

Investing in Art with Otis

A guide to understanding the art market to help invest
more confidently

Good art is expensive, and acquiring good art takes work and strong industry knowledge and connections. Further, prime works are generally inaccessible and prices can seem arbitrary and inflated.

This primer outlines the fundamental processes and players in the art market to clarify how works are bought and sold and what factors influence their price and value.

Otis focuses exclusively on Contemporary Art, which made up the largest sector of the fine art auction market for 2019 with a share of 53% by value (at \$6.1 billion)

Contemporary art is divided into the following categories:

Blue-Chip (Mark Rothko, Yayoi Kusama)

- Change how we think of art
- Represented by top galleries
- Featured in important international museum exhibitions

Established (Rashid Johnson, Tracey Emin)

- Recognized place in art history
- Represented by top galleries
- Major museum shows

Mid-Career Artists (Daniel Arsham, Nina Chanel Abney)

- Innovative approaches to work
- Represented by mid-sized influential galleries
- Exhibitions and smaller or regional museums

The art market is made up of:

The Primary Market (first sale of an artwork)

- Artist creates work → Gallery represents artist and sells work or artist sells directly → Collector institution purchases

The Secondary Market (resale of an artwork)

- Collector offers a work they currently own to the gallery they bought the work from (best practice) → If the gallery declines to purchase the collector can →
 - (a) privately sell to another collector institution,
 - (b) sell to a different gallery that works with the artist or focus on the secondary market
 - (c) sell through an auction house

Otis acquires work through both the primary
and secondary market.

Value and Price

Clarifying the difference between Value and Price: Artworks have both cultural and financial value.

The cultural value is determined by the importance – as decided by curators, collectors, academics, commercial (ie. galleries) and non-commercial (ie. museums) institutions – of an artist and specifically a certain work.

The financial value of a work is the maximum a single collector is willing to pay for that work.

Cultural value can catalyse the financial value of a work (see Diddy purchasing Kerry James Marshall for \$21M or the da Vinci for 450M).

But the price of a work is not always the same as its value.

Particularly in the primary market, galleries often price works below their value in order to control the destination of the sale and manage which collectors purchase a work.

The result is an opaque market, where prices are often only revealed to collectors who the gallery identifies as suitable for an artist.

Collectors who do not meet the standards that the gallery sets, either because they have a reputation for reselling works, do not have an impressive enough collection, or are simply new to the market, are placed on long waiting lists.

Therefore, having enough money to purchase a work does not equate to access.

Access on the secondary market is more transparent, as collectors are motivated to capture the full financial value of a work.

The result is work going to auction or being offered in a private sale, where either the highest bidder or the person who meets the seller's asking price respectively, regardless of the perceived status of their collection, will purchase the work.

On an individual work basis, both price and value are broadly informed by factors including:

- General demand for the artist
- Exhibition history
- Cultural relevance
- Career stage
- Gallery representation
- Artist's sales history

The price of a specific work is informed by factors including:

- If piece is considered aesthetic or meaningful
- If work is an important part of artist's body of work
- Whether unique or part of a series
- Medium
- Year
- Dimensions
- Condition
- Presence of markings or signatures
- Provenance

Exhibition history plays a significant role in determining the value of art. An artist's inclusion in an important gallery or museum show (or in the collections of influential and respected collectors) will shape an artist's career and have a positive impact on price.

Primary Market Pricing

The gallery controls the primary market pricing of an artist in order to ensure a steady rise in prices over time.

The gallery does this by choosing where to place works (who gets to buy them). They manage the artist's available inventory and set prices in order to capture maximum value from reputable collectors. They often hold on to the remaining inventory for later sales both to increase scarcity and as a hedge that the work will increase in value over time.

For an in-demand artist, price on the primary market is often below the value (amount the market will pay) of the work. This is because the gallery wants to place the limited supply of works available into reputable collections – ones that will support the artist's long-term career (through word of mouth, future purchases, or loans to museums).

While prices on the primary market are generally lower than on the secondary, access to the art is limited; galleries generally prioritize notable and long-time customers.

Prices on the primary market are available by request from the gallery and sometimes visible on platforms such as Artsy and Artnet.

Secondary Market Pricing

Prices for in-demand artists on the secondary market are typically higher than on the primary market. This is driven primarily by market scarcity, and the fact that art accumulates value based on its exhibition history and its established position within an artist's practice.

When a collector offers a work for sale back to the gallery, the gallery names a price it is willing to pay. Generally, galleries do not want an artwork to go to auction, as that can potentially contribute to the gallery losing control of pricing (a high result could raise an artist's price beyond the means of the gallery's collector base, and a poor result could cause the artist's overall prices to go down). Galleries are therefore generally incentivized to offer competitive prices to collectors.

Final sale prices for works bought by a gallery are not publicly available, but they are presumed to be in line with the artist's market.

Advisors and auction house private sales departments have broad networks and access to both buyers and sellers to facilitate P2P sales. Prices in this market are extremely opaque and are determined by the ability of the advisor to find a single buyer at the seller's desired price.

Prices for works sold privately are not available.

Auctions are public sales of singular artworks. In 2019, auctions brought in \$24.2B in sales, which accounted for approximately 39.7% of the art market.

When a collector brings an artwork to an auction house, they will agree on an estimated price range and a minimum reserve price. The auction house will then generate interest for the sale and attempt to capture the full value of the work at the auction. If the work does not meet the reserve, it is "bought-in" and returned to the collector. Registration for auctions is open to the public, and anyone who meets the minimum financial requirements to bid is allowed to participate.

Auction sale price is made public after the sale.

Galleries and private dealers also use art fairs such as Art Basel, Frieze, and TEFAF to sell art and attract new clients.

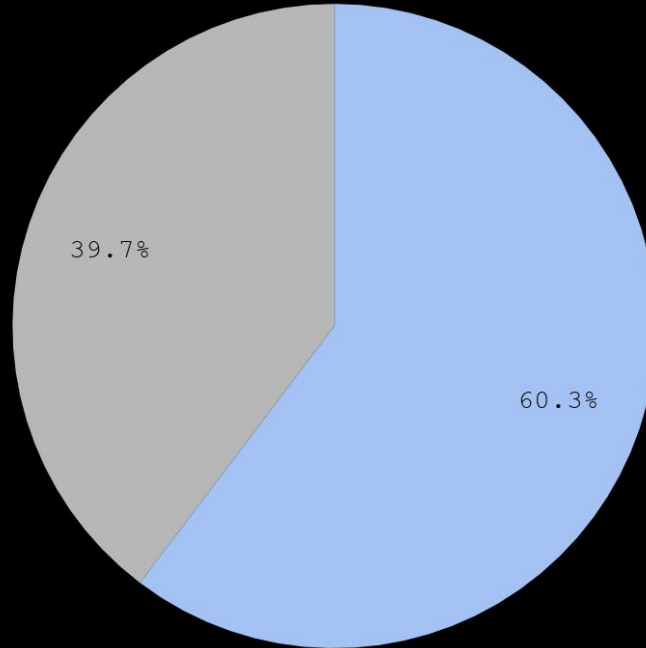
According to the 2020 Art Basel Report, the share of dealers' annual sales by value made at art fairs has grown from less than 30% in 2010 to 45% in 2019.

Sizing the Art Market (2019):

- **\$64.1 billion** sales globally in Art & Antiques
- **44%** of sales were in U.S.
- **\$24.2 billion** annual auction sales
- **55%** of annual auction sales were for works valued at \$1 million+
- **\$3 million** spent on average over two years by millennial collectors

Auction (\$24.2 B) Sales vs. Private (\$38.6 B) (2019)

- Private Sales
- Auction Sales



The art market is difficult to size up as data is limited, but there are a number of sources that try to aggregate whatever data is available:

Industry reports:

- Art Basel's Annual 'Art Market Report'
- TEFAF Annual Report
- Art and Finance Biannual Report (by Deloitte & ArtTactic)

Websites:

- Artory.com
- Artprice.com
- Artnet.com

Databases:

- Christie's, Sotheby's, and Philips regularly publish data retaining to upcoming and past auction sales

The value of art has a low correlation to other assets.

Artwork prices appear to take political unrest and the accompanying market volatility in stride.

That said, prices do have a positive correlation with global accumulated wealth.

Art can help diversify a portfolio

It is widely accepted that investments should be diversified across asset classes, industries, and geographies as a means of spreading out risk. Modern Portfolio Theory (MPT) builds on this idea, using a mathematical framework to determine the optimal amount of risk necessary to maximize returns.

Returns are relatively resilient during financial downturns

As a result of The Great Recession, artists who fell in the post-war and contemporary category saw a 69% decline in total sales volume between 2008 and 2009. However, by 2012 artists in this category had surpassed their pre-recession highs.

During The Great Recession, the lots that suffered the least were those priced in the \$1 million to \$5 million range (bought-in rate 19%), while those below \$500,000 were impacted the most (bought-in rate 57%).