The curious case of Art Investment Funds

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Abstract

The purpose of this research is to create more transparency regarding Art Investment Funds. Although many Art Investment Funds operate very differently from each other, a thorough research did allow for formulating two models on common features among them. The first model depicts the structure and involved parties and the second model portrays several aspects common to the operation of Art Investment Funds. These models were compared on similarities and differences to Traditional Investment Funds. Findings show that for the operation of Art Investment Funds many more parties and aspects are involved. Furthermore, a case study was executed in order to test the two models for reliability and applicability. Subsequently, a model on involved parties regarding the case was generated which showed many similarities to the first model formed in the data analysis. Although this research provides one step forward in increasing transparency regarding the world of Art Investment Funds, there are many aspects still left to research, such as the effect of tax regulations and the possible factors for success.

Table of contents pages

1. Introduction

How is it possible that in a world, characterized by uncertainty, vagueness and secrecy, millions of dollars are invested? When there is a lack of track records, one would assume that people are hesitant to invest. The contrary is true; Art Investment Funds are popping up, raising millions of dollars as investment capital.

Art Investment Funds (AIFs) can be defined as privately offered investment funds that aim at generating financial returns through the buying and selling of art works (FAMW, 2010). The monetary advantages of art markets seem to have always been a bit disregarded. Art works are usually associated with aesthetic and social values. When art works are bought, it is mostly because buyers find it beautiful and not because it might yield increased financial returns in the future. Still, although the monetary value might not always have been a priority of buyers, it is something that they are aware of and have always kept in mind (podcast Green & Horowitz, 2011). Although AIFs are careful with emphasizing the monetary return of art works, as this still might be regarded as blunt and unethical, it is their primary objective.

The ways in which they try to achieve this objective are various, depending on their strategy and structure. Moreover, as one would already assume, their biggest challenge remains operating in two assumed opposing markets. Velthuis (2002) states that art markets are divided into two *circuits*. The *art world circuit*, where cultural capital is of main importance and is characterized by inefficiency, illiquidity and lack of regulation. While in the *financial circuit*, of which AIFs take part, economic capital is of main importance and is characterized by clear structures, transparency and regulations. Although AIFs might be classified under the financial circuit, their main occupation is still in the art world circuit. The consequent contradictions might present AIFs with high risks and costs. However, at the same time it could present them with extreme advantages, when the right expertise is applied.

Unfortunately but not unexpectedly, AIFs are commonly very secretive about their business. Although most of the AIFs do not enjoy the benefit of a solid track record, they portray themselves with much confidence and will easily require a minimum of € 100 000 as initial investment. A possible reason for this high minimum investment is that AIFs pool money from investors in order to gain access to purchasing reputable and expensive art works. Still, it is remarkable for a business, which is regarded as highly risky and with no undisputed proof of success, to start at such a high minimum investment.

Consequently, the question prevails how it is possible that millions of dollars are invested in these AIFs? What do they offer investors that will make them say ‘yes’? Considering the

AIFs themselves, what is in it for them? When comparing them to Traditional Investment Funds (TIFs; which focus on securities, warranties, stocks and bonds. Retrieved June 19, 2012, from www. investorwords.com), one can already imagine that many more costs, risks and management tasks are involved for the functioning of AIFs, as they actually buy and sell real assets. Moreover, these are real assets as in art works, which strongly deal with issues of valuation.

Even more astonishing is the limited research performed on this topic (Arnold, 2008). If it is a million dollar business, how come that there is so little known about the operations and structure?

The aim of this research is to gain more insights regarding the functioning and structure of AIFs. The paper will start with discussing the basic characteristics of the markets AIFs deal with, as this probably affects the operation and structure of AIFs. Moreover, with the information on nineteen AIFs, general conclusions are formed regarding the topics of internal structure, operations, strategies and several other fascinating aspects (risks, reasons, management tasks and costs).

The thesis is structured in such a way, that all the discussed topics are actually the building blocks which will eventually form the foundation for the two concluding models on related parties and aspects. More specifically, Model 1 will address the structure and related parties regarding AIFs. This model will increase our understanding of parties necessary for the operation of AIFs. What might be even more interesting is the comparison made between AIFs and Traditional Investment Funds. When putting the aspects related to both sorts of funds in a visual model, one will be able to detect at a glance what parties are needed in addition for the functioning of AIFs. Model 2 provides insights regarding the four important aspects of risks, costs, management tasks and reasons for investing. Model 2 is, as well as Model 1, compared to Traditional Investment Funds. So, one can immediately notice what kind of additional risks, costs, management tasks, as well as reasons for investing, AIFs carry. In addition, a case study is done to test the two models for reliability and validity.

Moreover, besides the final objective of creating the two models in order to gain more insights on the functioning and structure of AIFs, there are three main questions which are continuously kept in mind during the conduction of the research. These concern the investors perspective: why would investors want to get involved in this relatively risky business? The AIFs' perspective: why are AIFs launched when they carry many additional (compared to

TIFs) risks, costs and management tasks? Finally, why do investors choose for investing in AIFs instead of approaching an art dealer or gallery directly?

2. Literature review

Section 1. Art markets in general

1. Introduction

As art markets are certainly of importance to AIFs, it is of primary concern that the basics of art markets are defined and well understood. Moreover, as the topic of AIFs is clearly related to financial markets as well, the occurring similarities and dissimilarities will be continuously discussed. In addition, the characteristics of art works will also be reviewed as it is important to be aware of the goods underlying your investment.

2. Art markets characteristics

2.1. Asymmetric information

In the standard international market situation, the producer supplies goods and/or services in order to yield revenue, and the consumer has access to sufficient information to value the price of the good/service (Plattner, 1998). However, art markets are characterized by informational asymmetries (Baumol, 1986; Coffman, 1991; Horowitz, 2010; Marmarbachi, Day, & Favato, 2008; among others). The phenomenon of asymmetrical information has been studied by Akerlof (1970) identifying it as the case where sellers possess more knowledge on the assets than the buyers or the other way around.

Asymmetric information also affects the financial capital structure among others in art markets (Plattner, 1998). The price for stock is a common known fact, while the price for an art work is often only known by the parties directly involved (Baumol, 1986).

Asymmetric information always causes someone to lose. In the case where the seller has more information about the asset, he will never lose as he is aware of its value. However, when the buyer is more knowledgeable about the asset, the seller probably undervalues the asset and the buyer generates a profit if they resell (Plattner, 1998). Therefore, the existence of asymmetries should not be regarded as something negative. Asymmetries allow for bargains and above normal returns to happen (Coffman, 1991). Moreover, combining asymmetries with expertise and making sure that you are the one with extensive knowledge, is something of which AIFs make use (Horowitz, 2010).

2.2. Liquidity

While in general transactions in international financial markets occur on a frequent basis, the resale of a particular art work is not assured (Baumol, 1986). An art work might even be withdrawn from art markets for example when a museum buys it to complete their collection. This infrequent occurrence of transactions leads to a low liquidity in art markets. When a market has a high liquidity, it indicates that an asset is easily sold at any time without any significant movement in price and a minimum loss of value. As art markets are characterized by low liquidity (Mei & Moses, 2002), the price might fluctuate over time and an added or loss in value occurs.

2.3. Heterogeneity & imperfect substitutes

Art markets are identified to be heterogeneous, where art works are chosen on the basis of their characteristics (Frey & Pommerehne, 1989). Sold goods are heterogeneous, unique and inherently not substitutable. Even two paintings on the same subject by the same painter are imperfect substitutes (Baumol, 1986). Stocks and securities on the other hand are homogeneous and are perfectly substitutable. The level heterogeneity and substitutability has consequences for its liquidity and subsequently, for the level of risk involved.

The high level of heterogeneity in art markets implies difficulty in establishing a liable price index, as the price of an art work might only be established when comparing the price at two different points in time (Candela & Scorcu, 1997). On the other hand, the price of an art work might also be established when identifying several dimensions of the work itself, such as size, artist, medium, etc. (Knebel, 2007). However, the methods of pricing will be shortly highlighted in section 1, part 5.

2.4. Transaction costs

Of significant importance are the transactions costs in art dealings. Commissions among ten to thirty per cent are paid by seller and buyer to auction houses. These commissions are considerably higher than commissions paid in financial markets (Frey & Eichenberger, 1995). Paying high commissions can be seen as a proof of lack of liquidity and an imperfect market. As the uncertainty exists of reselling an art work for the same or an increased price, charged commissions are high. Moreover, the costs of transaction as well as the costs of insurance and handling costs differ substantially among countries.

2.5. Segmentation

Art markets are characterized by high segmentation. Art objects range from paintings and sculptures to furniture and ceramics. Thereby, the different styles broadly array from Cubism and Impressionism to Contemporary and Surrealism. This high degree of art market segmentation leads to a high degree of product differentiation (Bates, 1983).

3. Supply

Another fact by which art markets are different from financial markets, is that the supply is fixed (Frey & Pommerehne, 1989; Horvitz, 2009). Each art work is unique and never identical[1]. Especially on the short term, one could say that supply is inelastic as it takes generally three to six months to market an art work (ensuring its acceptance by the auction house, have it photographed, published in catalogues, etc.) (Frey & Eichenberger, 1995). Another fact, which makes the supply fixed, is when the artist is dead. From that moment on, the supply of his/her art works is fixed, as no more can be produced (Frey & Pommerehne, 1989).

However, the supply of art works is not always a stable factor and can change due to various causes. When the artists is not dead, and still produces art works, the supply increases (Frey & Pommerehne, 1989). Moreover, when a museum decides to sell a collection of a certain artist, supply will also temporarily increase. A last mentioned increasing effect is, when the art works concern prints or photographs, and it is possible to make exact and identical copies (see footnote). On the other hand, supply can also decrease. Suppliers (artists themselves, collectors, galleries) may hold on to their works for a long time. Works can be damaged or destroyed. Or works become part of a museum collection and are not resold (Horvitz, 2009). Moreover, a negative change in attribution; when an art work is revealed to be a fake or forgery, decreases supply (Frey & Pommerehne, 1989).

Supply is one of the most important factors to consider for AIFs. As it determines its rarity and scarcity and consequently, as economics will explain, the price. However, basic economics explains that price is not only determined by supply, but also by demand (Marmarbachi et al., 2008).

4. Demand

As the characteristics of art markets are discussed and compared with financial markets, it does not portray an overwhelming positive picture for the arts. Performance and returns are easier to measure in financial markets than in art markets. Art markets are characterized by asymmetries in information, high illiquidity, heterogeneity and transaction costs, which form

[1] Prints excluded (see Pesando, 1993), photographs exluded (Pompe, 1996).

major constraints on demand for art works. Subsequently, investing in art includes taking major risks as concluded by many researchers (Frey & Eichenberger, 1995; Frey & Pommerehne, 1989; Grace, 2010). Therefore, the financial markets might be a more reliable and secure option when making investments. Subsequently, one might wonder why art is bought, especially when taking an investor's perspective in mind. Adjustments in demand are often a consequence of changes in perception and taste, including the reordering of intentions among collectors and museums (Horvitz, 2009). Moreover, Marmarbachi, et al., (2008) drew a similarity between art goods and luxury goods; when there is a limited supply, this will contribute to a higher value. Thereby, indicators such as the presence of substitutes, pricing, accessibility, changes in income and taste suggest an inelastic demand curve over the period of 1998-2008. While some may argue that demand always occurs in cycles (Ewen, 2007), others argue that art markets have a stable demand, mainly as a consequence of the 'wealth-effect' and 'economic-crisis'-effect, which will be discussed in the next section.

4.1. The 'Wealth'- effect

In the U.S, after the World War II, the number of art dealers rapidly expanded due to the country's immense growth in wealth (Plattner, 1998). The post-war increased wealth experienced by companies permitted them to spend some of their wealth on art collections. Starting from the 1960s, all sorts of companies started to collect art progressively (Martorella, 1990). The increased interest and demand for arts was evidently related to the boosting wealth of the U.S. economy (Plattner, 1998).

The effect of wealth on demand for art over the long-term was also identified by Goetzmann (1993). He constructed an art return index over the period 1715-1986 which allowed him to relate fluctuations of painting prices to changes in the stock-market. He founded a positive relationship between art and the stock market on the short term, which has been confirmed by many researchers (Bryan, 1985; Chanel, Gérard-Varet & Ginsburgh, 1990; Singer, 1990). He also mentions the stylistic risk, which he refers to as the risk of the price dependency upon the number of people who prefer to obtain a work of art and the level of wealth the individuals are enjoying. The level of wealth, which can be related to income, has a positive effect on demand for art works (Horowitz, 2010; McAndrew, 2008). McAndrew (2009) found that a country with an accumulating national income has a greater consumption pattern, and more luxury goods are consumed as wealth increases. In addition, the emergence of art markets in developing countries is a consequence of growth in wealth (McAndrew, 2009).

The demand for art (as investment) can also be related to the emergence of the ‘new buyers’ group, the High Net Worth Individuals (HNWIs). HNWIs, defined in the private banking world as individuals who have at least one million US dollars in investable assets, can be regarded as a group with a constant demand for art works. This new generation of ‘global shoppers’ is not regarded as connoisseurs of the art, neither possess the knowledge nor experience, but do own a considerable amount of money and buy art for several reasons ranging from investment to fashion, from prestige to nationalism (McAndrew, 2008). Noticing from previous periods of recession, is that HNWIs (especially ultra-HNWIs) are not so much affected by economic downturns. Ultra- HNWIs are in possession of such a large amount of money that even if they lose some, there is still much left. Moreover, the increasing number of HNWIs from countries such as India and China impose a stable demand for art works (McAndrew, 2009). So, investments and purchases of art should remain comparatively more immune to a recession than other financial assets would (McAndrew, 2009). This assumption is validated by Petterson & Williams (2009), who found that for all the segments in the art markets there is evidence of a positive relation between HNWIs’ wealth growth and demand for art.

4.2. The ‘Economic-Crisis’ – effect

The ‘Economic-Crisis’-effect suggest the opposite of the ‘Wealth’-effect. During an economic crisis or recession, the level of wealth decreases and consequently, one would think that the demand for art works will decrease as well.

However, the opposite might be true. It is argued that in case of financial instability the purchase of art works with their inherent tangibility might become a relatively more interesting investment. Tangibility makes people feel more secure, that they have something to hold on to, something real. Moreover, art works contain inherently aesthetic and non-monetary values, which always remain even when financial values fall (McAndrew, 2009). Therefore, a crisis in the international market does not necessarily indicate a crisis in art markets (Grace, 2010).

The relationship between the state of the economy and art was firstly reviewed by R. Lopez (Ammannati, 2010). The Lopez-Thesis states the fact that the Italian economy was extremely prosperous during the 13th century and not so much during the Renaissance, and that the good economic conditions of the 13th century had not delivered any noteworthy artistic achievements. Lopez suggested that investments in culture are more stimulated in times of economic depression, than in times of economic wealth (Lopez, 1969). He reasoned that during a prosperous economic period, people invest in lucrative businesses and industrial production; only in periods of recession and depression, when financial businesses, land and trade are not gainful, one will invest in assets such as art and architecture (Ammannati, 2010).

When considering the statement by several researchers (Frey & Pommerehne, 1989; Horowitz, 2010 ; McAndrew, 2008) that art markets for paintings do not or have a low correlation with international financial markets, suggests that the demand for art might even increase during a financial recession. As when including it in your investment portfolio, your art assets correlate minimally with financial assets and therefore, including them would be an attractive option. This effect is also defined by McAndrew (2008) as the 'substitution effect', where the low correlation of art markets with the financial indices initiates the consideration of art as alternative investment to diversify risk.

Moreover, as of 2008, the financial crisis was not felt by everyone around the world. Asian buyers and Asian art proved to attain a relatively low susceptibility for the effects of the financial crisis as the level of demand remained stable (Grace, 2010). McAndrew (2008) adds that the increasing number of collectors from emerging economies will secure a stable demand for art and shield art markets from recessive forces.

4.3. Other

In addition, while considering wealth and the economy as having a serious effect on demand, the importance of tax efficiencies, regulatory frameworks, governmental and cultural policies and infrastructure should not be overlooked (McAndrew, 2008).

During the beginning of the 1900s, France experienced a decline in their art market (McAndrew, 2009). The Wall Street crash and a strong devaluation of the French franc created a shift of power to the American and British markets, where economic power remained. However, in the 1960s, while London and New York still prevailed as art capitals, France experienced a revival due to a changes in their tax system and regulatory frameworks, which stimulated the buying and selling of art works. Moreover, beneficial tax systems were also noticed by the Japanese during the late 1980s. Thereby, the Yen appreciated immensely against the dollar, which caused a strong demand for mainly Impressionist and post-Impressionist sectors. From these two examples, it is evident that when establishing demand for art works, one should consider the effect of these factors as well.

5. Art prices

As the underlying goods of AIFs are art works, the establishment of price is extremely important to consider when evaluating the financial performance. As art works are said to be heterogeneous, illiquid and unique, the construction of its price is difficult.

However, there are several methods to determine the price, each of which take a different approach for the establishment of price. Despite the difficulties and limitations, the construction of a price index is necessary in order to establish an art work's financial performance and to detect general trends on the art markets (Ashenfelter & Graddy, 2006; Ginsburgh, Mei, & Moses, 2006). Moreover, one must be aware, when interpreting research on the return of art investments, of the limitations of methods regarding price establishments. The two mostly employed methods are the repeat-sales regression and the hedonic approach (Collins, Scorcu, & Zanola, 2009), which will be highlighted with an additional discussion of the risks and advantages of employing these two methods.

5.1. Repeat – sales regression

Bailey, Muth, & Nourse (1963) first published an article on the repeat-sales regression method to establish a price index for real estate construction. Although they found that price establishment due to quality differences is difficult. However, they also found that these difficulties can be largely overcome by founding an index on sales prices of the same property at several points in time. A large proportion of the difficulties encountered when having to specify and measure the many quality characteristics, can be eluded by founding a price index on sales prices of identical properties at various times. Although the repeat-sales regression has been frequently employed to approximate a price index of real-estate (Bailey et al., 1963; Case & Schiller, 1987; Goetzmann, 1992). Anderson (1974) and Goetzmann (1991) employ this method as one of the first to art markets.

Moreover, Gérard-Varet (1995) also introduces the repeat-sales regression method as a major methodology, which considers art works that have been sold at least twice in a particular period, to calculate an index, by regressing the alteration in price of each art work on a determined bundle of dummy variables. In general, the repeat-sales regression method determines the price of an asset sold at least twice and is an appealing method employ in art markets as it identifies how specific works increase or decrease in price over time (Horowitz, 2010). In addition, Goetzmann (1993) explains the repeat-sales regression as taking into account the purchase and sales price of individual assets to determine the changes in value of an indicative asset over a specific time period.

To conclude, the very basic form of the repeat-sales regression method is portrayed as this:

ritt' = - *bt* + *bt'* + *uitt'* Where ritt' is the ration of the final sales price in period *t'* to the first sales price in period t for the i-th pair of selling with the first and final sales in these two periods. *bt* and *bt'* are the true but unidentified indexes for period t and *t'*, respectively, where t = 0,1, . . . , T – 1, and t' = 1, . . . , T. *uitt'* represent the residuals (Bailey et al., 1963).

The advantage of the repeat-sales method is that, unlike the hedonic price method, where the importance of several characteristics needs to be determined but can never be established for certain, it focuses on art works that have been sold at least twice to estimate an index and addresses the change in price of each art work including a group of dummy variables (Bailey et al., 1963). Moreover, Goetzmann (1993) indicates that the induced price index is founded on gross investor returns and is not subject to different specifications as the hedonic price method is.

A limitation of the repeat-sales method is that much available data is not used (Ashenfelter & Graddy, 2006) and that information on single transactions is dismissed (Chanel et al., 1996). More than one sale is required in order to determine the time index. Additionally, as considering only repeat-sales, the method limits itself to a small group of art trade (Horowitz, 2010). This limitation to only re-sales, indicates an utmost decrease of the data base, which lead to a data base that is too small and subsequently, a generalization of the result is no longer attainable (Holub, Hutter, & Tappeiner, 1993). Holub et al. (1993) add that when there is a relatively large time period between two sales, such as twenty years, the relatively new art works are left out on principle. Moreover, the imposed homogeneity in the repeat-sales method assumes that a deterioration or damage of the art work has not taken place (Horowitz, 2010).

Horowitz (2010) commented that one of the limitations of the repeat-sales method is that it offers an imposing upward bias when assuming the seller will only sell his painting when he detects that the perceived value of the art work has increased. Additionally, one cannot eliminate the possibility of selection bias when employing only re-sales. It is often the case that at auctions only 'good' works show up (Chanel et al., 1996). An additional problem relating to the showing of only 'good' works on auctions, is that many of these 'good' works are bought by museums and will never appear at auction in repeat-sales data (Ashenfelter & Graddy, 2006).

5.2. The hedonic approach

Andrew Court, a pioneer on the hedonic price analysis in 1939 (Goodman, 1998), wrote groundbreaking work on establishing the hedonic pricing method, which treats problems of nonlinearity and with alterations in implicit good bundles.

The research done on the hedonic approach has been widely reviewed by many (Gorden, 1973; Griliches, 1971; Muellbauer, 1972; Ohta, 1973, Rosen; 1973). During the time of the method's development, it has been positively received by real estate and consumer product research and, lately, by art markets. Art works are featured by identifiable variables, which are required for the hedonic method. Moreover, art markets are prone to using the hedonic price method.

In general, the hedonic technique is applied to correct for heterogeneity in quality (Yu & Ive, 2008). The heterogeneity of assets is accounted for in the model and the performance of an assembling of unique goods founded on common characteristics is measured (Horowitz, 2010). The hedonic price index assumes that people value a good for its several dimensions and characteristics. Consequently, goods can be regarded as a package of characteristics and their value is the accumulated sum of the value given to the individual characteristic separately. The hedonic function cites the correlation between the price of the good and the underlying prices of the various characteristics included in the good (Yu & Ive, 2008). It performs a disaggregation of a commodity and a pricing of the characteristics enables a concept of price indexes and the measurement of price alterations across various versions of the same commodity (Ohta & Griliches, 1976). If a level of presence of a particular characteristic can be measured, a regression technique is generally employed to approximate a hedonic function of the good, using historical data.

Because of the heterogeneous aspect of art works, the hedonic price method offers the opportunity to control for the differences between art works (Gatzlaff & Haurin, 1997). Constructing art price indices using a hedonic model is based on the assumption that a bundle of x variables seizes a noticeable part of the variability in the fixed elements of price and that the attributes of the objects do not alter systematically over time (Ashenfelter & Graddy, 2006). Hedonic attributes are for example artist's name, signature, date of execution, medium (Horowitz, 2010) and title of work, date and city of sales and pre-sale estimate available at auctions (Collins et al., 2009). Because the hedonic model is relying on a fixed part of measurable characteristics, it is mostly used to chart the financial returns to prints and paintings, whose characteristics incline to be the most standardized (Horowitz, 2010). The hedonic model controls for the fixed part, established by a small number of hedonic attributes reflecting the unique character or quality of the art work (pi), where pt indicates the index of aggregate changes in prices, and εi is the independent error term. Which leads to the following index where the price of the ith art work is sold in time period t : $pit = pi + pt + \varepsilon it$

(Ashenfelter & Graddy, 2006). More extensively, when assuming $pi = \beta xi + \varepsilon i$ (where ß is the weight of *x* variables), the index will be:

$pit = \beta xi + pt + \varepsilon i + \varepsilon it$ (Ashenfelter & Graddy, 2006).

One of the advantages and appealing characteristic of the hedonic price method is that all data may be applied in estimation. Including art works that are only sold once may be used for data collection (Ashenfelter & Graddy, 2006). Chanel, Gérard-Varet & Ginsburg (1996) argue that when trying to establish the returns of art works, using the hedonic price method is regarded suitable for the construction of a price index as it permits using information on one-time sales in combination with information on repeat-sales for art works of which characteristics may vary over time. In that way all obtainable sales data is used.

One of the drawbacks related to the hedonic price method is the belief that a proportion of *x* variables account for much of the variability in the fixed dimensions of price. Moreover, the variables of an art work are assumed not to change systematically over time (Ashenfelter & Graddy, 2006). In addition to this, Horowitz (2010) states that in the hedonic price method it is expected that the chosen variables cover all inherent price shifts. Moreover, it will not be able to detect the current condition of goods.

Both approaches deal with the limitation of sample selection. Almost all studies estimating price or return on art works are structured on available sales data from public auctions, where less than fifty percent of all art transactions take place (Chanel et al., 1996, Goetzmann, 1993). The kind of transactions that happen outside the auction houses are not included. So, although the sample selection bias occurs in the repeat-sales method as well as the hedonic price method, the way in which it occurs is different according to each estimation method. The hedonic method is only applied to sold art works, consequently, sample selection occurs as unsold art works are excluded. The characteristics identified by the hedonic method may explain the price objectively.

However, an unexplained and irrational element remains when considering the prices paid at auctions (Von Habsburg, Goodman, Johns & McAndrew, 2010). A part of the price can be determined by a buyer's emotional and aesthetic appeal to the art work and is specific to each buyer. Moreover, this part is highly subjective and might change over time (Von Habsburg et al., 2010). The repeat-sales method only includes art works that are sold twice, subsequently is information on single sales disregarded (Collins et al., 2009).

5.3. Online availability of information

One will inevitably have noticed the increased availability of art information on the internet and wonders how this might have an impact on art prices. Besides the old ways of retrieving information from magazines, newspapers and trade journals, one can nowadays read art research reports and review auction house publications online (Adelaar, 2006). The world-wide availability of information has a positive influence on the quality of information because information can be easily compared and balanced when it is available (Castells, 1996). Moreover, the increased availability of information led to an empowerment on the buyers side and a diminished occurrence of asymmetries (McAndrew, 2008). Online information allows buyers (and investors) to inform themselves thoroughly before they decide to buy or invest and improves their bargaining power (Adelaar, 2006). When relating the availability of information to art prices, one will notice that costs regarding transactions and sales processes are less, which will finally lead to a lower price (Flynn, 1997). The internet poses the opportunity of cutting costs of sending and producing catalogues. Moreover, digital imaging, online available databases and internet auctions ensure and easy access to art buying and selling and to research the market, which consequently leads to a diminished need for intermediaries (auction houses, art advisors, etc.) which decreases the costs (McAndrew, 2008).

Section 2. Investments in art

1. Introduction

As the general characteristics of art markets have been discussed, it is now time to continue with the more financial side relating to art markets, namely the investments in art. It is of utmost importance to discuss several aspects of art investments as this is the main practice of AIFs. So, bear in mind that the discussed aspects are of relevance to AIFs. Section 3 will subsequently specify on aspects involved regarding investments in art through AIFs.

2. History

Although it might seem that the interest in art as investment is something of the last decade, it is actually not that new. Already in the eighteenth century in England, the idea of paintings as an asset for capital investment emerged (Solkin, 1993). Moreover, Watson (1992), relied on the saying by Baron Friedrich von Grimm, who stated, in the eighteenth century, that “purchasing paintings for resale was an excellent way to invest one’s money” (Watson, 1992, p. 157). Moreover, the major Cubist art dealer Kahnweiler already commented in the seventeenth century that paintings might be just as worthy as gold.

Notwithstanding these early developments, the rise of the art investor appeared more often at the end of the nineteenth century. Before that, art investments were made on the premise that art would enhance one's social prestige and to signal the owner's cultural status (Plattner, 1998), which is related to the 'Veblen' – effect, explained as when the price of a good increases, the demand increases as well (Veblen, 1934). It was not until the late nineteenth century that art investments were made in order to yield financial rewards (Horowitz, 2010).

The idea of investing is art has developed over the last century. At the beginning of the 1900s, the rising prices of art works were emphasized to encourage investments, while a few noted the (non-) correlation between art markets and the financial market and thus its appeal as a financial hedge (Horowitz, 2010). After the Great Depression, there was a time of high inflation. People began to appreciate the non-monetary value of art works, which led to the statement that the intrinsic value of art is extremely attractive in times of high inflation, financial commotion and political upheaval, as art is an asset of irrefutable worth during hard times (Horowitz, 2010).

Additionally, the studies by Reitlinger (1961, 1963, 1970) on art prices confirm that after the Second World War, the inflation and financial recession contributed to the flourishing of the concept of art as investment. The idea of investing in art became accepted as a way to protect yourself against high inflation (Horowitz, 2010).

3. Risks

Obviously, when considering an investment in art, one should be aware of the risks. Generally, investing in art purely for a profit is foolish (Baumol, 1986). However, at certain times, it might be possible that the returns outweigh the risks. Therefore, a provision of a clear overview of the risks when purchasing and owning a work of art, followed by an overview of the returns, one itself can decide whether a direct investment in art should be pursued.

3.1. Costs

There are numerous costs involved when purchasing an art work and owning it. To start with the transaction costs. These are the commissions paid by the seller and buyer to the auction house or dealer (Frey & Eichenberger, 1995; McAndrew, 2008), as mentioned in section 1.

Moreover, when you have purchased an art work, there are several holding costs to protect yourself from the material risk; the art work might be demolished by fire, destroyed by war, or stolen (Frey & Pommerehne, 1989). Related costs incur insurance, maintenance and storage, tax and transport (McAndrew, 2008).

3.2. Subjectivity

As art goods are characterized by heterogeneity, substitutability (see section1), and as a high level of subjectivity is involved, the risk of valuation issues ensues (McAndrew, 2008). Thereby, the valuation is generally based upon a small number of experts, which actually indicates a reliance on a person's judgment. Consequently, this qualitative dimension might lead to a biased valuation process (McAndrew, 2008).

Another subjective element is taste. The risk of change in taste is that it might cause a change in value of an art work (Grace, 2010). This could be exemplified by the Japanese interest for Impressionist and post-Impressionist paintings during the 1980s, which led to a significant increase in price.

3.3. Attribution risk

Attributions to art works may change or accumulate over time. If a painting is not recognized to be a Rubens, but in a couple of years it is, you are dealing with an attribution risk (Frey & Pommerehne, 1989). This also works the other way around; if a painting is revealed to be a fake or forgery, serious price changes occur and it is the risk of the buyer and seller to take.

4. Returns

One of the most interesting subjects to research related art investments, is the return. For the direct investments in art, contrary to indirect investments (through AIFs), a considerable amount of returns is identified to be non-monetary. Some might even say that the non-monetary return will at least reap the same amount of financial return on art investment (Frey & Pommerehne, 1989). It is important to be aware of these non-monetary returns when researching investments in art, as they play an enormous role in investments in arts.

4.1. Non-monetary returns

Psychic returns is one of the most often mentioned return on direct investments by several researchers (Frey & Pommerehne, 1989; Coffman 1991; McAndrew, 2008). A psychic return can be for example aesthetic return; when people just really love the art work and find it very beautiful and decorate their homes with it.

Art owners also derive status from their purchase (Horowitz, 2010). The art work should represent the possessor's high cultural reputation (Plattner, 1998) and enhance one's social status (Goetzmann, 1993). Horowitz (2010) adds that the high prices paid for contemporary art, attracts new buyers to the market with the reason to establish their prominence in the social, political and cultural field.

Owning an art work can also have its returns in the fact that the work is tangible and therefore passable to your children as a sort of heritance. This is the so-called bequest aspect; where the value of the gift to your children is higher than a similar amount of money would have. Moreover, the art work might also present part of their identity, which in this way is passed on (Frey & Pommerehne, 1989).

Baumol (1986) relates (non-) monetary returns to financial returns and concludes that comparing art prices to stock prices is a losing game. The only way to beat this game is to deduct a high rate of return as in aesthetic pleasure. Moreover, an equilibrium in price for an art work can be reached by employing non-monetary returns. For example, when having bought an art work for $ 1 000 000 and eventually selling it for $ 700 000, an equilibrium is reached by identifying that the $ 300 000 is enjoyed in the form of non-monetary returns (aesthetic pleasure, social prestige/status).

4.2. Monetary returns

As the primary focus of AIFs is on the monetary returns, it is of importance to review this part. Table 1 portrays the research done on financial returns of art executed by Frey & Eichenberger (1995). They distinguish the time period, the real rate of returns, the nominal rate of return and its authors. One should notice that the studies performed, differ greatly with regard to the discussed period, its length, and the duration of holding period.

Table. 1. Returns on investments in paintings, antiques and collectibles				
Object Time period	*Return (%)*		*Return alternative investments**	*Authors*
	Real	*Nominal*		
Paintings in general				
1800-1970		3.3	6.6 (st)	Anderson (1974)
1652-1961	0.55		2.5 (gb)	Baumol (1986)
1635-1987	1.5		3.0 (gb)	Frey and Pommerehne (1989)
1716—1986	2.0		3.3 (BoEr)	Goetzmann (1993)
1700-1961	0.9			Buelens and Ginsburgh (1993)
1946-1968		10.5	14.3 (st)	Stein (1977)
1950-1987	1.6		2.4 (gb)	Frey and Pommerehne (1989)
Specific paintings				
Impressionists				
1951-1969		17.2		Anderson (1974)
1700-1961	3.0			Buelens and Ginsburgh (1989)
Late Renaissance				
1951-1969		7.8		Anderson (1974)
English paintings				
1700-1961	0.6			Buelens and Ginsburgh (1989)
Paint. from the 50's				
1960-1990	5.9			Rouget et al. (1991)
Paint. of selected artists				
1960-1988	6.7			Chanel et al. (1994)
Modem Chinese p.				
1980-1990		53		Mok et al. (1993)

**gb= government bonds; st= stocks; BoEr= Bank of England rate,*

Table deducted from Frey & Eichenberger (1995)

What can be concluded from this table is that in art markets, the real rate of return has not been founded less than 0.55 percent annually. Thereby, there is a distinction made among several segments. One can detect clear differences in the real rate of return per segment.

4.3. Comparison with alternative investments

Concluding from the table by Frey & Eichenberger (1995), is that the return on alternative investments (identified as government bonds UK, stocks UK, Treasury bills) have always been higher than the return on art. A study by Fase (1996) also found that alternative investments yielded most of the time more than art investments. Except for the period from 1982-1992, they discovered that return on art investment was higher than the return on gold and real estate.

4.4. Problems monetary return studies

The real rate of return on art investments is of considerable interest when studying AIFs. Therefore, the inherent problems related to these monetary return studies will be shortly mentioned.

Up to this point, there are three major limitations mentioned by Frey & Eichenberger (1995) the monetary return studies deal with. Namely, data, transaction costs and taxation. Data selection problems and transaction costs were discussed in the previous section, as well as the effect of taxation and related regulatory policies.

A serious limitation of the attempt to compare returns of art with returns on alternative investments, is that the scope of researched alternative investments is limited. Most comparisons made are on financial assets from the UK or USA, while other countries are excluded. Moreover, a comparison to more substitutable assets for art, such as other collectibles or real estate, are often not considered.

5. Correlations with financial markets

Discussing the correlation of art markets with the financial market is extremely difficult but most interesting. Difficult as there are many art segments to invest in, each with its own specific return. Most interesting because a low correlation with financial assets would lead to a positive advice on investing in art.

Table 2. Overview of studies on art markets' correlation with the financial market

Author (s)	*Conclusion*
Campbell (2008)	Finds low correlations of art with other asset classes (UK/US Bonds, UK/US equity, world equity, US/UK government bonds, UK government treasury bills).

	Return on assets with similar risks are higher so investment in art should only be used as diversification tool.
Goetzmannn (1993)	Finds high correlation between art and UK bonds, but especially UK stock over shorter time periods. (Periods: 1716 – 1986; 1850 – 1986; 1900 – 1986). Return: Bond returns have exceeded art returns in the period 1716 – 1986. When looking at the periods 1850 – 1986 and 1900 – 1986 separately, art returns exceeded bond and stock return. Art as investment is only attractive for people who choose a relatively volatile portfolio.
Frey & Pommerehne (1989)	Find low correlations between paintings and shares, bonds and gold. Returns are not exceptionally high regarding the level of risk.
Worthington & Higgs (2004)	Find low correlations between art and financial assets (US government debt, corporate debt and equity). Period 1976 – 2001). Returns are less, risks are higher than in more conventional markets (but there is variation across several segments of art) and therefore, inferior to financial assets.
Horowitz (2010)	Observes the assumption that art is weakly or non-correlated to the international equities markets.
Mamarbachi et al. (2008)	Find a low correlation with other financial assets. The referred to ABN AMRO report (2005) states a small or negative correlation with traditional classes.

Table 2 provides an overview of studies commenting on the correlation between art markets and financial markets. On one hand, Goetzmann (1993) observes a high correlation between art and the stock and bond markets. This would lead to the assumption that art is an inferior asset to a financial asset. A weakness of this research, is that the compared financial assets are based on investments specifically in the UK over the period 1716-1986.

On the other hand, Frey & Pommerehne (1989) detect a low correlation between art assets and shares, bonds and gold. Moreover, Horowitz (2010) and Campbell (2009) notice that the price of art fluctuates independently of other financial assets and that art assets are low or non-correlated to international financial markets. A low correlation with financial assets would lead to the conclusion that including art assets as part of your investment portfolio is beneficial. However, Horowitz (2010) warns for the veracity of the low correlation; at the beginning of 2008, the synchronic decrease in financial markets and art markets might suggest that they are in fact correlated.

The subject of correlation is extremely important, as it forms one of the main reasons why people would invest in art through AIFs: for diversification and for monetary reasons. So, if a negative correlation is proved, the art investments would be significantly higher. AIFs, operating as investment vehicles for art, are receiving more attention nowadays and are increasingly upcoming in emerging markets, such as India (FAWM, 2008).

Section 3. Investments in art through ART INVESTMENT FUNDS

As the basics of art markets and art investments are reviewed, it is time to discuss the main topic of the thesis: investments in art through AIFs. Up to present days, the research done on art investment funds has been fairly limited (except for the British Rail Pension Fund). Additionally, performed research is often commission by AIFs themselves or other involved organizations who might benefit from the outcomes (Arnold, 2008). Therefore, with a continuous critical attitude, the research is conducted.

1. Development

There is a lengthy history of people buying and selling old master paintings, coins, sculptures, antiques, and other tangible collectibles. In general, the activity of funds that operate in art for commercial reasons, rather than selling bonds or shares, has not received much attention (Arnold, 2008).

This lack of attention might run parallel to considerations of reputation and value. Formerly, social elites were appraised for having the ability to disregard the business and engage in connoisseurship. Trade was pursued in useful goods, such as food and clothes, and the purchase of art was regarded as an act to distinguish oneself (Veblen, 1934). The lack of interest can also be explained as investments in art were considered to be risky and investments in the stock market would provide the wealthy with better secured returns and higher liquidity.

Despite this lack of attention, academics recommended, since the 1850s, the development of AIFs. Whereupon, individuals initiated clubs for the buying and selling of established paintings or contemporary art by upcoming artists (Arnold, 2008). In Paris, the earliest example of an art investment fund was founded, named the Peau de l'Ours art club in 1904, supported by André Level (Arnold, 2008; Horowitz, 2010). The thirteen participating member paid each 250 francs per year to the fund in order to invest in art works. In ten years the fund bought roughly one hundred works. In 1914, when the total collection was put up for sale, it yielded 100 000 francs, about four times the initial spending.

Nevertheless, because of the First World War, the succeeding Great Depression and the eventual Second World War, the idea of AIFs was not yet recognized. It was not until the 1960s when an increased attention for art investments was raised. In 1961 the first research on art as investment was published; in 1966 the article 'Art as Investment' in the German paper Der Spiegel was debated and during the 60s and 70s three volumes of Reitlinger's study of historical art prices were published (Horowitz, 2010). However, because of the stock market crash of 1962 and effects of the Great Depression were still present, it might not seem strange that the emergence of AIFs was re-founded in the 1970s.

In Luxembourg, in 1970, Baron Leon Lambert launched Artemis, which coined itself to be an art investment banking firm. However, within a year it became a publicly traded dealership and finally folded in 2006. In 1971, Modarco was established by Ephraim Ilin in Panama. Unfortunately, during 1974-1975 they suffered losses and eventually in 1977 they integrated with the fine art dealer Knoedler (Horowitz, 2010). Situations akin occurred in this period, and eventually none survived it in its original form, except for one.

The British Rail Pension Fund was launched in 1974. They benefitted not only from the flourishing art economy but they portrayed their fund to be a perfect hedge against the extreme inflation offset by the OPEC-led oil crisis of 1973. The executive C. Lewin referred to the publications of Reitlinger and reasoned that good performance of art was proved on the long-term. Eventually, the BRPF collected £40 million and spent it on approximately 2 400 items of art as well as on other collectibles such as books, antiques and jewelry while being advised by Sotheby's.

In 1987, the high maintenance costs, the emergence of substitute ways to invest money, the increased criticism on the Fund and the attractive climate for enhancing investment returns, ensured the start of the liquidation of the Fund. Already in 1988, 1 000 items got sold approximately three times their price. Eventually, after the final liquidation in 2000, an accumulated amount of £170 million was yielded.

While the BRPF is regarded as a successful AIF, there are many critiques. First of all, timing; it was identified that the Fund did outperform inflation, but performed under the stock markets in that same period. Moreover, it significantly benefited from its competitive advantage of the involvement of Sotheby's, as the auction houses ensured minimal premiums and commissions (Arnold, 2008; Horowitz, 2010).

Since 2000, the development of AIFs can be divided into two cycles (Deloitte & ArtTactic, 2011). One cycle depicts the period of 2000 till 2005: which includes the establishment of Fernwood, The Fine Art Fund Group founded in London, and a fund-of-funds structure initiated and led by ABN Amro. While only a few of the initiatives were launched and many disappeared, The Fine Art Fund Group is probably one of the successful AIFs. The subsequent cycle, from 2005 till 2008, includes the appearance of AIFs in the emerging markets as South-Korea and India. Already in 2007, India had developed to being one of the markets with the highest density of AIFs (Arnold, 2008; Deloitte & ArtTactic, 2011). A final period of 2009 till now could be added and be described as the period where the global financial crisis does have an effect on the image of AIFs. It is a period of recovery, re-evaluation, and where market uncertainty might slow down developments. At the same time, it is a period of optimism, as the financial crisis stimulates a growing interest in art as alternative investment class (FAWM, May/July, 2011). Investors afraid of high inflation and low return due to financial instability, are encouraged to increase their investments in art to hedge against inflation (Deloitte & ArtTactic, 2011; FAWM, 2008, May 2011).

In 2010, the art investment market began to take form again and showed positive developments. At the beginning of 2010 a significant improvement was noted by Christie's and Sotheby's as their total combined revenue increased by 255% (McAndrew, 2009). At the end of 2011, the art fund market was estimated to carry a rough estimate of US$960 million under management[2] (Deloitte & ArtTactic, 2011). Still, the AIF industry world-wide remains a small part of the investment market. The increased demand for emotional assets (art, wine, gold) during times of financial turmoil is not unexpected as during 2008-2011 the performance of emotional assets proved to be resilient to the economic crisis, reaping interest in art as an asset class.

Important to mention, is that the global financial crisis was not felt by everyone. The emerging new wealth nations (throughout Asia, Latin America, Africa, the Middle East and Eastern Europe) cause a continuous demand for investments in art markets, despite the

[2] Deloitte & ArtTactic (December 2011), 'Art & Finance report 2011'. US$ 640 of the US$960 is based on art investment funds in Europe, US, Korea and Brasil. The Chinese art fund and art investment trust market was worth an estimated US$320 by the first half of 2011. The total art fund market figure does not include a number of large art funds announced in the press, such as Aurora Art Fund, Sobranie Photoeffect, Motif Art. If reported amount in the media are correct, these funds would add a further rough US$1.05 billion to the art fund industry in total. Private, family-wealth oriented art funds, which do not raise funds from external investors are not included in the calculations.

turbulence the Western economy is experiencing (FAWM, 2008, 2010, May 2011; Nazvanov, 2010). The increasing number of very wealthy people, the (Ultra) High Net Worth Individuals (HNWIs), causes an increase in the number of buyers of art (FAWM, 2008, 2010; McAndrew, 2009; Nazvanov, 2010). Moreover, high salaries of executives and the interest of well-known people in music, film and sports has additionally led to an increase in demand for art. When looking at art segments separately, one should notice that over the last ten years, the auction turnover on contemporary art and contemporary photography has increased ten times (FAWM, May 2011; podcast Green, & Roehl, 2011).

2. Underlying theories

As newspapers are lately disclosing extreme prices on art works yielded in auction houses, one might interpret the art business as a lucrative one. As interest increased for art as investment, recent established art funds draw upon economic academic research revealing the benefits of art as investment. Mei & Moses (2002) found that the annual returns attained by art, between 1875-2000, were in between equities and bonds. Moreover, they held lower correlation and volatility with these equities and bonds. Thereby, during the period of 2000 till 2011, their research showed that art actually outperformed equities. Campbell (2005, 2008) confirms this research and adds that particularly during market fluctuations art might return significantly high on the long-term. In addition, the Barclays Equity Gilt study of 2005, included art as part of the portfolio and evaluated its performance as a diversifier as well as the ability to serve as an inflation hedge (retrieved July 31, 2012, from www.finfacts.ie /Private/currency/equity2005.htm. Founded on the Mei & Moses study, Barclays advocated for a ten percent art inclusion in portfolios over the next 10-20 years. They also found that the positive correlation between annual GDP growth and annual art returns over the last thirty years was 58 percent. Thereby, the value of art shifted independently from UK equities over the past century with a correlation of -4 percent and -7 percent with stocks. Lately, the correlation with stock has been calculated at +12 percent and -18 percent with bonds (retrieved July 31, 2012, from http://www.fineartwealthmgt.com/newsletters/fall_ 2005.html#art8).

2.1. Financial jargon and the Modern Finance Theory

First of all, to comprehend the outcomes of these papers, one must understand the underlying financial jargon, including terms as actual return, average expected return and volatility. The actual return is the money you will certainly attain or certainly lose. For example, when drawing straws; there are two straws, a short one which will yield $10 and a long one which yields $5. Your actual return is $5 or $10 and your average expected return is ($10-$5=) $5. Relating to investing on the long-term, the probability of reaching the average expected return is higher to be achieved on the long-term. An asset's volatility is also referred to as the asset's risk, it is the probability of yielding the average return at any point in time. Variances and Standard Deviations refer to the boundaries within an outcome is anticipated to occur to a certain percentage. So, if there is a high standard deviation, the boundaries for fluctuations become larger, volatility rises and investment risk increase (Horowitz, 2010).

As art is determined to have on average a higher volatility and lower return, they would be less favored according to the Modern Finance Theory. The Modern Finance Theory assumes that everything being equal, an investor prefers higher mean returns to lower mean returns (Markowitz, 1952). Thereby, investors do not favor high risks and prefer less return variance to a more return variance (Arnold, 2008).

2.2. Modern Portfolio Theory

For AIFs it is not that simple. Art investment through AIFs are based on the assumption of a low correlation with other assets (Campbell, 2008; FAWM, 2008). The level of correlation or covariance explains the relationship between one asset (eg. art) and another (eg. stocks). This is where the Modern Portfolio Theory is introduced. This theory, firstly developed by Markowitz in 1952, identifies the multidimensional problem of investing in an environment of uncertainty in a large amount of asset, which may diminish to the problem of a trade-off between two sides; the expected return and the variance of the return of the portfolio (French, 2010). In general, the Markowitz optimal portfolio is acquired as a collection of the accessible assets that exploit the expected return of the portfolio, dependent on the limitation that its variance should not surpass some level (Flores, Ginsburg, & Jeanfils, 1999). Markowitz found that in an investment portfolio, the variance of each asset in particular is secondary to the correlation between the return of each asset and all assets taken in the investment portfolio. So, while previously was assumed that risk-alike investors should just choose high volatile investments, the Portfolio Theory suggests that a diversification in your investment portfolio with assets that have low correlations with each other, will decrease the overall risk and increase your average return (Campbell, 2008; Horowitz, 2010).

3. Operation

As the aim is to gain more insights regarding AIFs, the operations will be discussed. This part will discuss their aim, strategy and structure. It is more an introduction to the operations, as a more thoroughly description is given in the Data analysis. One should notice when looking at an AIF separately, different operations might be employed.

3.1. Aim

The most prevailing aim of AIF is to outperform the market to a substantial extent (Campbell, 2008). AIFs ensure the purchase and sale of art by exposing accredited individuals (HNWIs) and institutional investors to art markets and offer them shares in their AIF (Horowitz, 2010). In order to achieve returns, resources are pooled to take advantage of art markets inefficiencies and to gain access to reputable and expensive art works (Marmarbachi et al., 2008). More financially specific, is AIFs' aim for asset returns around ten to fifteen percent per year net of fees.

3.2. Strategy

Arnold (2008) concludes that the strategies employed by AIFs generally take two forms; the first strategy is to trade only in recognized important works by established masters. The value is supposed to increase as the supply of established art works is limited. Thereby, increased value is generated as when AIFs lend their acquired works to museums, the recognition and status of the artist rises, and subsequently will the value rise. Lending works to famous museums, high-status galleries or exhibitions is a recognized manner used by AIF managers to hype their collection and consequently enhancing its value. It is a form of their value-added active management strategy when AIFs support and boost the careers of the artists whose work they purchased (Horowitz, 2010). Moreover, it is also a way of creating an additional cash flow as museums or other institutions often pay a fee for borrowing (Horowitz, 2010).

The second strategy is to purchase detected undervalued art works. They retain them for a long period and then sell them. AIF Managers might be eager to uncover new talent. The possible advantage is that the price of new artists' work might fluctuate heavily and that is exactly where profits can be made.

Horowitz (2010) articulates three investment strategies mainly employed by AIFs: one is a 'diversified' strategy, where the investments involve different geographical markets and several market segments; another one is the vertically integrated 'region-specific' strategy, where several segments are included (as antiquities, Contemporary Art and Old Masters) but limited to a geographical spread; and the last one is the 'opportunistic' strategy, which relies on information asymmetries and detection of undervalued art works in a broad market.

3.3. Structure

It is observed that most of the AIFs use a multi-tiered management structure (Horowitz, 2010). This refers to board consisting of people from several disciplines; the fund's establishers, a chief investment officer and several esteemed consultants. Most employees are experts in finance, art history or economy and use their expertise and insider knowledge to profit from (Campbell, 2008). They often have already acquired experience in the field of art markets or financial markets before being involved in AIFs.

Arnold (2008) concludes that there are three streams of personnel working at AIFs; first of all, the skilled investment adviser, who often has a background as consultant for major financial organizations providing advice to universities, trust funds, pension funds, etc. with generally no background in the art world. The second stream consists of technical specialists, who can tell an original from a copy apart. Finally, the third stream connects the other two. They are the ones with extensive knowledge on and have experience in the commercial art world. They often ran commercial galleries or had a high function in prominent auction houses. They might act as a public persona for art marketing but often also have important contacts within the art world.

Unfortunately, it is often problematic to acquire the right experts for an AIF, who are able to select art works that potentially appreciate in value and who have the network to source art works at a relatively low price. The finding of these experts on art markets as well as on financial markets incur high costs regarding fees and salaries paid to them (Deloitte & ArtTactic, 2011; FAWM, 2008; Nazvanov, 2010).

Now, as human resources are discussed, will the next part introduce the more structural component of the operations. An AIF is mostly found to be operating along the economic structure of an hedge fund or private equity fund (Campbell, 2011; Horowitz, 2010; Marmarbachi, et al., 2008). Therefore, will the next section elaborate on both structures.

3.3.1. Private equity and hedge funds

The AIFs have changed their structure from earlier being set up as a syndicate or private partnership to today's structure of private equity or hedge funds (Horowitz, 2010). Most of them offer a variety of segments/funds were people can invest in. These segments/funds operate on the long-term and after having pooled the set amount for the fund together, the fund is sealed and the investor is not able to retrieve his money for 5 – 10 years.

Concerning the fee investors pay, the general amount of 2% is yearly levied for the management team, which is subtracted from the committed capital to compensate for operational costs and overhead (Horowitz, 2010). Moreover, another 20% is withheld from the profits, the so-called performance fee (Horowitz, 2010). The 20% is usually on top of the hurdle rate of 6-8%. Where hurdle rate is defined as the rate at which the AIFs assumes the costs of the project are covered.

4. Arbitrage

As has been stated before, AIFs make use of their expertise and knowledge in order to be one step ahead of their investors (Coffman, 1991; Marmarbachi et al., 2008). Knowledge on art industries is never complete, but AIFs do have access to expertise that is not on hand for private individuals. This forms a prominent tool of competition (Mamarbachi, et al., 2008). However, there opportunities for arbitrage might be limited by several aspects.

First of all, the expanded accessibility to information on art – mainly by online sales databases – has diminished the possibilities for arbitrage (Horowitz, 2010). Another constraint on arbitrage can be caused by governmental interventions. As art prices are influenced by currency fluctuations, political and administrative limitations, which hamper eminent arbitrage (Frey & Eichenberger, 1995). Additionally, the theoretically possible arbitrage effect of buying low from a gallery and selling high at an auction, is in practice highly constrained by gallery owners (Horowitz, 2010). The reason for this will be explained in the next section where the relationships between artists-dealers-galleries-art investors and AIFs are discussed.

5. Conflict of interests: risks and advantages

Velthuis (2002) identifies two *circuits* in the art markets. The *art world circuit* is characterized by important personal relationships between artist, dealer and collector and the significance of cultural capital, dealing mainly in the primary market. While the *financial circuit*, and AIFs being part of that, is characterized by the importance of economic capital and deals mostly in the secondary market, but this is particular to each AIF. The opposing priorities of both circuit, might cause a conflict of interest, which forms a risk for AIFs as dealers might act reserved when recommending or selling off art works to AIFs (podcast Green & Horowitz, 2011).

The goal of a gallerist is to establish a stable and sustainable career path for their artist on the long run (Horowitz, 2010). To prevent art works being used for arbitrage, they diminish the liquidity of art works by establishing moral and semi-legal frontiers between the auction houses and themselves (Velthuis, 2002). That the collector is not supposed to resell a work for financial purposes is often considered as a verbal mutual understanding between the gallerist and collector. Still, at times it is particularly specified in written sales contracts. If collectors do resell the work they risk their relationship with a dealer, who might place them on a blacklist which circulates among dealers and identifies untrustworthy collectors.

The relationship between AIFs and dealers is also of significant importance as AIFs make use of dealers' advice on art works (Horowitz, 2010). AIFs should not underestimate the behavioral aspect of art markets; often do dealers help artists and collectors and may purchase work in order to support a gallery. These favors and mutual gifts blur the transparency of art markets and contradict the free-trade economy on which AIFs rely (Velthuis, 2002; Zelizer, 1994). Another risk for AIFs when making use of art dealers is that generally the dealer receives only a small percentage on the gain of a recommended work which leads to dealers keeping potentially high profit works rather to themselves than recommending them to AIFs (Horowitz, 2010).

One of the advantages AIFs do enjoy, contrary to dealers, is the availability of a large sum of money pooled from investors and so their superior purchasing power of art works (Horowitz, 2010). So, AIFs have the advantage of being able to quickly react to opportunities and have access to large, important and expensive works due to the accumulated amount of investment money. Moreover, AIFs avoid the often costly and time consuming activity of acquiring a bank loan, which dealers generally use to finance transactions but only receive on a limited basis.

Section 4. Literature: conclusions and limitations

Horowitz (2010) concludes that there are still three ongoing issues regarding AIFs and the practice of investing in art. First of all, the effects investing in art through AIFs is not clearly established; will the prevailing monetary aim of AIFs become detrimental for them?

Moreover, there is no overwhelming evidence of art assets' non-correlative relationship with financial assets. Several researches state the small/non/(even negative) correlation. One should be aware of timing, place and to what kind of financial assets (funds, bonds, real estate, gold) and segment of art works (contemporary, Old Masters, paintings, photography) comparisons are made. This is obviously crucial for the establishment of a correlation.

At last, the practice of art investing might lessen art's symbolic value, which was seen as a sign of distinction. If art becomes more an utility good for storage of economic value and a financial asset, its role of prestige, exclusivity and status symbol might soften. Subsequently, as often exceptional prices are set by this symbolic economy, one should take in mind what this will eventually do to the economic value.

Mamarbachi et al. (2008) conclude that problems, encountered by starting-up AIFs, mainly concern their lack of a track record. Thereby, lack of transparency regarding organizational structure as well as legal structure cause AIFs to remain a mystery to many. Subsequently, as potential investors have trouble understanding the concept of AIFs, they will be hesitant to invest. In addition, from a social perspective, AIFs remain to be seen as unethical businesses as their main goal is financial return.

Arnold (2008) comments that there is little salient researches on AIFs. Especially independent writings on AIFs are rare. The literature kept by banks or financial institutions are basically focused on advising HNWIs about diversifying their portfolio. He concludes that because of the lack of recognized public AIFs (therefore, no examples for models and structures), the questionable nature of AIFs and lack of regulation on them, lead to vagueness about their operations and management.

From this Literature Review it can be concluded that up until now the research and information on Art Investment Funds has been limited. On the one hand, the questionable nature and lack of transparency regarding AIFs have kept investors at a distant and aloof. While at the same time, there are some AIFs that raise millions of dollars on initial capital from investors. This leads inherently to questions about reasons and the willingness to find out more about AIFs' structure and operations.

3. Methodology

3.1. Qualitative method and the grounded theory

A qualitative method is used for the research as the aim was to reveal subjective outlooks and the research question involves providing an understanding of an area still relatively unexplored (Strauss & Corbin, 1997).

This research is founded on the precepts of grounded theory as one of the most widely applied qualitative methods (Creswell, 2007). The grounded theory is founded on observations and a variety of data sources such as a review of records, interviews, observations and surveys. The grounded theory is not especially aiming for 'the truth', but the researcher is constantly asking him/herself what is going on during the empirical research. It is not a descriptive method but the goal is to formalize concepts. The results of a grounded theory is not about stating statistically significant probabilities, but to form a group of probability statements about the connections among concepts, or a unified group of conceptual hypotheses advanced from empirical data (Glaser, 1998). The researcher focusses on formulating hypotheses on conceptual ideas and to reveal participants' main interest and how they are dealing with it.

3.2. Data collection

The grounded theory seems to be the only method appropriate when researching the subject of AIFs. There has not been written much on AIFs and as they entail a high level of confidentiality and secrecy, the final concepts are derived from interviews, (financial) reports, records and email communications. Moreover, this research aims at forming a set of probability statements and trying to relate certain concepts with each other, while it is does not focus specifically on testing the statistically significance of a hypotheses. From the variety of data sources, it is important to be aware of the perspective/background of the author or company. Many used articles were actually promoting AIFs. Therefore, the following part will discuss the background and perspective of the used sources, which were critically reviewed and kept in mind when compiling an objective data analysis.

- *Art Fund Tracker (Issues July 2011, May 2011, December 2010, November 2008)*

The Art Fund Tracker is provided by Fine Art Wealth Management. Fine Art Wealth Management is a membership-based advisory firm that presents independent consulting, education, networking and research to art investors and families with exceptional art wealth. They offer objective knowledge on art governance, art investment, and financial planning for art assets as that is their top priority.

In 2003, the Fine Art Wealth Management first began researching art funds in order to fill in the gaps in the limited information available around art funds for wealth managers and private clients. It covers the art fund market by distributing information on global developments, analysis of regulatory issues, new art fund initiatives and interviews with the people behind them. The Art Fund Tracker is published four times a year.

- *Skate's Art Market Research*

Set up in 2004 by Sergey Skaterschikov, in order to provide institutions and wealthy individuals with trustworthy and independent conducted research to assist in their investment decisions. Profit is not derived from the buying and selling of art works, but by providing information to their clients. Skate's publishes investment reports, investment reviews, keeps track of art stocks, offers Art Finance services and most interestingly, provides reports on Art Investment Funds.

- *Magazines, Newspapers & Journals*

Magazines and specialist journals may provide useful insights when researching a specific area. For this research, as some of the AIFs are registered in Gibraltar, the *Gibraltar International Finance and Business Journal* (Autumn 2008) was used, especially to gain understanding in the field of investments, the registration procedure, paid taxes and the relationship with location. The *Gibraltar International Finance and Business Journal* is published quarterly since 1998 and promotes itself as the only specialist magazine for professionals and individuals interested in Gibraltar as a leading international finance center within the EU.

For more in-depth knowledge on general concepts and for a probably more objective perspective regarding art markets, newspapers, such as The Art Newspaper, and specialist journals, such as the Journal of Cultural Economics, the Journal of Finance and the Journal of Alternative Investments, were used.

- *Reports*

The ArtTactic report, *US and European Art Market Confidence Survey,* October 10, 2011 was used. In addition, the *Art & Finance Report 2011* (December) published by Deloitte Luxembourg and ArtTactic, was used in order to gain greater understanding in the more general aspect of the world of Art Investment Funds. The aim of the report was to increase the understanding and awareness of art as an asset class among the wealth management community. Moreover, the main trends and developments for the Art and Finance industry are highlighted. Thereby, the main obstacles that wealth managers deal with and possible solutions are discussed.

For their report they surveyed 19 large private banks, employing over 900 private wealth managers. A similar survey was executed among 140 international art professionals and 48 top international collectors. Moreover, 34 Art Investment Funds were contacted for the research. The limitation of the report is the main focus is on private banks and wealth managers in Luxembourg.

Another report that was used for this research, was *Noble's Secrets of Art Funds and Art Investing* (2010), by Dr. G. Nazvanov. The author is nominated in the top ten of financial advisors in Australia and is a specialist in Wealth Management. He has published seventeen books on Wealth Management and is an advocate for art as an investment class.

- *Annual Report and Audited Financial Statements & Offering Memorandum of the Fine Art Invest Fund*

The Annual Report and Audited Financial Statements (August 31, 2010 – September 30, 2011) provided information including a manager's report, director's report, statement of financial positions, statement of cash flows and notes in addition to the financial statements.

The *Offering Memorandum (December 2010)* constitutes specifics on the Fine Art Invest Fund including definitions, objectives, policies, functionaries, fees/charges/expenses and operational details.

Detected as the only AIFs that discloses an *Annual Report and Audited Statement* and an *Offering Memorandum*, the Fine Art Invest Fund was selected to be discussed as a case study.

- *Podcasts ArtTactic*

ArtTactic is an advanced art market analysis firm that provides insightful research and commentary on the fast-moving and continuously developing art world. While new markets appear and tastes changes, ArtTactic claims to possess the knowledge and network to assure that your current and future art investments maintain the lead of the curve and are sustained by up-to-date information worldwide. Their knowledge is based on continuous research (industry reports, market analyses) and interviews (with several actors within art markets). The fact that they try to assure that art investments maintain the lead, should one make aware of the possibility that they might try to portray information in a certain way.

For the research the following podcasts by A. Green were used:

- C. Kubern, February 7, 2011, Castlestone Management's Collection of Modern Art Fund
- F. Kiradi, May 13, 2010, Art Photography Fund
- J. Lumbreras, September 13, 2010 & October 13, 2011, Artemundi
- O. Roehl, July 6, 2011, FAIF – Loubna art society
- P. Hoffman, July 22, 2009 & August 4, 2010, The Fine Art Fund
- T. Huang, March 9, 2012, Motif Art Fund Group
- N. Horowitz, April 5, 2011, art investments
- E. Tawil, September 21, 2011, Art Fund Association
- F. Salmon, April 19, 2011, art investments

- *Companies' websites*

Another approach for data collection is to observe what is stated on public records such as companies' websites. Analyzing the websites of AIFs may sometimes provide you with insights or may give you an understanding of how secretive their business is, as often the information on their actual operations and structure is limited.

However, some AIFs do provide records on their annual reports, historical reports and internal memoranda. These reports are describing institutional characteristics and help to identify institutional strengths and weaknesses. These can support the researcher's understanding of the AIFs' resources, values, processes and concerns. While the companies' websites do provide useful information, one should take into account that the information they present is selected and chosen by the AIFs themselves.

- *Books*

The book by Noah Horowitz, *Art of the Deal – Contemporary Art in a Global Financial Market* (2010), was specifically used as to gain insight into the basics of AIFs. Interesting about this book is that it was published after the global financial crisis. However, as many say that the influence of the financial crisis was only felt by art markets after two years, one might argue that the effect of the financial crisis of 2008 could not be discussed in a book that is published in 2010. However, reports made up in 2009 were included and as the impact of the financial crisis on the art economy has already been written about by many, Horowitz highlights the importance of historical reflection, whereby the art bubble of 1980 is often mentioned, discussed and compared to the financial crisis of 2008.

Noah Horowitz is an art historian, an expert on the international art market and wrote his PhD on Art Funds. He wrote numerous articles for high quality art specialist magazines and is currently the Managing Director of The Armory Show.

- *Email communications*

Email contact directly with insiders of the AIFs, provides a great opportunity to gain insight into their operations. Although many AIFs did not wish to cooperate or disclose confidential information, some AIFs did provide some useful documents and information.

The following Art Investment Funds cooperated and provided in-depth information:

- Massimiliano Subba – Board of Managers, Anthea 1 Contemporary Art Investment. Provided: Marketing powerpoint presentations and Term Sheet.
- Martin Bouchon – Managing Board, Artfonds 21 AG
  Provided: emails and powerpoint presentation of the Fund.
- Faye Chen – Motif Art Management, Taiwan Office
  Provided: Offering Memorandum.
- Friedrich Kiradi – Art Photography Fund

3.3. Sampling

Although there are various opinions about the analytical dimensions of the grounded theory, it is commonly agreed upon that sampling procedures and the collecting of sufficient in-depth data is important to detect patterns, concepts, models and categories of a certain phenomenon (Glaser & Strauss, 1967; Strauss & Corbin, 1998). Therefore, it is critical to have an appropriate sample size (Auberbach & Silverstein, 2003).

In order to obtain quality data, the theoretical sampling technique was applied. Theoretical sampling is not the same as probabilistic sampling, where the aim is to acquire a representative sample of all assertable variations. In a controlled manner data is collected, which indicates one of the most important characteristics of theoretical sampling, that it is a ongoing process (Bryman, 2012). Thereby, theoretical sampling aims at obtaining a deeper understanding of examined cases and to assist in the formation of analytic frames and concepts commented upon in the research (Glaser & Strauss, 1967). Theoretical sampling can also be seen as a method of data triangulation: exploiting independent pieces of information in order to gain an improved understanding of something that is only understood to a certain degree.

AIFs that disclosed information on their operations and structures and outlined their objectives and aims were included in the sample. What should be noted is that gathered information focusses mostly on AIFs residing in Europe.

The data analysis was conducted by connecting information on the following 19 funds:

Name Art Investment Fund (still operating)	Date of launch	Minimum investment	Management location
Anthea 1 Contemporary Art Investment Fund	May 2010	€ 250 000	Switzerland
Atlanta Art Fund	August 2010	€ 25 000	Russia
Artemundi Global Fund	April 2010	€ 200 000	Spain
Artfonds 21 AG	April 2007	€ 3 000 maximum €30 000	Switzerland
Art Photography Fund	March 2008	€ 70 000	Austria
Castlestone Management Collection of Modern Art	March 2009	€ 10 000 (individuals) € 1 000 000 (institutions)	USA
Emotional Assets-Management & Research	November 2009	€ 125 000	UK
Golden Art Fund	September 2011	€ 170 000	Brazil
PMG Fine Art Invest Fund	November 2010	€ 75 000	Switzerland
Sobranie FotoEffect Fund	November 2010	€ 12 000	Russia
Terry Art Fund	May 2009	€ 125 000	China
The Daman Middle East Art Fund	May 2008	€ 100 000	UAE / Dubai
The Fine Art Fund Group			
The Motif Art Fund Group	2003	€ 400 000	China
Name Art Investment Funds (dissolced/abandoned/closed)	Date of launch - date of closure	Minimum investment	Management location
Castle Apollo Fund Limited	2008-2009	€ 100 000	UK
Dean Art Investments	Structured but	-	UK

	never launched		
Meridian Art Partners	2008-2009	€ 200 000	USA
Prime Art Funds	2008-2009	-	USA
Sharpe Art Fund	2006-2011	€ 100 000	Gibraltar

3.4. Limitations of the grounded theory

As with each methodology, there are certain limitations. One of the criticisms given on the grounded theory is the risk that the researcher cannot put aside his/her awareness of relevant theories or concepts (Bulmer, 1979). The interpretation and conceptualization of gathered data is done by the researcher, who might be influenced by what he/she already knows. Moreover, the task of transcribing all gathered data is time consuming. Thereby, the established generalized concepts might be described precisely, but the exact difference among the concepts could remain vague. Finally, there is always the risk of losing context and information when concepts are formed (Bryman, 2012).

4. Data Analysis

4.1. Introduction

The goal of the data analysis is to create an in-depth knowledge on the operation of AIFs. The data analysis covers a few similar points as the literature review did, but will provide much more specifics on these topics as gathered information allows for that.

The Data Analysis is composed out of several topics depicting the main characterizations and processes involved around AIFs. These topics form the building blocks for the final generation of two models. The first one will focus on involved parties and structure of AIFs. The second model depicts four aspects, considered most important regarding AIFs. Namely, risks, reasons, managerial tasks and costs. Eventually, the two models will be evaluated on its similarities and differences with regard to Traditional Investment Funds (TIFs).

In addition to the two models, the three questions proposed in the introduction form basic guidelines for determining the relevance of the topics.

4.2. Reasons for investing in AIFs

The reason why AIFs are offered and the motivations of people investing in them are important to highlight. Especially, as the risks of establishing an AIF and the risks involved when investing in them are relatively high. Remarkable is that when comparing monetary returns achieved in financial markets are often higher than in art markets (Frey & Eichenberger, 1995). What might even be more interesting, and what also will be discussed in this section, is why people invest in art through AIFs; why do they not approach an art dealer themselves? what do Art Funds offer them in addition?

One of the reasons is that art has a secure value, it is a ‘safe haven’ or a ‘store of value’, particularly in times of economic uncertainty (Deloitte & ArtTactic, 2011; Nazvanov, 2010; podcast Green, & Hoffman, 2010). When there is no confidence in the economy, a demand for tangible assets is generated (Deloitte & ArtTactic, 2011; Campbell, 2011; FAWM, 2010). Moreover, especially in the high end of the market, art is gradually being regarded as a safe reserve for value. The tangibility of art works is one characteristic which defines art to be an appropriate asset class. Other positive characteristics, also possessed by other real assets, contain high residual value, inflation proofing, low volatility and low/negative correlation with traditional asset classes (Campbell, 2008; Frey & Pommerehne, 1989; Horowitz, 2010; McAndrew, 2009; Shari, 2009; Worthington & Higgs, 2004). On which will be elaborated further on this section.

Social values and aesthetic values also play a role in motivating people to invest in art (Deloitte & ArtTactic, 2011). Generally, one would assume that these values only occur when buying art directly (not through AIFs) for hanging in their homes. However, some AIFs, such as Artemundi and the Fine Art Invest Fund, allow investors to borrow art works and let them be used for personal pleasure and cultural enrichment (podcast Green & Lumbreras, 2011; PMG FAIF Offering Memorandum, 2010). So, aesthetic values do postulate themselves here. Social values, such as status, prestige and social network certainly apply, as when becoming member of an AIF you consequently become a member of a social network of other wealthy investors (retrieved May 10, from www.artemundiglobalfund.com).

Moreover, as social status might initially seem to occur only in a direct way, the image of investing in art might convey a similar elite status. Investors might also use it to flaunt at their friends or neighbors, showing off their new found and exclusive wealth. Moreover, the idea of art investing as being in fashion and being in vogue might also trigger people to invest. People are susceptible to notions of trends and moods (Nazvanov, 2010).

Reasons to invest in art from an economic perspective include diversification, low correlation with traditional asset classes, inflation/currency hedge, advantageous tax systems and art’s positive performance over the last ten years (Deloitte & ArtTactic, 2011; FAWM, 2010M. Bouchon, personal communications, June 11, 2012). Many investors employ a portfolio diversification strategy (Campbell, 2005; Deitch, 1989; Eckstein, 2006; Frey, 2003 Mei & Moses, 2002). As part of their risk management they diversify their investments across several asset classes (FAWM, May 2011). As already explained in the Literature Review, this practice is based upon the Modern Portfolio Theory by Markowitz, where one tries to maximize return and minimize risk by selectively choosing different assets (Markowitz, 1952). There are several ways to diversify; one could diversify across different asset classes (cash, fixed interest, art, property, shares, private equity), diversify within your asset class (blue-chip artists with contemporary artists) or among different art medium or style (photography, film, paintings) (Nazvanov, 2010).

Another structural advantage are the tax benefits (FAWM, 2008). Some countries may offer advantageous tax systems encouraging investments in art. However, location related taxation benefits will be discussed in chapter 4.7.

When considering the perspective from AIFs, wealth managers and banks offering art investments, it is a manner to differentiate themselves from competition. The private banking sector is in fierce competition and they see themselves forced to focus on new ideas, products and solutions. In a way, the offering of investments in art is a mode of creating a competitive advantage. Other possible reasons why these organizations are interested in offering art as investment are client entertainment, client demand, trying to monetize the value of increasing art prices or the usage of art as accounting for a larger share of clients overall asset value/wealth (Deloitte & ArtTactic, 2011).

Why the required minimum investment is often around € 100 000 could, in particular for The Netherlands, be related to rule established by the AFM (Authority Financial Markets). This rule entails that an organization that trades in shares is obliged to let their prospectus to be approved by the AFM. Moreover, the organization should also acquire a license to trade, provided by the AFM. However, when the organization requires minimum investments of € 50 000, they are no longer compulsory to attain the approval and license of the AFM. The AFM reasons that when such large minimum investments are asked, they assume that investors themselves are capable of assessing the offered product(s). Since January 1, 2012, the minimum was raised to € 100 000 (retrieved August 2, 2012, from http://www.afm.nl/nl/consumenten/vertrouwen/bedrijf_bekend/prospectus/wijzigingen-per-1-jan-2012.aspx). The part on investment reporting requirements is only briefly mentioned in this part, as this is specific and different per country and consequently, would be too extensive to elaborate upon. However, it is important to be aware of the existence of these requirements and to imagine possible consequences for AIFs and its investors.

Another important topic to discuss concerning reasons, is why investors/clients choose to invest in art through AIFs. Nowadays, internet has made it possible that information on art works is widely spread and accessible. Therefore, one could track records of paintings themselves and buy them by themselves or through an art dealer. So, the question remains what do AIFs offer their clients? As stated before, art markets are characterized by non-transparency, imperfect information and illiquidity, among others. What an AIF offers, is that they are able to provide clients a clear, intensive and understandable view on art markets. The level of expertise on finance as well as on art employed by AIFs is extremely high and therefore they are better capable of making sound investment decisions with a limited amount of risk (FAWM, 2008; M. Bouchon, personal communications, May 8, June 11, 2012). The claim of providing more transparency on art markets, is grounded on the experiences and track records of AIFs' employees. Besides the offering of this, AIFs enjoy the ability of pooling clients' resources, which allows for an increased access to art markets (Horowitz, 2010).

Finally, probably one of the most important reasons is that AIFs cover logistical, management, maintenance, transaction and promotional costs. This is an enormous relief for art investors as the costs involved in purchasing art works are often extremely high. What should be noted, is that AIFs generally do not cover for costs when art works are being lent to clients (Art & Finance 2010; Nazvanov, 2010; PMG FAIF Offering Memorandum, 2010)

So, in general, the reason why people invest through AIFs is that they provide a more efficient and easier choice for the art investor. Investors in AIFs do not need to comprehend the regulatory structure nor have any knowledge on art investments and art markets.

4.3. Risks

Although there are several grounded reasons why AIFs exist and why people invest in them, there are also numerous risks involved. For investors as well as for AIFs, it is important to make a careful consideration between the risks and advantages. Therefore, the next section is dedicated to discussing these aspects.

Art markets in general are characterized by numerous attributes that imply a level of risk. It is the largest lawful industry that remains to be unregulated (Coffman, 1991; FAWM 2008, May 2011; Deloitte & ArtTactic, 2011). There is a general market risk, which entails that art markets may shift on to an unexpected direction or express signs of volatility. Illiquidity is another characteristic of art markets which manifest itself not so much in the risk of whether a price rises or falls, but if there is a market for the art work at all. Moreover, valuation issues occur, as the value of an art work entails a high level of subjectivity. Subjectivity inherently causes uncertainty. Moreover, a more external risk to art markets is the impact of economic and market trends on future buying and selling. The changing global environment might unexpectedly influence the behavior on art markets. These known general characteristics of art markets (illiquidity, non-transparency, subjective valuation, external influences, assessing viability) cause a challenge in persuading people to invest in art markets. Therefore, it still remains a challenge to raise income and attract new capital (FAWM May 2011; Horowitz, 2010; Nazvanov; podcast Green & Salmon, 2012; M. Bouchon, personal communications, May 8, 2012). In addition, when large institutional investments remain low for similar reasons, it will limit AIFs' access to art markets (Deloitte & ArtTactic, 2011; FAWM, May 2011).

There are also specific risks involved when purchasing art works. The authenticity, title, condition and provenance are often hard to verify (FAWM, 2008). In addition, one could be unaware of buying a copy or a damaged good (Nazvanov, 2010). Moreover, the cost of insurance are high and often do not cover all cases of loss (Deloitte & ArtTactic, 2011).

Most AIFs buy and sell art works through auction houses. As an auction house offers some benefits such as the status of being neutral, there are risks as well related to doing business with auction houses. There is the risk of rescission and finality, where purchases and sales can be cancelled or not finalized in the end (FAWM, 2008). Moreover, a loss could incur due to unlimited provided warranties of title an AIF must provide when selling privately or at an auction house, or to the right of an auction house to abandon the sale or purchase. Another risk and disadvantage of doing business with auction houses are, as previously mentioned, the high transaction costs.

Additionally, there are several risks and challenges specifically related to the operation of AIFs. One of the main struggles AIFs deal with is their lack of reputation (Deloitte & ArtTactic, 2011; FAWM, May 2011; Nazvanov, 2010; M. Bouchon, personal communications, May 8, 2012). Subsequently, as there is no proof of a positive past performance, it is more difficult to convey people or institutions to invest (podcast Green & Horowitz, 2011).

AIFs are also subject to a significant amount of operational risk. This entails that the organizational processes and procedures should suffice for accounting and safeguarding art works (Nasvanov, 2010). Thereby, when an art work is not held at the AIF but are given in loan to museums, investors or galleries, the audit trial is often not properly formulated (FAWM, 2008).

What is of general concern to AIFs and on which they have limited influence, are changing tax regulations. Tax laws are subject to modifications which might impact investors' transfers (Nazvanov, 2010).

Another risk that is shared by AIFs, but mostly by the investors, is their lack of education on art markets in combination with the financial market. It is often the case that one possess either knowledge on one of these markets, but not on both of them. For AIFs it remains a challenge to integrate and understand these two expertise and to try to create synergies. Subsequently, it is necessary to convince unknowledgeable investors of these possible synergies, as the absence of understanding manifests itself in uncertainty and an abstention from involvement in AIFs (Deloitte & ArtTactic, 2011; FAWM, 2011; Nazvanov, 2010).

The uneven supply of art works remains a challenge with which AIFs deal. As already discussed in the Literature Review, supply is generally fixed but several factors may cause a change (copies, attribution risk, new artists) which can seriously have an impact on pricing (Frey & Pommerehne, 1989).

Finally, one of the largest challenges AIFs deal with, are the multiple restrictions on marketing and advertising of private offered investment vehicles. These restrictions imply a force on AIFs to operate mostly outside the view of the large public, which inherently generates a negative ambiance (FAWM, 2008, 2010).

4.4. Strategy

As one of the main goals of this research is to create more insights regarding the operations of AIFs, strategy and structure should not be overlooked. These two aspects form the foundations for internal operations of AIFs.

According to Johnson & Scholes (1998) strategy depicts the direction and scope of an organization over the long-term. A structure is formed to support the strategies. As the objective of AIFs is similar, one might assume that strategies employed are also similar. However, one will detect certain differences among AIFs when evaluating them closely.

A strategy occurs at different levels of the organization, ranging from an overall general strategy for the whole organization to more specific strategies for single departments. The levels of strategy can be roughly divided into three categories. The corporate strategy entails the overall objectives/mission statement by which decision making processes are led. The business unit strategy focuses on strategic decisions about the choice of products, gaining a competitive advantage and creating opportunities. Finally, the operational strategy involves guidelines regarding the use of resources, processes and people in order to achieve the business unit strategy and the corporate strategy.

The following section will discuss the three categories of strategy of AIFs. What can be seen from the information on the various AIFs, is that often their corporate strategy (objectives) are closely aligned, while their way of achieving these objectives (through business unit and operational strategies) often differ.

4.4.1. Corporate strategy

The main objective of AIFs is to seek superior returns/to capture the appreciation of capital in addition to offering investors the opportunity to diversify their investment portfolio (Skate's, 2012). Moreover, objectives are often made more specific in terms of desired rate of return and minimum investment amount. There is a desired rate of return between 10-15% annually (Horowitz, 2010; Skate's, 2012). The minimum investment is thereby set on € 150 000 approximately. However, not all funds require high minimum investments; Artfonds 21 AG requires a minimum investment of € 3 000 and even has a maximum amount of investments limited to € 30 000 (retrieved May 5, 2012, from www. Artfonds21.de). The low minimum is set to attract investors, while the maximum is set to protect the investors from large losses (M. Bouchon, personal communications, June 16, 2012).

An additional note to this, is the amount of required investments often differs among the different types of investors. At Castlestone Management Collection of Modern Art Fund, an individual investor is required to invest a minimum of € 10 000, while for institutional investors, the minimum starts at € 1 000 000 (retrieved May 1, 2012, from www.castlestonemanagement.com).

4.4.2. Business unit strategy

More interesting to discuss is the business unit strategy. This is where a competitive advantage is outlaid and consequently where AIFs differ.

The allocation of investments into two broad categories (FAWM, 2008). The first one is the sector allocation strategy; where investments are made in specific established sectors in order to emulate the world's top collectors. The other one is more opportunistic, where opportunities for financial gain are identified by copying world's leading art dealers' behavior or partner with a group of art professionals.

However, these two strategies are often used in combination and will finally lead to three broad diversification strategies (FAWM, 2010; Nazvanov, 2010; M. Bouchon, personal communications, June 18, 2012). A diversification in asset classes (expand your portfolio with real assets/collectibles such as fine art, stamps, coins, watches, etc.), such as the Emotional Assets Management & Research Fund (retrieved June 8, 2012, from www.emotionalassets.com). Or they offer a diversification within the art asset class (for example, a focus on photography, but a diversification in blue chip artists combined with emerging artists or artists from different geographical regions), for example the Art Photography Fund (podcast Green & Kiradi, 2010). Moreover, AIFs could also offer the opportunity to invest in art and to diversify regarding the medium or style.

The reason for these diversifications is that the consumer demands a diversified portfolio, but for AIFs as well, it is beneficial to employ diversification in order to minimize their own risks. Concerning the budget spending, AIFs often reserve a proportion of money for opportunistic buying or to cover for unexpected losses.

Another awareness that was raised concerning type of medium, is the recent focus on photography by AIFs such as the Fine Art Invest Fund and the Art Photography Fund. Why AIFs recently focus on photography is that the Global Art Index indicates that photography has the highest increase in value of all art forms over the last ten years (2000 – 2010). A more functional reason is that it is easier to transport than paintings. Thereby, the price of photographs is generally lower. Subsequently, the number of potential buyers is higher, which positively influences the level of liquidity (podcast Green & Kiradi, 2010; podcast Green & Roehl, 2011; retrieved June 2, 2012, from www.faif.ch; retrieved June 8, 2012, from www.artphotographyfund.com).

4.4.3. Operational strategy

Tasks and use of specific resources are devised in order to achieve the objectives of the business unit strategy and the corporate strategy. One will detect that these aspects are similar among AIFs.

The management of an AIF is required to perform several tasks. Among others raising initial capital, performing due diligence, sourcing and buying of art works, managing logistics (storage, insurance, transport), discussing the loan of art works, ensuring conformity with government rules, deciding on sales of art works, limiting risks and administering profits (Art & Finance, 2011; Nazvanov, 2010).

Important tasks for the management of AIFs include increasing/creating value of their art works and managing buyer-side liquidity. This is accomplished by applying active management (FAWM, 2008; Horowitz, 2010; Nazvanov, 2010). Active management contains creating know-how. AIFs loan their art works to museums, displaying institutions such as galleries/collections or organize their own exhibitions in order to generate broader market recognition but also to minimize their cost of holding (M.Bouchon, personal communications, June 11, 2012).

Another task of management is to limit risk. The Fine Art Fund has clear guidelines to minimize risks. One of them is that no single acquired work should cost more than 15% of total commitments. Another guideline indicates that when a work is purchased of a price higher than 7% of total commitments, it should be approved by the Fund Board (retrieved May 25, 2012, from www.thefineartfund.com). Some AIFs, such as Artfonds 21 AG, only buy works under a certain price (eg. $ 250 000) or focus on smaller size piece which cost less to hold, regarding maintenance and storage.

The acquisition, selection and selling of works is also one of the major tasks of the management. This process includes a thoroughly and extensive research and analysis, which will finally lead to a perfect portfolio fit and complies with the strategies of risk management.

The sale of art works is can be divided into two different strategies. Interesting to notice is that these two strategies influence the NAV calculation in opposing ways. One strategy is to sell the so-called over-performers; which have, for example, more than doubled their initial paid price. The NAV will be sky high after such a major sale, which will portray a very positive rose colored picture for the AIF. However, at the end of the investment period, when the under-performers are sold as well, will decrease the NAV (podcast Green & Salmon, April 19, 2012).

The other strategy is to set a minimum percentage that an art work must increase annually to be kept within the AIF. For example, there is a ten percent benchmark; if a painting annually increases in value with ten percent, the AIF will hold on to the painting. But, if the value of the painting increases annually with less than ten percent, the AIF will sell the painting and reinvest the money in the over-performers (with an increasing value of over ten percent yearly) or pay it out to investors. Eventually, at the end of the investment period, the AIF is left with over-performers, which will increase their NAV when there is a total liquidation. (M. Bouchon, personal communications, May 8, 2012).

Moreover, as in each business, it is essential to establish a competitive advantage; to use your resources and attract resources in order to excel and outshine your competitors. Well considered strategic market positioning and beneficial use of resources is essential to achieving this advantage (FAWM, 2008).

What is noted by each AIF and on which they heavily rely, are art markets' inefficiencies. A direct relationship is founded between the inefficiency of the market and the value of expertise. This is something which is not particular to AIFs, but it is something that all investors are aware of: if a market is characterized by inefficiency, opacity and lack of regulation, there is a significant possibility for financial gain (FAWM, 2008).

Nevertheless, there are different resources needed for this gain when comparing AIFs to Traditional Investment Funds (TIFs). One of the most important assets of AIFs' management is their profound combined expertise in financial markets as well as art markets. Their team of experts generally exists out of former employees of Sotheby's, BRPF, international law firms, eminent galleries, highly accredited banking firms and investment fund governance. They often enjoyed an education at a prominent university and have experience for over 15 years in their field (Skate's, 2012).

4.5. Structure

A structure is designed in order to achieve the objectives specified in the strategy (retrieved June 4, 2012, from www.referenceforbusiness.com). The structure describes the way in which roles, responsibilities and power are coordinated, monitored and delegated. It identifies the flow of information between levels of management.

In general, a structure always contains a process of decision-making, a description of rules by which de organization operates and a division of work (retrieved June 4, 2012, from www.ctb.ku.edu/eng). These segments regarding AIFs will be discussed in this part. In particular, the legal structure and the operational infrastructure.

4.5.1. Legal structure

Legal structure is interesting to discuss as one can already detect the main characteristics of an AIF by looking at their legal structure. There are two main questions regarding the legal structure of AIFs: whether they are open-ended or closed-ended and if they form a (offshore) partnership or a corporate structure (FAWM, 2008).

An open-ended structure offers shares continuously. The value and the price of the shares is determined by the current Net Asset Value. If there are new investors, new shares will be issued. Moreover, sold shares receive the prevailing price at that moment. So, the value of shares is directly related to the value of the underlying assets. Often, until there is no redemption of shares, profit is not distributed. On the other hand, in a closed-ended structure, market value is determined by demand and supply. The invested money is directly related to the initially raised capital. So, there is a limited number of shares, a limited lifespan and profits are distributed on a regular basis. AIFs are mostly closed-ended structured, as investment strategies are often long-term which do not match the open-ended structure in which investors are provided with the right to redeem at regular basis. So, the portrayed NAV numbers which are published during the life-span of an AIF, depends partly on their legal structure. However, when evaluating performances of AIFs, it would be best to compare them when they have reached the stage of final liquidation and a total balance can be made up (Horowitz, 2010; podcast Green & Salmon, 2012).

Another component of the legal structure is whether an AIF is formed as a hedge or private equity fund (Nazvanov, 2010). A hedge fund is characterized by the fact that they are more flexible, investors may invest for a short or long period and enjoy similar features as an open-ended fund (such as calculation of NAV). Subsequently, it may not be unexpected, that most AIFs are formed as private equity funds, featuring long-term investments only with high levels of control.

Finally, most AIFs acquire a partnership or corporate structure. The choice is generally determined by tax regulations. The Limited Partnership structure is mostly chosen. The Limited Partnership entails one person/company that has unlimited personal liability, the General Partner (which is often the investment manager), while the liability of the Limited

Partners (investors) is limited to their investment. Another important notice considering tax structures, is the AIF manager's interest for offshore partnerships. An improved tax transparency and beneficial tax treatments are possible reasons for this interest (FAWM, 2008).

4.5.2. Operational infrastructure

This part on operational infrastructure will describe the division of tasks, the roles and responsibilities of the entities involved around AIFs. Addressing the operational infrastructure is important as it will increase our understanding of AIFs' operations. Moreover, when the operational infrastructure is determined, it will be easier to compare the operations of AIFs to these of Traditional Investment Funds. Therefore, in order to provide a clear view on the operational infrastructure of AIFs, two tables are provided: table 3 describes the tasks and responsibilities of the internal teams and table 4 describes the tasks and responsibilities of other involved parties[3].

Table 3. Operational Infrastructure - Teams

Teams (internal to AIFs)	**Tasks & responsibilities**
Supervisory Board	Art handling, exhibition technology, archiving, documentation, screening the art scene, general consulting
Managing Board	Selection/acquisition/support of artists, sales, legal matters, financial matters, administration, investors relations

Note: The size of these board differ among AIFs. For example, the Fine Art Fund employ over 35 people, while the Art Photography Fund and the Artfonds 21 AG only employ 3 people. Still, tasks involved are similar, only the smaller AIFs do not perform them directly internal but acquire other parties for performing the tasks (see table 'other parties' below). Task and responsibilities marked in blue are specific and additional to AIFs, when compared to TIFs.

[3] Based on information from Skate's (2012) and companies' websites

Table 4. Operational Infrastructure – other parties	
Other parties	**Tasks & responsibilities**
Investment Manager	Most directly involved on day-to-day basis. Set target investments, perform due diligence, pricing target investments, determine art works' provenance, ensure absence of pending liens, estimate fair market value, manage and market AIF's assets. Often is the IM a large banking or investment company (such as in the case of PMG FAIF).
Investment Committee & Advisory Committee	Consists out of representatives of investors as well as IM. To make recommendations on art works, evaluations and involved risks.
Paying Agent/ Bank/ Depository Bank	An independent operating party. Responsible for AIF's compliance with regulatory requirements and safekeeping of cash.
Insurance	Professional handling of possible damages. Preservation and maintenance of art works.
Administrator	Back office tasks: calculation NAV, keeping of books, archiving (partly delegated to Auditor).
Independent Experts	Team of independently operating experts providing valuations of AIF's assets.
Auditor	Prepares and evaluates financial records.
Custodian	Arranging settlements regarding purchasing, buying, safekeeping of assets.

Note: the parts written in blue are parties specifically needed for the operation of AIFs, when compared to TIFs.

[3] Based on information from Skate's (2012) and companies' websites

4.6. Conflict of interest

When considering the many parties involved and especially the different teams of experts on financial markets and art markets, one assumes that a conflict of interests will be inevitable. It is true that the core of these jobs seems opposing (Deloitte & ArtTactic, 2011; FAWM, 2008). However, it is also because of these diverging cores that when compromises and mutual understanding take place, synergies might arise. Combining expert knowledge on art markets and financial markets, might cause for opportunities to rise and gaps to be filled. (FAWM, 2008).

The following part will deal with the two conflicts of interest mostly occurring in AIFs namely, between the financial experts and art markets experts and the conflict advisors/dealers/investment managers face when they are in the position to work in favor of the Fund or for other clients.

Art markets experts versus financial market experts

It will be no surprise that a conflict of interest may arise between art markets experts and financial markets experts. A financial market expert is someone who calculates profits, returns and risks. His job is to measure and provide detailed recommendations. Financial experts also have the responsibility of limiting AIF's costs to a minimum. They do this, for example, by locating the administrator in a location where they have to pay a minimal amount of tax. The uncertainty, high risk and asymmetry of art markets are possible causes of conflict when trying to cooperate with art markets specialists. Art markets experts are those with a very extensive knowledge of art markets. They are the ones with the right contacts and relationships with other dealers and galleries. If the art expert of an AIF is a well-respected and knowledgeable man, it will provide the AIF with the opportunity to buy art works (mainly from the primary market) for a relatively low price (M. Bouchon, personal communications, May 8, 2012). Subsequently, through activities of active management, the value of the bought art work will supposedly rise while costs are being minimized, which will eventually lead to a higher price being raised for the art work (FAWM, 2008; Horowitz, 2010; Nazvanov, 2010).

In order to limit the causes of possible conflicts between art market experts and financial market experts, is to increase the understanding for both parties on both markets. Financial markets experts should comprehend the possible financial opportunities associated with art. What might be the only way to achieve this, is that both parties intensively exchange their knowledge and create a mutual understanding of both markets (Deloitte and ArtTactic, 2011).

Function conflicts

Although a conflict between financial experts and art markets experts might seem quite predictable, conflicts of interest may also occur among different functional departments/functions. The person responsible for risk management might advise on a limited amount of art works that carry highly unpredictable values, while at the same time the Art Advisor detects that these works are a targetable part of the market. Moreover, Advisors, Inventory, Banks and Insurance do often not have the AIF as their only client. So, for them individually, a conflict arises on what they offer and recommend the AIF and what they tell their other clients (Motif Offering Memorandum, 2008; PMG FAIF Offering Memorandum, 2010).

The Fine Art Fund Group foresaw these possible conflicts and established a specific decision-making process consisting out of four steps in order to preclude conflicts of interest. The first step concerns the Art Buyer, who sources deals and recommends the Management on purchases. The second step includes the Art Advisor, who performs due diligence on all proposals and provides independent perspectives to the Management. In the third step, the Manager performs due diligence on all proposals. Finally, the fourth step is where the Fund Board offers advice and approval on any purchases charging more than 7% of total commitments to Fund.

In addition to the decision-making process, some of the involved parties are limited as well as encouraged in some way. The Art Buyers sign a contract that prohibits them from advising other funds and to get involved in the process of decision-making when they offer their own works. They are encouraged to act in favor of the Fund by the possibility to receive a fee on lucrative purchases at the end of the Fund's life as part of the Manager's carry. The Art Advisors, who offer an extra check on buyers' recommendations are paid an advisory fee related to the successful sale of the works they recommended. Moreover, auction houses have no financial interest or shareholding in the Fund.

When comparing the taken measures against conflicts of interests by the FAF with other AIFs, such as the Fine Art Invest Fund, it can be concluded that fees on performance are provided in order to reward and encourage the various functions to act in favor of the Fund and that transparency and due diligence are most important to prevent conflicts from happening. However, while FAF prohibits its employees from certain actions, the Fine Art Invest Fund, allows its advisors and partners to offer their services to other clients, which may be the same or different from their service and advice to the Fund, but should contain no more favorable conditions than to the Fund (PMG FAIF Offering Memorandum, 2010).

Besides the specific established measurements, for all AIFs it is important to have a network. Close contacts with galleries, art dealers and other leading figures are crucial when initiating an AIF and sustaining it. Regarding these relationships, trust and integrity play a large role, something which cannot be secured in measurements and rules (Horowitz, 2010; M. Bouchon, personal communications, June 11, 2012; PMG FAIF Offering Memorandum, 2010).

4.7. Location choice

Impossible not to notice is the choice of location by AIFs. Almost all of them are located in off-shore tax jurisdictions such as Luxembourg, Jersey, Guernsey, Cayman Islands, British Virgin Islands, Ireland, Singapore (FAWM, May 2011). This part will discuss the two domiciles of Luxembourg and Gibraltar. A reason for moving off-shore is that in 2009 the European Union proposed The New Alternative Fund Managers Directive, which expects Fund Managers to be supervised under an EU regulatory body. This means that Alternative Investment Managers are obliged to report to financial regulators and to achieve minimum capital requirements, which in turn is probably going to weigh heavily on AIFs' investments by extending their costs and administrative burden (FAWM, May 2011).

One of the reassuring characteristics of Luxembourg is their continuous stable political environment, their responsive and accessible government and that they are equipped with an international financial center, specializing in Funds and Wealth Management (Deloitte & ArtTactic, 2011). When being registered as a Luxembourg Specialized Investment Fund, the Fund is liable to the Luxembourg financial supervision body (under which a tight selection criteria exists for eligible investors). But, the regulatory restrictions and supervision level is less than for standard investment funds (FAWM, 2008).

Gibraltar might be chosen for slightly different reasons. In 2005 a new legislation was introduced which allowed Funds a quick and easy launch process. Although there are many details and conditions involved, to start the Fund is relatively easy. Another advantage is that there is no limit on borrowing or owning investments. So, the Fund is able to invest in any class as long as the investors are informed and accept the risks. Regarding tax, Gibraltar uses a territorial principle in establishing liability to taxation. Most important, income derived from outside Gibraltar is exempt from tax. Thereby, there are no capital gains duties charged so Gibraltar grants a tax free haven for international investors and no withholding tax is paid on returns to non-Gibraltar investors. A particular detail about investments in Gibraltar is that they can be established in Protected Cell Companies (considering Art Funds; to split the various segments invested in, up in to different Cells), where these Cells are statutorily protected from each other in case of bankruptcy (Lasry, 2008).

To conclude, as was already mentioned in the Literature Review, it is not the whole Fund that is located in an off-shore location. Often, it is only the Administrator who is registered in tax-free havens, while the company operates from big financial and art centers such as London or New York (Deloitte & ArtTactic, 2011; FAWM, 2008; Lasry, 2008; Skate's, 2008).

4.8. Art Investment Funds versus Traditional Investment Funds (TIFs)

As the most important building blocks of AIFs have been discussed, it is finally time to move on to the most exciting part. This part will compare AIFs to TIFs. The differences and similarities are divided into three main components; functional, operational and risks.

4.8.1. Functional

One of the reasons why earlier set up AIFs failed is that they were led by successful art dealers or collectors, whose knowledge and experience of art markets was not enough for operating an AIF (Nazvanov, 2010). So, as already was described in the part on structure, a combination of the two expertises on art markets as well as financial markets is required (FAWM, 2008; podcast Green & Tawil, 2011). Another challenge managers of AIFs deal with, is the still current misperception that art is only for collecting (FAWM, 2010). This runs contrary to the operations of art markets, that has a complete industry dedicated to maintenance and disposition (including art dealers, auction houses, art leverage financiers, insurance products at a level of refinement that has no connection to traditional collectables). However, investors and other parties involved such as an Administrator and Depositary Bank often still need to be convinced of the advantages art may offer (Deloitte & ArtTactic, 2011).

4.8.2. Operational

Operationally there are some inefficiencies especially related to AIFs, which are not found in Traditional Investment Markets. One of them, is the low frequency of transactions; where trade occurs daily in financial markets, in art markets it may take up to 6 months before a transaction takes place (Baumol, 1986; Deloitte & ArtTactic, 2011; FAWM, 2008, June 2011). Thereby, an art work might not be on the market for a long period if acquired by museum or collector (Nazvanov, 2010). Moreover, there is no central, reliable information source for buyers and sellers. Valuation is another operational challenge AIFs deal with. Art works do not come with standard prices. However, it is also because of this limited availability of information and lack of a common, agreed method of valuation, of which AIFs make use (Deloitte & ArtTactic, 2011; FAWM, May 2011; Nazvanov, 2010).

Another advantage for AIFs is their ability to diversify within their chosen asset class of art in order to spread their risk. But on the other hand, AIFs deal with a list of additional cost with which TIFs do not deal. (Arnold, 2008; Deloitte & ArtTactic, 2011; FAWM, 2008; Horowitz, 2010; M. Bouchon, personal communications, June 11, 2012).

4.8.3. Risks

A clear overview will be given regarding the additional risks AIFs carry. The risks are already discussed and will therefore mentioned only briefly. Regarding art markets involve illiquidity, valuation, insurance and fraudulent copy (Baumol, 1986; Coffman, 1991, FAWM, 2008, May 2011; Marmarbachi et al., 2008; Nazvanov, 2010; among others). Risks AIFs carry in addition to these are, the lack of a track record and risks in selecting assets. Similar risks among Traditional Investment Funds and Art Investment Funds can be concluded to be inflation, interest rate movements, government legislation, tax changes, compliance and change in consumer confidence (Nazvanov, 2010).

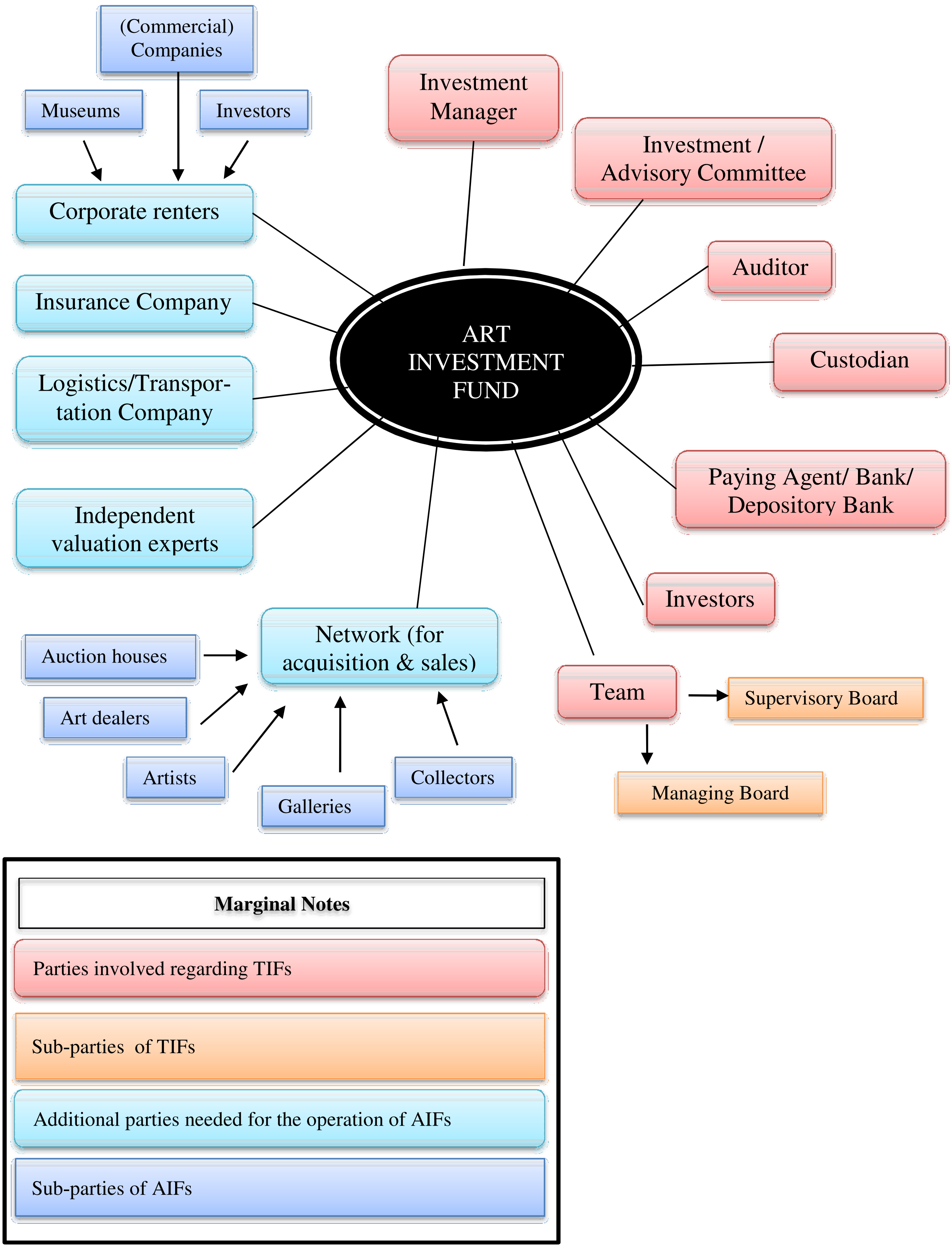
4.9. Art Investment Fund Models

After having researched and gathered the information on AIFs, the final goal was to create greater transparency regarding the structure and operations of Art Investment Funds. The data analysis already provides a thorough evaluation on the materials, which was documented as clearly as possible. However, to provide an even more comprehensible and transparent view on Art Investment Funds, two final models are generated, in which the outcomes of the data analysis are summarized.

4.9.1. Involved parties / structure

The first model offers a view on a common detected structure among AIFs including involved parties. Besides portraying the involved parties concerning AIFs, the model presents a clear distinction in what parties are involved regarding TIFs (the pink colored boxes) and what parties are in addition need for the operation of AIFs (the blue colored boxes). As can be seen at a glance, is that there are many more parties involved in the structure of AIFs. Moreover, the importance of the network for Art Investment Funds should be noted (podcast Green & Kiradi, 2010; F. Kiradi, personal communications, June 8, 2012).

Considering this model, one would assume that for operating an AIF, many people are needed. It is true that these parties are related to AIFs. However, the parties are not necessarily delegated by the AIF (as the earlier on mentioned comparison between The Fine Art Fund and the Art Photography Fund). An AIF, such as the Art Photography Fund, may employ only three people, combining at least an art markets expert with a financial markets expert (podcast Green & Hoffman, 2009, 2010; Green & Kiradi, 2010). In that case, the Investment Manager often operates as a sort of umbrella organization, who delegates the responsibilities and tasks of insurance, logistics and transportation. This happens for example at the Castlestone Management Collection of Modern Art Fund and the Fine Art Invest Fund. Still, the network will remain a crucial part of the AIF self.

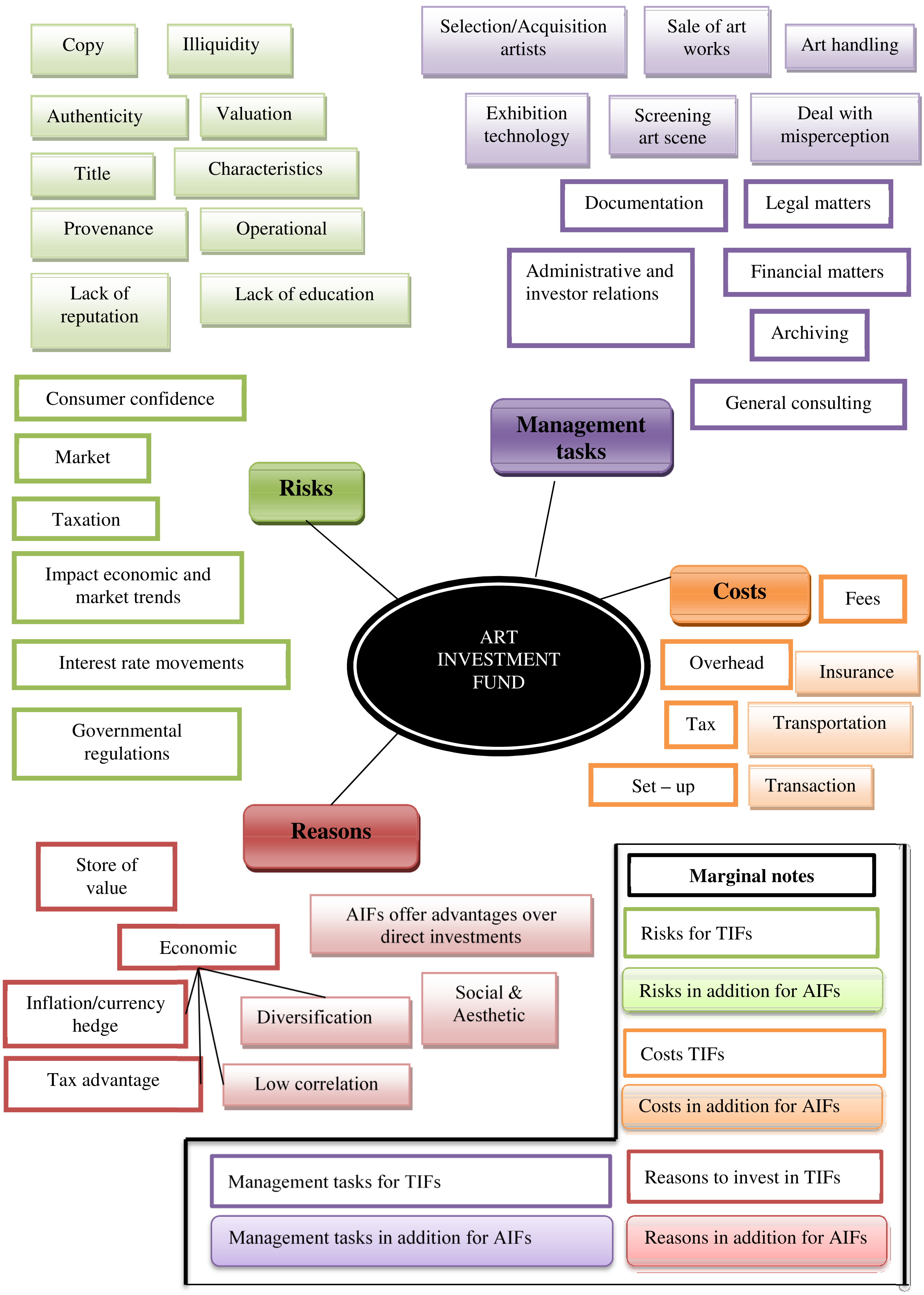


Model 1. Involved parties / structure of Art Investment Funds

4.9.2. Art Investment Funds' aspects

As the first model concentrates on the involved parties regarding AIFs, the second model portrays the most prominent aspects concerning the operations of AIFs. Generated from the data analysis, the model portray four of the most interesting aspects regarding AIFs. Again, a distinction is made to what extend the aspects play a role in TIFs, and what aspects are additional for AIFs. The four aspects are divided into four different colors, where related boxes are encircled in the same color and the additional parts for AIFs are filled up in the same color.

Model 2. (Art) Investment Funds' aspects



As can be directly observed are, again, the many additional boxes associated with AIFs. First of all, they carry additional risks. These concern risks inherently related to art markets (such as illiquidity), to the assets underlying the investments (art works carry risks of copy, authenticity, valuation and provenance) and risks directly related to AIFs (such as the lack of education and lack of reputation). Moreover, additional management tasks for the functioning of AIFs include selection and sales of art works, and tasks related to active management. Costs also expand due to activities of insurance, logistics and transportation.

However, there are also additional reasons for investing especially in AIFs. These are extremely important to notice, as these form the reasons for the existence of AIFs in general. There are two economic related reasons; diversification and low correlation of art assets with traditional assets, as explained in the part on 'reasons'. Social and aesthetic reasons are also mentioned as AIFs often offer art works for borrowing (aesthetic) or a membership of an elite club (social). Moreover, AIFs offer additional advantages when comparing it to a purchase from an art dealer or gallery (such as the covering of insurance, logistic and acquisition costs).

4.9.3. Conclusion

The formation of two models, depicting the functioning as well as four aspects of AIFs, has been the ultimate goal of this research. Provided with these two models, the transparency and understanding of AIFs has increased and a clear comprehension of the operations and aspects is finally given. Thereby, from the structured models, one can easily detect what parties and aspects are additionally involved when comparing AIFs to TIFs.

However, after analyzing and generalizing information on nineteen AIFs, it will only be even more interesting to see to what extent the models are applicable to one specific fund. So, after having provided a broad analysis on AIFs, a more specific analysis by means of a Case Study is executed on the following AIF: the Fine Art Invest Fund.

5. Case Study: Fine Art Invest Fund

5.1. Introduction

As already stated in the final paragraph of the data analysis, the aim of this case study is to determine to what extend the two finally generated models, on structure and aspects of Art Investment Funds, apply to the Fine Art Invest Fund (FAIF).

The FAIF is selected for a case study, as compared to other AIFs, it is the most transparent one about its operations and structure. It is the only AIF that has provided an extensive Offering Memorandum and an *Annual Report & Audited Financial Statements*. Moreover, their website and their given information is most comprehensible and clear.

Expectations regarding the similarities between this particular case and the generalized models on structure and aspects are high. Being aware of the fact that the constructed models are based on generalizations, it is most likely that the structural components as well as the model on involved aspects carry many similarities with the FAIF. One should be aware of each AIFs' specifics. Each AIF has its specifics in order to create a competitive advantage. While discussing the several aspects of FAIF's operations, the three main questions regarding AIFs' investments are kept in mind (as stated in the introduction).

Eventually, after the analysis of the FAIF, a similar model on structure and involved parties is generated. This model will be compared to the models generated in the data analysis. Finally, the similarities/differences as well as the three main questions are discussed.

5.2. Background

PMG Funds management is the Investment Manager of FAIF. PMG invests in eighteen different funds concentrating mainly on securities, stocks and bonds, with a total estimate of CHF 1.6. billion under management. At the end of 2010, they launched four sub-Focus Funds under the common denominator of PMG Focus Funds. Three of them focus on financial markets considering corporate bonds and securities, while the fourth fund is the Fine Art Invest Fund, which focusses on investments in contemporary photography.

PMG noticed that over the last ten years (2000-2010) art, especially photography, has proven its ability to serve as a sustainable asset class for investments. Moreover, because of increased interest by clients and an enhanced number of banks expanding their art banking departments, PMG deemed it necessary to offer an Art Investment Fund as well.
After already one year, FAIF had been able to display itself at several art fairs in cooperation with the Hammer Gallery. Moreover, the Fund got invited to become part of the Art Fund

Association, probably the only lobby worldwide and association which provides contact points for AIFs and investors.

5.3. Strategy

The corporate investment objective is a growth in return of 12-15%, which is similar to other AIFs. How they achieve this objective, is by employing a business unit strategy where they focus on one art asset segment, namely photography, but offer a diversification within this segment (neo-classics, contemporary photographers and new talents). A geographical diversification is also offered, as one can invest in photography from Europe, America and China.

In order to achieve the objectives set out in the corporate and business unit strategy, the FAIF management applies active management. Their short-term goal of profit and income is obtained from gallery sales, exhibitions and loans to museums. Their long-term goal to increase the intrinsic value of art works is achieved by holding exhibitions, expositions at museums and art fairs, supported by their contact with the Hammer Gallery.

To limit the risk of devaluation, they only purchase photographs with a limited edition of eight. Thereby, they only buy in the primary market with high gallery discounts mostly from Loubna Fine Art Society. Buying from the primary market provides them with the advantage of shaping and promoting the career of their own selected artist. Moreover, an exclusive contract with Loubna ensures that obtained art works by Loubna are first shown to FAIF, whereupon FAIF has eight weeks to decide whether they purchase before putting the art works on the market. The risk of buying a flop is limited by careful selection of art works is made taking in mind the advice of an independent art experts committee and the valuation of their insurance company. Loubna is not only an advisor to the company, but is in charge of the whole process concerning acquisitions and sales. Loubna Fine Art Society directly supports educational institutions which subsequently ensures a first pick of artists as well as a well sustained relationship with these academies.

The company’s website portrays their value chain (retrieved July, 31, 2012, from www.faif.ch) including sourcing, buying and selling, and the relationship between FAIF and Loubna, as the following:

The value chain shows that FAIF is operating in the primary market as well as in the secondary market. This probably provides them with the opportunity, with the help of an expert committee, to buy high-growth potential art works from the primary market at a relatively low price. Then, through the previously mentioned active management activities, FAIF attempts to raise the price and subsequently will sell the art works on the secondary market.

5.4. Structure

Structure is important to discuss as the legal structure will tell something about the calculation of NAV. Moreover, a table on operational structure is constructed in order to provide a clear overview of FAIF's distribution of tasks, responsibilities and control.

5.4.1. Legal structure

PMG funds management is a Limited Liability Company. FAIF has an open-ended structure, which allows a continuous inflow of investments, the issue of shares, but also the right of investors to redeem. However, this right to redeem can be withdrawn by the Directors of the Fund, as they are able to convert the Fund into a close-ended Fund if the Investment Manager (PMG) deems it to be necessary.

Furthermore, a minimum investment of € 75 000 is required, which will be issued in Non-Voting shares of the Initial Offer Price of CHF 100 per Share (as already explained in the data analysis, the offer price of a share in an open-ended fund depends on the value of the underlying asset).

5.4.2. Operational infrastructure

Table 5. FAIF's operational infrastructure – Teams	
Teams	Tasks & responsibilities
Three directors (no other people employed by FAIF. Specialized in law, finance and business).	Accounting record, safeguard assets, execute internal controls, guarantee reliability of financial reporting, effectiveness and efficiency of operations, ensure compliance with regulation
Note: Responsibility marked in green, is specific to operating an AIF	

Table 6 provides the actual names of organizations involved. Their tasks and responsibilities correspond to the title descriptions as given in the data analysis, table 5.

Table 6. FAIF's operational infrastructure – other parties	
Other parties	Tasks & responsibilities
PMG Funds Management	Investment Manager and Administrator Right to modify FAIF's investment approach. Several tasks are delegated to an Advisory Board, a Trading Advisor, an Auditor and a Legal Advisor. However, the final responsibility is located at PMG.
Loubna Fine Art Society	Investment Consultant and Purchaser. Prominent connection in FAIF's network. Sponsor living artists, preservation, assist in process of acquisitions, provides sales advice.
Independent Advisory Committee	Advisor. Provides PMG with independent advice on art works offered by Loubna.
Allianz Art Versicherung	Insurance company. Daily valuation of art works and maintain relationship with preservers and shippers.
Cosmotrans	Safekeeping and transportation logistics.
Note: The green marked parties, are the ones that PMG had to employ in addition, especially for operating their AIF: FAIF	

5.5. Conflict of interest

There exist two conflicts of interests regarding their Fund Advisor Loubna and the Investment Manager (PMG). PMG is not only Investment Manager of FAIF, but also of other funds. Therefore, they may give advice or take action which may be different or the same with regard to FAIF. The Offering Memorandum states that in this case, the Investment Manager should try to provide a fair allocation of investment opportunities among the funds. If a conflict of interest arises between the Fund and a service provider, the Directors of PMG guarantee that it is resolved fairly.

Loubna's task of Fund Advisor as well as art works supplier might raise a possible conflict of interest. Subsequently, the Investment Manager has employed an independent advisory committee to provide expert advice on art works offered by Loubna. Loubna is also allowed to provide similar or different advice to other clients and to sell pieces to other clients. However, works should first be offered to FAIF for at least a period of eight weeks, as a single offer only to FAIF.

5.6. Risks

Risks are similar to the ones recorded in the data analysis. However, the currency risk is one that is noteworthy. FAIF's reference currency, in which performance is measured and reported, is CHF. However, their base currency, in which payments are made, is stated in EUR. The Fund fully resigns the currency risk and the compliance with exchange control regulations to the investors.

5.7. Performance

The interesting part about this case study is that for the first time the financial performance of an AIF can be analyzed as an *Annual Report & Audited Financial Statements* on PMG Focus Funds is provided. The statements regard the first year from August 31, 2010 to September 30, 2011. Already stated in the Offering Memorandum regarding FAIF is that their target growth of Net Asset Value is set at 12% to 15%, which is grounded on reference indexes on the performance of the photographic art market. Important is to be aware of the fact that FAIF is open-ended structured. Which means that NAV is calculated by the value of the current underlying assets. The Annual Report provides various financial statements, but the two that present the most comprehensible overview are the Balance Sheet and the Income Statement.

The three directors of the four Focus Funds (including FAIF) are responsible for the financial statements. They assure that the Company holds internal records to ensure reliability of financial reporting in accordance with laws and regulations. According to the Companies Act of 1995, they are obliged to portray a true and fair view of the financial position of the Company conform with the criteria of International Financial Reporting Standards as followed by the EU.

Balance Sheet

The Balance Sheet provides a snapshot at a certain moment in time (September 30, 2011). Their financial assets consist mainly out of contemporary photography art valuated at fair value. Their Liabilities include accrued expenses on fees regarding management, audit, fund secretary, administrator and registration. To conclude, net assets are calculated at CHF 2 536 542.

From the Cash Flow Statement and the reported change in fair value on financial assets and liabilities, it is deduced that no profit or loss was accounted for on disposal. Neither were there payments on redemptions. This indicates that no art works got sold and that no investor redeemed his shares.

Interestingly, no income tax appears on the balance sheet. This is related to the domicile of the Administrator, which is Malta. FAIF is part of a collective investment scheme (PMG Focus Funds) and recorded in accordance to Malta's Collective Investment Schemes. PMG Focus Funds is qualified as a non-prescribed fund, which entails that if this fund carries a value of less than 85% of PMG's total assets, they are not subject to Malta income tax.

Income Statement

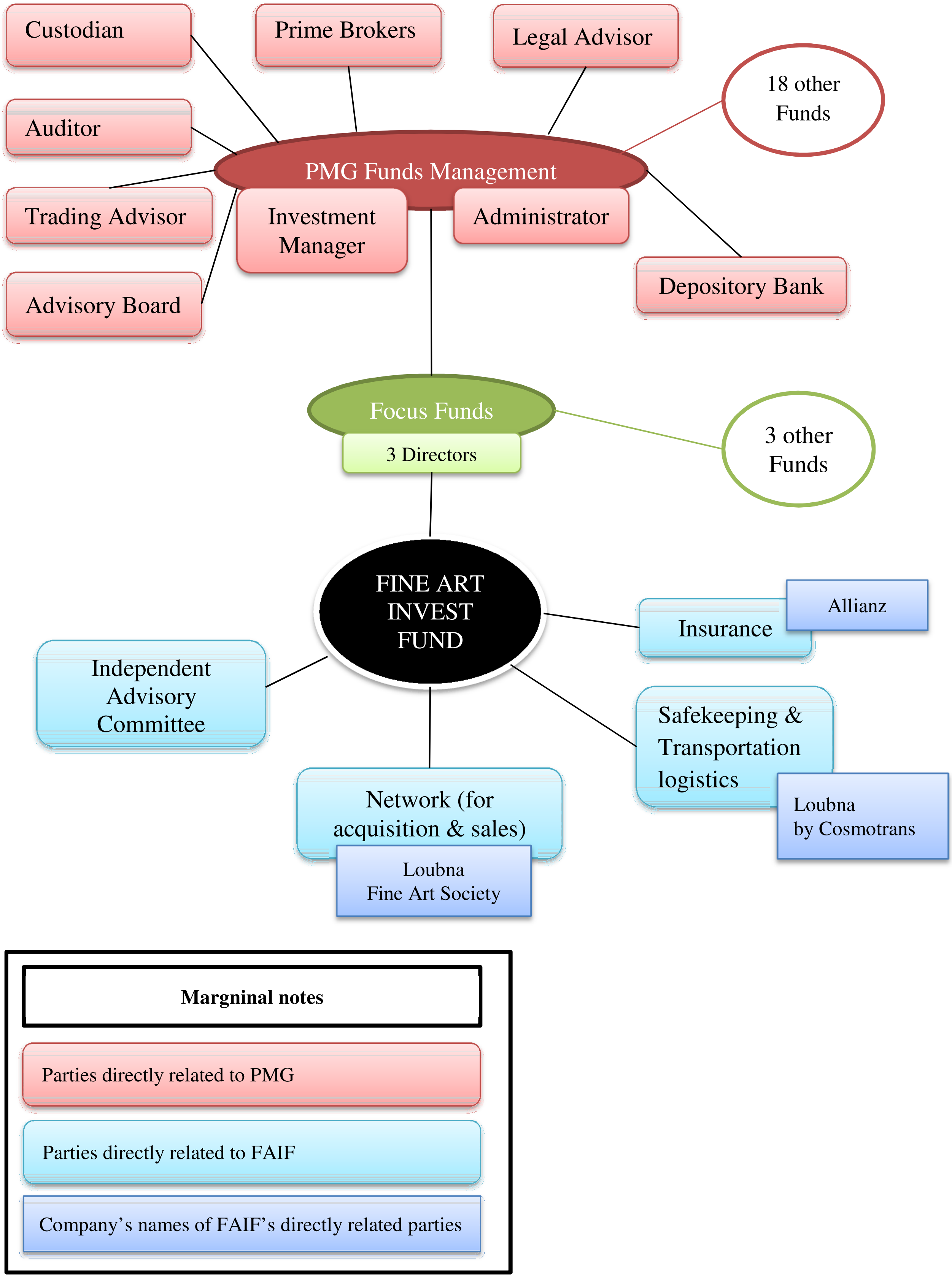
The Income Statement provides an overview of the performance of the company during a certain period (August 30, 2010 – September 30, 2011). So, this is FAIF's first financial year. FAIF's income is derived from interest on cash held by the bank and their financial liabilities at fair value. The expenses are fees on management, administration, audit, Directors, legal and professional fees. Additional expenses include bank charges, amortization and other administrative expenses. The total profit for the year, similar to the total comprehensive income for the year is CHF 194 188.

As conclusion on the first financial year, their net performance is calculated at 12,14 %. In December 2011 is was even quoted at 13,18%. This indicates that they achieved their set target growth of NAV (above 12%). Interesting to notice, as no redemptions nor disposals occurred, is that the calculation of NAV probably mostly relies on the valuation of the art works.

5.8. FAIF's involved parties / structure Model

Although the case study provides many exciting specifics, it is most interesting to see to what extent the generalized model on involved parties / structure concluded from the data analysis, apply to FAIF. Therefore, the model on involved parties / structure is generated from the analysis on FAIF.

Model 3. Fine Art Invest Fund – involved parties / structure



The parties involved around the FAIF are similar to the general model. Most parties, that were concluded to be part of Traditional Investment Funds as well, are managed or delegated by the Investment Manager, PMG Funds Management.

However, FAIF is somewhat differently structured. FAIF is part of a four sub- Focus Fund, which is managed by three Directors. So, FAIF itself does not have a team consisting of a Supervisory and Management Board. Decisions are taken by these three Directors, who in turn are monitored by their Investment Manager, PMG Funds Management. That an Art Investment Fund is not operating independently is something quite common.

More specific to FAIF is their close relationship with Loubna. Loubna operates in the primary market. Loubna provides FAIF with various contacts on the primary market e.g. galleries, artists, art dealers and collectors. Loubna is attracted to create a competitive advantage. However, what should be said, is that in general AIFs rely on a specific party or person, who is well-established, experienced and has useful contacts with the art world (M.Bouchon, personal communication, May 8, 2012).

A second generalized model on (Art) Investment Funds' aspects was not specifically generated for FAIF. The main reason being, that the aspects are largely applicable to FAIF as well, which would make a specific aspect model on FAIF unnecessary. Moreover, the Case Study already addresses many of the aspects and explains how FAIF deals with them.

5.9. Conclusion

It was most fortunate that PMG Fund Management provided sufficient information in order to conduct a case study. PMG can be seen as the only Investment Fund being overwhelmingly open and transparent about their structure and operations.

Not unexpectedly did the general model on involved parties / structure show similarities with FAIF's involved parties / structure Model. It was most interesting to research the exact operation and structure of FAIF and to conclude that these are actually similar to findings from the data analysis. The case study does provide a better overview on the level of hierarchy. Especially regarding potential conflicts of interest, it is clear that PMG has the highest order and the final say in everything concerning FAIF.

It seems that they offer investors great opportunities. However, reading the *Memorandum* carefully, Focus Funds does provide itself with the right to resign from offered matters to investors. Especially, regarding the initially attractive right of investors' to redeem or to transfer shares to other parties, they are able to decline.

When considering the three main questions to FAIF, one could relate the choice of investors for FAIF to the great transparency they offer, which makes their operations easier to understand and creates less uncertainty for investors. Another reason could also be the diversification they offer in the proven track record art segment: photography.

From PMG's perspective, they have launched FAIF to suffice customers' demand for diversification. As FAIF is part of a much larger investment fund structure (19 other funds are held by PMG), the risks PMG carries decrease. Moreover, these economies of scale allow PMG to easily delegate tasks.

Moreover, why investors will not approach an art dealer/gallery themselves, but go to FAIF, is that FAIF has a well-established relationship with Loubna Fine Art Society. In this way, FAIF has access to the primary market as well. Then rest the advantages of FAIF covering insurance, transportation and logistics, among others.

6. Conclusion

At the start of this thesis it was already known that there had been limited research done on Art Investment Funds. That could be seen as a drawback but also as an advantage, as this thesis had the potential of making a real contribution to the field. Considering financial reports and the initial capital AIFs try to raise, one could conclude that millions of dollars circulate in this business. This fact would make one only wonder how it is possible that research on this topic is limited and transparency is lacking. On the one hand, is the lack of transparency something of which AIFs make use, with their combination of art and financial expertise. On the other hand, it remains a challenge for AIFs' managers to raise money, as investors are uncertain and act generally reserved about investing in something which lacks transparency. Fortunately, information on nineteen AIFs was obtained in addition to some very helpful reports and email communications. This allowed for creating more insights regarding the operation of AIFs and even led to the generation of two comprehensive models regarding the structure and aspects of AIFs.

Model 1 on structure indicates that many additional parties are needed for operating an AIF, when compared to a Traditional Investment Fund. These extra parties concern corporate renters, an insurance company, a logistics/transportation company, independent experts and probably most important; their network. Their network provides them with the necessary contacts in order to gain access to art works. If an AIF has a well maintained relationship with an art dealer or collector, or when making them part of the AIF and paying them a fee that correlates with raised profits, it will increase AIFs' access to high growth potential art works. The initial assumption that AIFs need many additional parties for their operation is confirmed by model 1. However, whether the parties are directly or indirectly related to an AIF, is not explained by the model because this differs per AIF and cannot be generalized. It often occurs that tasks and responsibilities are delegated by the AIF or its Investment Manager to other parties. As the FAIF case study demonstrates, the Investment Manager PMG was responsible for most of the tasks. PMG did delegate tasks to other parties. Although the outsourcing of various tasks, PMG kept final responsibility. Subsequently, also kept the final say in decisions. Comparing the FAIF structure model to the general AIFs' structure model, indicates that most of the involved parties were similar.

The AIFs' aspects model 2 indicates that, as well as the structure model, many additional aspects are involved when operating an AIF in comparison to a Traditional Investment Fund. The list of risks, costs and management tasks is extensive. Additional risks for operating AIFs included risks related to art markets characteristics (e.g. illiquidity, valuation), to artworks (e.g. authenticity, provenance, copies) and to AIFs themselves (e.g. lack of reputation, lack of expertise). Additional management tasks related to AIFs were also extensive, including selection of artists/art works, sales, active management, etc. Moreover, cost were added in form of transportation, logistics and insurance when operating an AIF. However, and what is fascinating to notice, is that the list of reasons has also expanded. There are two economic reasons and two other reasons which form additional arguments for the benefit of investing in AIFs. The economic reason of diversification in your investment portfolio has been supported by many researchers. Diversification among different asset classes will decrease the overall level of risks as you are not betting on one horse, but you distribute the invested money among several assets. Moreover, when a non- or low correlation is found among your invested assets, your chance of generating a stable and constant return amount on your investments, is even more likely. Another reason why investors turn to AIFs instead of an art dealer, are the advantages AIFs offers regarding the covering of art works' related cost. Moreover, when investors want to have an art work in their home, they should invest in AIFs that offer the service of borrowing art works. In this way, AIF's acquired art works are lend to investors which subsequently derive social and aesthetic values from it. Especially social value can be derived from investing in AIFs as nowadays it is more seen as a trend and as something to flaunt with. So, although one would not initially assume that social and aesthetic values are derived from investing in AIFs, this research remarkably shows that these values are indeed related to AIFs.

Besides to two models, there were three questions which continuously prevailed during the conduction of this research. Namely, Why would investors want to get involved in this relatively risky business (investors perspective)? Why are AIFs set up when they carry many additional risks, costs and tasks (AIFs' perspective)? And why do investors choose for investing in AIFs instead of approaching an art dealer or gallery directly?

This first question on investors' motivations can be related to the reasons, mentioned in the previous paragraph and model 2. These are identified as store of value, economic reasons, yielding social and aesthetic values, and the advantages AIFs offer in addition to purchasing from art dealers. Moreover, mentioned motivations are reasons that AIFs offer in addition investing in TIFs.

The AIFs' perspective was also exciting to research. When establishing the many additional risks, management tasks and costs related to operating an AIF and determining what is needed in addition for operating an AIF compared to TIFs, one will immediately wonder why anyone would set up an AIF. This research indicates that AIFs are mainly launched in order to deal with competition and to suffice client demand. Especially during these times of economic turbulence, the demand for real assets has increased and investors regard art works as a safe store of value and are certainly willing to dedicate a part of their portfolio to art investments. The same reason of spreading risk applies to AIFs. When considering the case study of FAIF, the establishment of the four-sub Focus Funds (including FAIF), was initiated by PMG (who is already operating in eighteen funds) in order to diversify and to spread risk.

The question why investors go to AIFs in order to invest in art instead of purchasing art works from an art dealer or gallery directly, concludes with an elaborate answer. First of all, to invest in art through AIFs saves time. There is no need to be educated about art markets and art works. Neither is a relationship needed with a trustworthy art dealer or gallery. Moreover, AIFs are equipped with the finest experts on art markets as well as financial markets. This combination of expertise is what enables them to take advantage of inefficiencies regarding both markets. Involved costs when purchasing art works are also covered for by AIFs. Finally, one of the most important reasons to invest in an AIF instead of buying one or two works yourself, is the spreading of risk. By AIFs' ability to pool investors' money, they increase their access to quality art works. Thereby, the investor is not relying on the value of one or two art works, but owns a small part of many pieces.

In conclusion, there are many additional parties and aspects involved around AIFs when comparing them to traditional investment funds. What appears to be most important for AIFs is that they are featured by a combination of expertise, a well-established network and trust. From the AIFs' aspects model, one will conclude immediately that many unfortunate aspects regarding risks, management tasks and costs are additional to the operation of AIFs. However, AIFs do exist and the number of establishments is increasing. Therefore, what seems to be the only way to explain the existence of AIFs, is that the unfortunate aspects are outweighed by the additional reasons and advantages related to AIFs.

Limitations

The most challenging limitation was already known before starting the research, which is the high level of secrecy around the operation of AIFs and the minimal provision of information by AIFs. Conclusions are based on information drawn from nineteen different

AIFs was included. There are more AIFs in operation at the moment, but lack of information availability limited this research to nineteen AIFs.

Moreover, the lack of research done on AIFs has led to a small amount of generated theories about AIFs. Art investments have been researched (Frey & Pommerehne, 1989; Goetzmann, 1993; Reitlinger, 1961, 1963, 1970; among others). However, the idea of approaching art markets from a pure financial perspective, through AIFs, has not been approached by many (Arnold, 2008).

The non or low correlation between art markets and financial markets forms one of the biggest arguments for investing in AIFs. Correlations can be drawn between various art segments and numerous financial assets, where each correlation could differ. So, forming generalizations on the correlation is rather difficult and should be carefully looked at.

Performance was one of the most interesting but most difficult part to establish. Investments in AIFs are long-term (10 years). Also, NAV calculation do not always portray the actual truth. Sales strategies influence the outcomes of NAV, when calculated during the operation of the fund. Performance establishment should be done after final liquidation. Consequently, as most incorporated AIFs were launched during 2000 – 2010, the representation of their actual performance is difficult.

Discussion & further research

There are some aspects regarding AIFs which should be considered carefully. Information from the case study revealed that the rosy-colored offering of lending art works to investors, might lead to high costs. In general, AIFs are covering for costs regarding insurance, transportation and logistics. However, when they lend their art works to museums, institutions or their investors, it is the one who borrows the work that carries the responsibility and thus the costs. Another careful look should be given to the right to redeem of investors, when they invest in an open-ended AIF. With regard to the case study, it appears quite easy for an AIF to dissolve this right when they consider it to be necessary.

Regarding the research on the topic of Art Investment Funds, there is still much to discover. Interesting would be to research the component of tax. To determine whether there are countries that offer tax advantages to investors, related to investing in AIFs. Moreover, some of the AIFs stated that they wanted limited influx of American investors. This is probably related to several forms of registration, which are not everywhere the same.

Finally, as already mentioned in the limitations, more research should be conducted on the correlation between art markets and financial markets. This would entail a large study on the cross-sectional correlations between art markets and the financial market. These studies will probably conclude that, as most AIFs recommend, a five per cent of your investable income should go to AIFs in order to diversify and spread your risk. If so, one should bear in mind that this five per cent is at least €100 000, as that is often the required level of initial investment by AIFs.

Additional research on AIFs will create more insights regarding their operations. Thereby, a decreasing level of secrecy and a better understanding of AIFs will probably lead to an increase in number of investors and a broader acceptance of AIFs.

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