SAVORING THE REWARDS OF FINE WINE

DESPITE RISKS, **WINE HAS RETAINED VALUE**

BY MARISA D'VARI PHOTOGRAPH BY MARK HOOPER

Wine is capturing the attention of investors worldwide, attractive as much for the potential double-digit returns as for the social allure. Even teetotalers will appreciate the confluence of factors that make wine worth a closer look. Not surprisingly, interest among emerging market consumers is driving wine market demand and creating investment potential.

"SWAG has always been important," says Jack Hibberd, Head of Data and Research for the London International Vintner's Exchange (Liv-ex), referring to silver, wine, art and gold. "In a world where things are volatile, you don't get much from cash. Having physical assets in one's portfolio is key," says Hibberd, whose firm is a global fine wine trading and settlement platform.

Thanks to interest from wealthy Chinese investors, wine prices have shown strength over the past few years, but that trend ended in 2011. The Liv-ex Fine Wine 100 Index posted a 17 percent decline last year, which experts tied to a "correction" in the Chinese market. The Liv-ex 100 is the industry's leading benchmark and represents the price movement of 100 of the most sought-after fine wines for which there is a strong secondary market.

Despite the 2011 drop, when viewed over a 5-year period, wine prices increased. The Liv-ex 100 increased by 106 percent in the period Feb. 1, 2007, through Jan. 1, 2012.

Although last year's downturn prompted the demise of several hastily constructed wine investment entities, several of the established ones remain positive and solvent, as growing emerging-market interest in fine collectible wine and the accompanying new international generation of fine wine drinkers may support the continued escalation of fine wine prices.

TWO STRATEGIES: WINE AND FUNDS

When it comes to investing in fine wine, there are two basic strategies: buying the commodity itself and investing in a wine fund.

In the first approach, investors purchase cases of the best wine on market release, generally buying twice as much wine as they would consume. One case is kept for personal consumption, the other is allowed to mature and then is sold for a profit later. This strategy is popular in the United Kingdom, where wine is classified as a "wasting asset" and is not subject to capital gains tax as it would be in the United States.

Investors generally work with advisors called "merchants," who employ a team of experts with the knowledge and the vintner relationships necessary to obtain allocations of fine and rare wine.

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The strategy demands that the wine be bought as young (and, thus, as inexpensively) as possible, usually while still in barrels. This is referred to as "futures" and bought "en primeur" from Bordeaux-based negotiants with strong ties to the châteaux. Because first-growth Bordeaux has a centuries-long track record of rising prices, it is generally thought to be the safest of wine investments.

Clients pay for the wine, the storage and the insurance. Typically, the wine is warehoused for eight years. At that point, should the client wish to sell half (or all) the wine, the merchant will charge a broker's fee (10 to 12%). This strategy is best suited for a wealthy investor who needs guidance in selecting wines most likely to appreciate in value.

In contrast, the structured wine fund involves cash only and is run like any other asset class fund. An investor invests a given amount (minimums can range from $10,000 to $250,000) and pays a management fee of 2 percent per annum and 20 percent incentive fees, which support the experts and analysts who source the wines and find the best prices.

Unlike the merchant strategy, however, fund managers prefer to buy top-growth Bordeaux that are at least four or five years old, as they fear that the media buzz that may have inflated the price of a young top-growth wine (tasted in barrel) may not hold up when the wine has matured. At the end of the investment cycle (typically five years) the investors receive a return based on the amount by which the wine has appreciated.

HOW WINE IS VALUED

As with any other alternative asset, valuation of wine is based on numerous factors, including hard numbers from Liv-ex, which tracks the prices of the top fine and rare wines of the world. Many merchants and wine funds have their own analysts and consultants, and they may also commission independent research with the goal of outperforming the Liv-ex index with an intuitive reaction to market conditions.

Many fund managers interviewed include in their portfolios investment-grade wine from the northern Rhône valley or from Spain, some of which is priced well over $200 a bottle. Others rigidly stick to a classic mix of only Grand Cru Burgundy and Cru Classé Bordeaux or, even more strictly, the best vintages of the top five first-growth Bordeaux.

UNDERSTANDING RISKS

While the managers of both strategies point to the increasing scarcity of fine wine and rising demand from emerging markets as reasons to expect continued double-digit growth, they acknowledge that the market can be unpredictable and success is not guaranteed.

Liquidity can be an issue when investing in wine. "It's important to have an exit strategy. We are very careful to counsel our clients approaching retirement age that it may not be possible to recoup an investment on demand, which is why we suggest an 8-year window," says Stephen Williams, CEO and Managing Director of the Antique Wine Company.

In the past, fraud has been a problem. So it is important to verify the legitimacy of any fund or merchant. And, despite the gains of the past years, many sources point to negative, rather than positive, returns as a genuine threat. The recent correction in China, which resulted in a 15 to 20 percent fall, may not be a temporary blip as many suggest, but rather a deeper indication of continued fluctuation in the global market. Also, if 2012, 2013 and 2014 are good vintages, it can lessen the value of wines currently held in the portfolio.

Master of Wine Doug Frost says, "In order to make money in the wine market, you need a lot of patience and a healthy dose of luck. Most of us predicted that Bordeaux would go bonkers in Asia over the last few years; few of us saw it cooling off so quickly."

He adds, "Burgundy seems to be on a rapid rise there. But Burgundy is famously complicated, and I suspect that Domaine de la Romanée-Conti (DRC) and a handful of other domaines will benefit from the attention. But most other domaines will not be greatly affected. But that's the cynic in me."

Master of Wine Jean K. Reilly shares Frost's view. "When people ask me about investing in wine, my typical advice is, 'Don't.' However, the price strength collectible wines have shown throughout the recent economic downturn is hard to ignore.

"Given the amount of fraud that has taken place in wine investment schemes, I think the primary thing to look for is integrity," she says, adding, "Potential investors should look for a fund attached to a reputable institution. In terms of the manager, knowledge of the wine market, particularly the auction market, is more important than wine knowledge per se."

Whether you plan to drink your investment or enjoy the cash it may produce, there's no denying that wine funds are fun to talk about during business social events. Even if you never can take that sip of Château Lafite, it's fun to own it — even if it is only on paper. ■

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EMERGING MARKET CONSUMERS IMBIBE

The outlook for wine investment appears positive, according to the Antique Wine Company, which notes these emerging market trends.

When Hong Kong abolished its 80 percent alcoholic beverages tax in 2008, fine imported wine became more affordable for this wealthy and discriminating market.

Wine consumption is expected to grow by 25 percent in China within the year, with the young generation developing an appetite for wine consumption and wine education.

India has 600 million people between the ages of 20 and 35. While presently only 2 percent drink wine, market research predicts 10 percent will be drinking within the next few years.

Strong internal investment has fueled Brazil's growth, with luxury goods and fine wine becoming more important and affordable for its trend-driven 25- to 30-year-old generation.