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Future Returns: Art Funds Draw Few Investors, But Some Are Worth a Look

By Abby Schultz April 23, 2019 11:44 a.m. ET

Guests attend the Art Basel Miami Beach VIP preview at the Miami Beach Convention Center in December 2018. *GETTY IMAGES*

The global art market has been trending upward over the past six years thanks to healthy auction and dealer sales, but the same can't be said for art investment funds.

Despite the potential for strong returns and low correlation to the stock market, global art funds have been struggling to attract investor interest. Assets in these funds slid steadily from a peak US$2.1 billion in 2012 to US$830 million in 2017. Given global uncertainties ranging from Brexit to U.S. trade tensions with China, little change is anticipated to be reflected in asset trends once more recent data becomes available.

But a fresh look at art funds is warranted, says Enrique Liberman, founder of the Art Fund Association and managing partner of Liberman Canna, a New York law firm. "The industry has been changing a lot due to lessons learned."

Art Funds Are Still Young

Art funds are private investments available to accredited investors for minimums ranging from US$500,000 to US$1 million. There are no public disclosure requirements, so it isn't known how many exist globally. Deloitte, a global financial services and consulting firm, estimates that at there were about 90 funds at their peak in 2012. By 2014, there were fewer than 60. Given the continued loss of assets since then, it's likely there are even fewer now.

Yet as an asset class, art funds are young. They only started cropping up shortly before the 2008 global financial crisis. Managers are still grappling with how to structure them to help investors overcome major concerns.

Lack of regulation, limited transparency into the performance of existing funds, and the inability to track performance of underlying assets are some of the major reasons investors are hesitant to use art funds more broadly, according to Deloitte.When the first art funds were launched, they aimed to attract a large investor base. While disclosing general strategies—such as which art genre would be in the portfolio—they avoided identifying specific investment prospects.

But managers discovered it was difficult to raise money for intangible assets whose value couldn't be tracked on a regular basis, especially if they didn't know, up front, specifically what artwork the portfolio would be buying.

Problem Solving

Some managers have tried to address this. Rather than trying to raise up-front capital to be drawn upon for future purchases of art, some now drum up interest among investors for buying specifics pieces.

To enable this, these funds are set up as so-called series limited liability companies that allow investments in particular underlying assets, rather than in the LLC itself. So managers can have different investors in each artwork within the LLC.

"If you have 10 members of an investment group for a fund, only five might be invested in one piece, and five in another piece," Liberman says. "Some collectors love certain artists and others they don't like, so this is a way for investors to not just write a blank check for whatever art the manager wants to buy."

Other managers are addressing investor concerns about transparency by making performance data more accessible. Among funds sharing data is the Tiroche DeLeon Collection, a closed-end fund based in Gibraltar that debuted in 2012 and focuses on contemporary art in emerging markets. The fund publishes detailed quarterly performance reports on its website.

Closed-end funds require a specific end date at which investors will realize a potential return. The Artemundi Global Fund has been a model for success of this structure. Spanning 2010 to 2015, the Artemundi fund's diversified portfolio of fine art delivered a 17% average annual return.

What to Know Before Investing

When doing due diligence, interested investors should make sure the manager's fees are on the lower side and align with their interests, Liberman says. Fees generally run between 1% and 3%, plus 20% of profits—but be sure that it is 20% of realized profits, rather than increases in the net asset value of the fund, he adds. “Until something is sold, you don’t actually know what it’s worth.”

Art funds can be a great portfolio diversifier, but consider that the correlation to stocks varies by art genre. “If you’re looking at impressionist and modern works of art, they’re not so correlated. But post war contemporary—that is highly correlated to the market,” Liberman says.

If the unique risks of art funds are daunting, keep in mind that an art fund also has some unique opportunities. “The reason why to invest in an art fund in part is that these markets have information disparities that don’t exist in regular investment markets,” Liberman says. “There isn’t a Securities and Exchange Commission requiring all information has to be disclosed to investors at the same time. There are specialists who have access and opportunity that other people don’t have.” If you invest wisely, he says, potential returns can be substantial.