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## Introduction

The art market is one of the oldest investment markets in the world. Wealthy individuals and various special purpose vehicles, including royal and imperial museums, began purchasing paintings, sculptures and tapestries long before railway stocks became known to the investing public and well ahead of the textbook tulip bubble. In his highly entertaining book *Le métier de peintre au Grand Siècle*, Antoine Schnapper, Professor Emeritus of art history in Sorbonne<sup>1</sup>, provided a detailed overview of the art market's infrastructure in France roughly 400 years ago. His work included data on the markets for art and real estate, as well as descriptions of buy-side income levels, capital allocations for art assets and distribution of margins made on artworks among artists, dealers, curators and actual art investors and collectors.

While the infrastructure of all major investment markets, including real estate, evolved into forms that would have been unrecognizable four centuries ago, the art market turned out to be magically immune to social changes, new technologies or any other drivers that fueled the evolution of other types of investment markets. Centuries ago, the investment process for buying art, real estate or underwriting the cost of geographical expedition was largely the same, relying on expert opinions, connections and subjective judgments on the part of investors about exit opportunities, holding horizons and expected rates of return. In today's contemporary investment markets, however, only the art market is largely free from the scientific, rational and disciplined approach to institutional investing that is standard for how equity, debt,

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1. Antoine Schnapper, *Le métier de peintre au Grand Siècle*, (Éditions Gallimard, 2004)

commodities, foreign exchange, real estate and derivatives markets work these days.

On the one hand, the "archaic" nature of the art market's infrastructure and investment patterns is well justified. In 2005, the total trading volume on the global art market measured by the transaction volumes at the world's two largest art auction houses ("exchanges") equaled USD 5.8 billion.<sup>2</sup> In comparison, this figure roughly equals the average daily turnover in the market for shares of just two NASDAQ listed companies – Google and Microsoft. The rating of the world's 1000 most valuable works of art, created and maintained by Skate Press on the basis of data for public auctions since 1985, leads to an estimate of the public investable art market capitalization standing at USD 9.2 billion as of July 1, 2006 (a detailed description of the calculation methodology for art market capitalization is provided in section 2.1). Again, by way of comparison, the initial public offering of PartyGaming PLC on the London Stock Exchange on June 30, 2005 valued this company alone at GBP 4.64 billion (USD 8.17 billion). The entire public market of investment quality art is valued at barely more than a single online poker company.

An even more interesting comparison can be found in the market capitalizations of eBay Inc and Sotheby's Holding Inc. At the time this book went to press, the New York Stock Exchange listed Sotheby's Holding Inc, which controls over 50% of the trading volumes at public art auctions, at approximately USD 1.95 billion, or approximately 20% of the entire investable art market's capitalization. On the very same day, the market capitalization of eBay, the world's largest online auction company, stood in excess of USD 35.29 billion. Art and antiques is one of eBay's auction categories, but in the firm's entire history, no single painting or other work of art has been sold on eBay that could have made it into Skate's rating of world's 1000 most valuable works of art. This fact clearly shows that the market for art masterpieces is a very small world for a limited number of participants in terms of trading volumes and combined value.

While the public fraction of the global art market remains small, the entire value of art assets amassed by society and held largely by government sponsored collections is enormous. Skate Press estimates that the free float of the market for investment quality art is no more than 2%, with the combined value of this market<sup>3</sup> in excess of USD 250 billion.

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2. Calculated based on 2004 annual reports of Christies International PLC and Sotheby's Holding Inc

3. For the purpose of this edition "investment quality art" is defined as paintings and sculptures whose market price is equal to or exceeds the threshold price of the 1000th most valuable painting based on the rating of world's most valuable artworks prepared by Skate Press on the basis of public auction data. As of July 1, 2006, this price equaled USD 3,969,500 in nominal terms.

The lion's share of this wealth resides in the ownership or management of state-sponsored museums and galleries around the world. The dominant role of government ownership in the area of collecting, storage and management of investment quality art is arguably the most fundamental reason for the immunity of the art investment market to innovation and infrastructure evolution that has been observed elsewhere in investment markets over the last several centuries.

Governments' control over significant portions of the supply and demand sides of the market for investment quality art has helped to nourish and preserve the closed-circuit "clan" nature of art markets worldwide. Developing in the shadow of state ownership and protectionism, fueled with "national cultural heritage" rhetoric, the art investment market finds itself handicapped in comparison to other investment markets, including alternative investment categories to which the art market traditionally belongs. Trading in investment quality art is conducted with far higher transaction costs (10-15% commissions and other transaction costs for art trades versus less than 2% for securities trades) and in an archaic information environment where price information about most art dealings is not equally available to all market participants. Basic things like public registers of artworks produced by the world's most renowned artists also do not exist. Art deals involving the most significant players, most importantly state-sponsored museums and galleries, are not audited and are not assessed in a rational manner, despite the fact that art asset management by state institutions is done at the public's expense and for public benefit.

The objective of this book (heavily based on research and data produced by Skate Press) is to describe the rational approach to investing in the world's most valuable works of art. In addition to a thorough description of the global art market's most important institutions and how the art market compares to other alternative investment markets, this book includes a rating of the world's 1000 most valuable works of art, published here for the first time, as well as a detailed introduction to Skate's Art Asset Pricing Model (AAPM).<sup>4</sup>

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4. Skate's Art Asset Pricing Model (AAPM) is the intellectual property and protected trademark of Skate Press