artworks. They are managed by a professional investment management company or consulting firm, which receives a management fee and a portion of the returns provided by the fund. Investing in art through an investment fund is a very practical method for those who do not have an art collector's motivations, such as prestige or aesthetic value, and thus do not want to own the artwork itself. It provides advantages such as access to high-quality works, diversification opportunities for the portfolio that cannot be accessed by its individual means, and potential offers of active asset management. Today's established art investment funds are generally structured as private equity or hedge funds and differ from historical examples that have a union or private partnership structure. Art funds aim to securitize the purchase and sale of art in proportion to their shares in the fund to accredited individual and institutional investors. Most are planned as closed-ended investment vehicles with a duration of five to ten years. Unlike stocks or investment funds which have more liquid markets, art funds allow investors to buy up to a certain point whereupon the fund

closes. Shareholder investments are, in a way, locked into fund and can only change hands at certain intervals determined beforehand. These intervals can be quarterly, annual or the period from the launch to the closing date of the fund. Investors usually contribute up to \$250,000, with a minimum of \$100,000. The fund management company will deduct 2% of the invested capital for annual operating expenses based on overhead and operational expenses. In addition, a 20% performance fee is charged on top of the earnings. Art investment funds provide limited access to information about their performance because, similar to hedge funds and private equities, many art investment funds are unregulated and do not have public disclosure requirements. Although these funds, which are also known as passion investments, exhibit great similarities to financial asset funds, it must be noted that a completely different type of special expertise is required to manage them.

The fifth chapter examined *the investment strategies of art funds and the organizational structures and managerial skills that can help achieve their financial goals, through analyses of Fernwood and Fine Art Fund, two prominent examples among the art funds*. Art investment is a goal-oriented and intuitive process that involves buying artworks cheap and selling them the highest premium point while keeping the processing, transportation, storage and insurance costs to a minimum. They generally implement three main investment strategies; "diversified", "region-specific" or "opportunistic" strategies. Most funds are built upon one of these three strategies or a hybrid model. Two American art funds of remarkable importance in the art market, Fernwood and Fine Art Fund, both employ these strategies. *Fernwood Art Investments* was launched with an eye to democratizing art investment. It consisted of two primary funds: the Sector Allocation Fund; wherein the portfolio was divided into eight genres such as Old Masters and Emerging Masters as a diversification strategy, and the

Opportunity Fund, which offered higher-risk but immediately valuable opportunities. The fund closed without notice in 2006 and the founder, Taub was successfully sued on charges of embezzlement, fraud, deliberate and negligent misrepresentation, and abuse of attorney duty. This end to one of the prominent and profitable examples of its kind, caused considerable damage to the sector. The Fine Art Fund (FAF) launched its activities in 2004. It was the first fund with a minimum investment prerequisite of \$250,000. The fund's initial portfolio included 80 artworks. The fund began forming different portfolios and strategies and started concentrating on certain regions and genres as well as opportunities such as distress sales as it progressed. Each fund typically had between 30 and 40 clients who invested between \$250,000 and \$7 million. The fund began distributing profits from its first fund to its investors in 2009 with a net annual return of about 5% in 2015 when the sales had been completed. In 2018, the fund's investment volume exceeded \$500 million, and it had maintained its structure consisting of eight funds, ostensibly making it one of the few very successful examples that have been active for such a long period, but there is no clear evidence as to the profitability of the funds it manages. According to Hoffman, long-term capital and resilience are the main strengths behind its success. In 2005, after having announced its art consultancy services and that it would establish a fund-of-funds, ABN AMRO terminated both ventures before a year had passed and that had a negative impact on the art funds market.

The sixth chapter examined *differently structured examples of art funds from different geographies, their weaknesses and strengths with regard to the art market and art funds, as well as potential threats and opportunities*. As art funds do not have record-keeping obligations and do not operate publicly, it is not possible to estimate their number. It is only possible to assess the art fund market in light of the data

presented and it is difficult to know the details about most small-scale funds. Due to limited data and the absence of information about performance, sometimes it may not even be possible to determine whether a fund is already in progress.

According to the "Art and Finance Report 2019" from Deloitte & ArtTactic (2020), "trust" and "transparency" are highlighted as two key points in front of the financial growth of the art market. The threat and risk factors related to art market are; originality, lack of provenance, fraud and attribution, insufficient transparency, price manipulations and anti-competitive behaviors, registration or originality inadequacy of the determining qualities, lack of art market professional's qualifications at international standards, money laundering, undisclosed conflicts of interest, hidden commissions, insider dealing, buyer-seller confidentiality, auction guarantees, etc. A shift towards developing specialization and opportunistic investment strategies are necessary revisions to ensure resilience in the face of competitive conditions in the art investment industry. New technologies and data-driven business models are expected to reduce information asymmetry and increase transparency

UHNW individuals' assets related to art and collection products have been estimated to have reached \$1,448 billion as of 2020. The sector which provides services related to the safe-keeping, development and support of these products, as well as its profitability, are expected to gradually expand. It is predicted that the importance of online sales channels for retail sectors will increase in the near future. The growth will be possible through strategic partnerships between asset managers and art professionals, as well as the proliferation of suppliers who provide services at the intersection of technology and art. Over the past decade, the scope of art and asset management services has evolved away from an investment-oriented client strategy to a more holistic perspective. With the COVID-19 pandemic accelerating digitalization

like a catalyst, data-supported new generation solutions and digital skills come to the fore. Technology-oriented art and new generation management strategies are important in order to appeal to young collectors who stand out as the rising value of asset management. One of the main determinants of innovation and change in the art and asset markets is technology. There will always be great opportunities in the growing art market on a global scale for art funds that understand well the structure of the sector and can adapt to changes.

In conclusion:

In the light of the data presented by this research, the question of whether art funds are a big risk or a great opportunity will undoubtedly be shaped under the current regulations by fund managers' commitment to ethical values even if they have solid credentials and a good track record. As long as art and finance remain powerful lodestones for current day people who spend their lives in pursuit of prestige, power and reputation; art funds will continue to create opportunities by adapting innovative technologies and by distributing shares to its base at ever-diminishing rates, or in other words, in democratized form.

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