FINANCE and the ART MARKETS

B 8446 sec 1

Fall 2017, B-Term (Second part of the semester)

Instructor: Arturo Cifuentes

Course Description

Paintings, notwithstanding their artistic merits, can also be valuable financial assets. The same goes for other artistic objects such sculptures, photographs, rare books, and certain collectible items. Consequently, this course focuses on the art market from a financial viewpoint.

In recent years this market has grown in size, geographical diversity, and importance. However, many fundamental facts about the art market remain not fully understood; and compared to more established markets –such as stocks and bonds, for example– the art market presents a number of peculiarities that still fascinate scholars and investors, not to mention the popular media.

The motivation for this course is to apply the conventional tools of financial analysis to gain an understanding of the dynamics of the art markets. Special emphasis will be placed on the market for paintings. Nonetheless, the market for other art objects, such as certain musical instruments, antique furniture, classic cars, as well as stamps and photographs, will be discussed as well.

Among other things, the course seeks to help the students to answer concrete questions such as:

• Is it a good idea to buy a Picasso (or a Basquiat) as an investment?
• Can we improve the risk profile of a stock-dominated portfolio by adding a few art-related holdings?
• Is the art market an efficient market? Are there significant asymmetries of information?
• Could the development of art-related derivatives products contribute to improve the liquidity in this market?
• What are the legal or regulatory challenges that this market faces?
• Will the online auction market eventually threaten the dominance of the two major auction houses?
In summary, the course builds on the basic ideas, models and techniques from corporate finance, portfolio theory, economics, and applied statistics to gain an understanding of the functioning of this fascinating segment of the alternative investments space.

Additionally, given the increasing importance of art as an asset class, in all likelihood, even business professionals who are not directly involved with this market (for example, working for an auction house or a wealth management organization) might find themselves involved with art-related financial problems and decisions. Thus, the course will analyze this market segment from several vantage points, more specifically, not only from the viewpoint of a potential investor or speculator, but also from the viewpoint of a commercial banker, insurance company, asset manager, regulator, and auction house.

**Course Organization**

**Week 1**
- Introduction
- What Is Art?
- Brief History of the Art Markets
- Art Market(s) Today
- Cases: The structure and functioning of art markets and The Barbara Krakow gallery

**Week 2**
- Differences between Art and Other Assets
- Estimating Returns for Art Assets: Repeat Sales, Hedonic Models, and APV
- Some APV-based Comparisons
- Life-Cycle (Creativity) Curves
- Assignment # 1 is given

**Week 3**
- Market Indices: Basic Concepts
- Review of Some Art-Related Indices
- Art Assets: Risk, Return, and Correlation with other Assets
- Does the CAPM Work in the Art Market?
- Valuation Example: Jackson Pollock
- Invited Speaker
- Assignment # 1 is turned in

**Week 4**
- Paintings: Price and Color
- Case: Sotheby’s, Christie’s and the Auction Market
- Different Types of Auction Mechanisms
- Is the Art Market an Efficient Market?
- Assignment # 2 is given
Week 5
Two Interesting Cases: The American Leonardo and Andy Warhol
The Importance of Provenance
Beyond Paintings: Other Collectibles
Case: Damien Hirst and Contemporary Art
Invited Speaker
Assignment # 2 is turned in

Week 6
Art derivatives?
Art as collateral (Secured Lending)
Art Funds and Other Art-Related Investment Vehicles
Investing in art: Dos & Don'ts
Assignment (Final) # 3 is given

Class Format: Expository lectures with active class participation. Students will be required to read some material in preparation for certain lectures.

Grading
Final grade: based on the three assignments (done in groups of two students).
Weights: Assignments # 1 & 2, 25% each; Assignment # 3, 50%.

CASES
READ BEFORE LECTURE 1: The Structure and functioning of the art markers/ HBS case/ 9--815—042
READ BEFORE LECTURE 1: Barbara Krakow gallery/ HBS case/ 9--514—033
READ BEFORE LECTURE 4: Sotheby’s & Christie’s Inc. / HBS case/ 9--710—412
READ BEFORE LECTURE 5: Damien Hirst and the contemporary art market/ ESMT case study/ ESMT--310--0105--1, July 2011

Papers & Articles

READ AFTER LECTURE 5: Uber-warehouses for the ultra-rich, The Economist, Nov. 23, 2013

READ AFTER LECTURE 5: The big fake: behind the scenes of Knoedler gallery's downfall, ART NEWS, Summer 2016, page 84

**Book Chapters**

**Suggested (NOT Mandatory) Reading**

READ AFTER LECTURE 1: Michael Findlay, The value of art, Prestel, Chapters 1 and 4

READ AFTER LECTURE 3: David Galenson, Conceptual revolutions in twentieth-century art, NBER, Cambridge University Press, Chapters 2, 3 and 15