

## First Class Jacquie Hayes

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# Art collecting is about passion, not dollars

A recent mini-renovation in my home has left me with vast expanses of white wall that could do with some adornment. Another large-format Dale Frank might be nice, possibly in monochromatic green. Then again, a pair of paintings from Victoria Reichelt would work too, particularly if drawn from her photo-perfect renditions of book-related themes.

An early adopter of her work, I was delighted by Reichelt's recent Sulman Prize win at the Art Gallery of NSW, though I couldn't care less about the effect it might have on my painting's value. I bought it because I love it, and I'm not selling.

So perhaps it's time to step out of my comfort zone into something completely different but with a view to future investment prospects with a "mid-career" artist like Bill Sampson. I was introduced to his work recently when a friend generously donated a piece from his latest collection to a fund-raising event at my children's school. So I had to check it out.

MARS Gallery in Port Melbourne played host to Sampson's most recent exhibition from which the donated painting was drawn.

MARS director and new-talent "diviner" Andy Dinan says Sampson and similar peers are among a small segment of the Australian art market that are seeing serious appreciation in what people are prepared to pay for their work. When she started out eight years ago, their paintings went for \$2000. Now \$8000 is more common.

"Every time we show Sampson's work, the prices go up 20, 30 per cent, and now he's starting to appear on the secondary [auction] market along with other mid-career artists like Jeremy Kibel, Hazel Dooney and Samuel Tupou," Dinan says.

These are exactly the people that she started her gallery to support, she says.

"There was a lack of mid-career support for artists because so many auction houses push – and collectors buy – autographs" to ensure their status," she says.

"I'm not interested in that sector of the market – the [John] Bracks, [Charles] Blackmans, [Ben] Quilts – and I'm not particularly interested in people who collect autographs. If you've got enough money, anyone can do that."

Being an artist has been tough lately. Cameron Menzies, head of art for Lawson Menzies Art Auctioneers, says art demand is down overall on the boom years of 2006 and 2007.

"If you were charting the actual price [of works] in 2013 versus 2007 ... the best artist would be down 15-20 per cent. At the extreme end, there would be artists bringing 60 to 70 per cent less," Menzies says.

The auction market, he says, is dictated by the three "Ds" – death, debt and divorce. He could well add "demand", which has been off since the global financial crisis.

What many believe has caused the most long-term damage has been federal government changes to the rules about how art investments must



Victoria Reichelt's 2013 Sir John Sulman Prize-winning work, *After (books)*. PHOTO: IMAGE COURTESY OF THE ARTIST AND DIANNE TANZER GALLERY + PROJECTS.

be treated in superannuation.

"The Cooper inquiry attacked the whole arts industry on the basis that it was a rich-man's play area," says Tom Lowenstein, head of Melbourne-based specialist arts-focused accounting firm Lowenstein's Art Management.

In adopting some of its recommendations, the Tax Office "penalised a lot of people for the potential actions of a few, resulting in the closure of at least 30 galleries and the consolidation of many others".

"This started as a GFC thing but the global art world has recovered. We

*The auction market, he says, is dictated by the three "Ds" – death, debt and divorce.*

haven't in Australia," Lowenstein says.

It all started, he says, back in 2007 when many DIY super funds were cash-heavy, having taken advantage of a window to invest up to \$1 million into the tax-advantaged retirement savings vehicle.

About then, he estimates SMSFs poured about \$100 million into art. The flow stopped once the selective Cooper Review recommendations – which were mainly administrative but costly for SMSF trustees – were adopted. Uncertainty, it seems, can quash enthusiasm.

Which brings me back to my blank wall. In dressing it, did I seek a healthy investment return or aesthetic pleasure? Or could I have both?

There are three types of people

who buy art, apparently: passionate collectors interested in acquiring art for art's sake; those drawn to it as an investment after seeing the growth in value and recognition of art as something to hold; and those who entered the market in the mid-2000s after seeing record prices achieved at auction for individual artists' work in the hope of profiting from them.

Not surprisingly, the last two types of buyers have vanished.

"As an art adviser I don't think I could advise anyone to buy art in their SMSF today," he says.

"It's too full of administrative hurdles not worth bothering with, so they might as well buy it in their own name."

If the work is something one hopes to hand down to future generations, there are tax advantages in holding it in a discretionary family trust which enables ownership to continue from one generation to the next without triggering capital gains tax.

Where money's no issue and kudos is valuable, there are also generous benefits in giving artworks to institutions under the Federal Cultural Gifts Program.

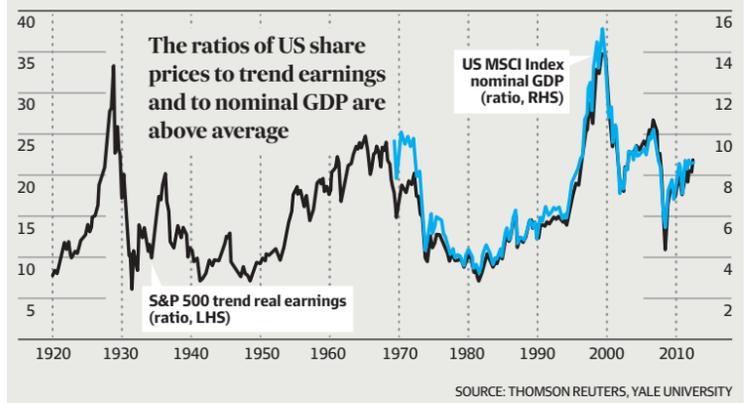
These days, says Menzies, most people are in the market because they love collecting. Those people, says MARS Gallery's Dinan, should buy with their eyes and their hearts.

Dinan's maxims for those starting a collection are: "Don't rush: the more you look, the more you will see" and "Follow the now rather than the autographs".

Which sends me back to the drawing board, so to speak, with my large blank wall. It will remain a work in progress for some time, I suspect.

## Too high?

US share market valuations



SOURCE: THOMSON REUTERS, YALE UNIVERSITY

## This time is different – heard that before?

Bassanese



David Bassanese

Among the more dangerous notions that investors may encounter when grappling with financial markets is that "this time is different".

After a very strong run in a certain financial asset class, fundamentals often give way to what former Federal Reserve Chairman Alan Greenspan once described as "irrational exuberance" – or bubble-like conditions fuelled by trend-followers jumping on the bandwagon.

But even as prices for a favoured investment move well beyond that justified by traditional valuation metrics, there are always a few quick to claim old rules no longer apply, such as – you've guessed it – this time is different.

I've recently argued that such irrational exuberance appears to have gripped the gold market in recent years. But what about one of the other more important financial asset classes in the global economy – the US stockmarket? US stocks have also increased strongly in recent years, even in the face of what has been fairly sluggish US economic growth.

The good news is that from a short-run valuation perspective, the US market does not appear overly stretched. The US S&P 500's price to forward-earnings ratio is about 13.5, which is a touch below its decade average of 14. Considering 10-year US government bond yields are only 1.8 per cent – or about half their decade average of 3.6 per cent – the equity market seems fairly valued in outright terms and quite cheap relative to bonds and cash.

US corporate earnings, moreover, are still holding up fairly well – although overly bullish earnings growth expectations for 2012 and 2013 have been scaled back somewhat over the past year.

After growing by 45 per cent and 15 per cent respectively in 2010 and 2011 as America recovered from recession, US corporate earnings earlier last year were expected to grow 9 per cent and 12 per cent respectively in 2012 and 2013.

According to Thomson Reuters estimates, however, analysts now expect earnings to grow by only 6 per cent and 7.5 per cent in these years. That's still reasonably good growth, although we can't rule out further earnings downgrades as the upswing of the earnings cycle matures.

But based on present earnings expectations, the market's measure of "forward earnings" would grow by 7 per cent over the remainder of this year, and 10 per cent next year. Unless the PE ratio can lift a lot further,

modest 7 to 10 per cent annual equity price growth – broadly in line with earnings growth – might be a reasonable expectation over the next two years.

And those wanting to be bullish might note there's scope for the PE ratio to rise to above-average levels if bond yields remains stuck at quite low levels.

So far so good, but here's the challenge – interest rates could rise and earnings could disappoint. Of these two, the lesser concern is interest rates. After all, US bond yields are unsustainably low and should eventually rise as the US economy gains traction.

The fact the US equity market is only at fair value (based on short-run valuation metrics) – and very cheap compared to bonds – suggests the market is not yet overly reliant on artificially low interest rates staying around.

To my mind, the bigger issue is the sustainability of the earnings recovery. Over the past century, real US corporate earnings growth has been about 2 per cent a year.

Despite America's three recessions since 1990, trend growth in real earnings has been much stronger than 2 per cent in recent decades – such that earnings are now above their longer-run trend. Ominously, this was last evident in the three years to 2007.

The question is whether the period of exceptionally strong US earnings growth, which is evident by the US corporate profit margin at historically high levels, soon requires a correction back to its long-run trend. If earnings can continue at a higher trend path, the US market looks in good shape – and some argue this is possible due to globalisation and the rising share of US profits earned in foreign markets. But if earnings eventually need to return to trend, the US market is 20 to 30 per cent over valued.

Indeed, the market's price to reported earnings ratio is about 17 – or just above its century average of 16. But relative to long-run trend earnings, which are 20 per cent below present earnings, the market's PE ratio is a much higher 22.

Even if we look at the averages for the past 40 years alone, US equity prices are 30 per cent above trend reported earnings and 20 per cent above nominal national output respectively.

All up, while I'm comfortable with the US market over the next year or so, I'm less confident returns will be strong on a five-to-10-year basis, which no doubt has implications for our market.

Of course, I could be wrong about the longer term outlook.

But it would require believing that this time is different.