Exploring more Exotic Asset Classes

London (HedgeNordic) – Most investors are familiar with private equity, venture capital and private debt, but more exotic asset classes might offer additional diversification, and potentially higher and less volatile returns. Investors need to choose carefully because these exotic areas have provided a wide range of returns, and some of them have performed poorly for many years.

Royalties – Creative Industries

At a time when investors are starved of yield, royalties could be a good place to start. Worldwide royalty collections for creators of music, audiovisual, visual arts, drama and literature reached a record €9.65 billion in 2018, according to the 2019 Global Collections Report published by CISAC.This was up 25.4% since 2018 thanks partly to growing digital revenues. Growth could even be accelerated by new laws, such as the April 2019 EU Copyright Directive.

To focus on one category, music royalties, there are private funds and some publicly listed investment companies. For instance, the London Stock Exchange already has one closed end fund, Hipgnosis Songs [ticker: SONG] which floated in July 2018 and has grown to a market capitalisation of over GBP 1 billion. Round Hill Music, which has acquired Elvis Presley catalogue owner Carlin Music Publishing, will float its investment trust in November 2020.

Royalties – Other Industries

Buying shares in a pharmaceutical company clearly provides indirect exposure to drug and other royalties, but also potentially a lot of volatility around politics, regulation, new drug approvals and so on. A drug royalties fund – which may also source royalty deals from inventors and universities – can provide regular income with less volatility. Medical devices and diagnostics can also generate royalties and Greenfield Advisors estimate the worldwide market for healthcare royalties is worth at least $100 billion a year.

Beyond healthcare, patents or other intellectual property in any industry could be securitised into a fund or special purpose vehicle structure to generate income.

The income from some deals can be as high as 20% a year, partly because patents provide a temporary monopoly. Income from IP is also high for a more controversial reason: these assets are often structured to be domiciled in low tax jurisidictions, such as Ireland or parts of Switzerland.

Art

High net worth individuals are already keen buyers of art, with 35% of them investing in it according to a UBS survey. Foundations related to museums buy art to exhibit, but institutional investors in general are less active, although the UK's British Rail pension fund did invest in fine art as long ago as the inflationary 1970s. The headlines are dominated by stories of record-breaking prices, such as US$450.3 million for a Leonardo da Vinci Salvatore Mundi *(pictured)* in 2017, but average returns from art have been fairly unexciting. Art has returned an average annual 5.3% and contemporary art an average 7.5% between 1985 and 2018, according to a report from Citigroup, using data from Masterworks.io.

This was pretty close to corporate debt over the period. Annual sales of $67.4 billion in 2018 make art a sizeable market, but investors need to consider that transaction costs for art, including storage, transport, insurance, and possibly auction house commissions of 5-25% when it is sold, can be higher than for most conventional assets.

Classic cars

Individual classic cars do not come close to the prices paid for fine art: the highest sale price in 2020 wasUS$7.1m for a 1932 Bugatti Type 55 Super Sport Roadster (sold by auctioneer Bonhams). But overall returns have been strong over the long term: the most diversified index – Historic Automobile Group International (HAGI) Top Index for rare classic cars – has appreciated by about 600% since inception in April 2005, though it has also been roughly flat for the past three years or so. For European classic cars, HAGI also publishes more narrowly focused purely on Ferraris; Lamborghinis; Porsches and classic Mercedes Benz cars made between 1920 and 1980.

Wine and Whisky

Fine wines have generated strong returns over the past five years, ranging from 26.62% for the Liv-Ex Rhone 100 index to 80.02% for the Liv-Ex Burgundy 150 index, which includes the legendary Romanee Conti. The largest investment category for fine wines, Bordeaux in France, has made 34.47% for the Bordeaux Legends 40 index over the same period. Liv-Ex publishes an index of the most investable wines, called Liv-Ex Fine Wine Investables, but perhaps confusingly, the index itself is not actually investable. Various funds do exist for wine, but some investors would rather maintain their own cellar as an unusual type of "hedge": if the investment does not perform, it can be consumed.

One approach is to buy wine "en primeur", while it is ageing in barrels, before it is bottled, and the same applies to whisky. Swedish whisky has been a treat in the pre-Covid days of the HedgeNordic awards, though whisky from Scotland is the most popular for investment. Historical returns have been as high as 12-20% per year, which can compound up to a very high level. One fund claims to have made 582% over the past decade. Certain rare Japanese whiskies might have done even better.

Coins and Stamps

Coins, such as Krugerrands, can be a way to get exposure to physical gold and silver, which is sought after by "goldbugs" who fear that the Government might nationalise gold, as the US Government did in the 1930s. Another type of coin investment seeks coins that have a rarity or scarcity value rather than an intrinsic value from the metals used to make them. This asset class overall has not performed particularly well. The PCGS3000 Rare Coin Index is nearly 70% below the peak it reached in 1989, and has also lost value over the past 10 years. Rarity and scarcity is not sufficient for an investment to perform, and coins have clearly been less fashionable that art, classic cars or wine.

Postage stamps are also very much about scarcity value and can sometimes command extraordinary prices: an 1865 British Guiana One-Cent Magenta stamp holds the world record, selling for USD 9.48 million in 2015. However, the asset class has had a bad experience due to an unusual fund structure. The Stanley Gibbons rare stamps fund had offered investors a guarantee to buy back stamps for either 75% of their present value or 100% of the price paid for them. This resulted in a contingent liability that was many times greater than the value of the fund, which ultimately went into administration. This suggests that if innovative asset classes are combined with an innovative fund structure, the situation can become too complicated. Exotic asset classes should offer enough excitement already, without trying to be too clever on fund structures.

Salvator Mundi is a painting by Italian Renaissance artist Leonardo da Vinci dated to c. 1500.Long thought to be a copy of a lost original veiled with overpainting, it was rediscovered, restored, and included in a major Leonardo exhibition at the National Gallery, London, in 2011–12. It is one of fewer than 20 known works by Leonardo, and was the only one to remain in a private collection. It was sold at auction for $450.3 million on 15 November 2017 by Christie’s in New York to Prince Badr bin Abdullah, setting a new record for most expensive painting ever sold at public auction.

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