Wine in an Asset Allocation Context

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Those conducting annual investment portfolio reviews will most likely be experiencing unusually painful reading this time around.

The 'risk-on' mindset of financial markets over the last several years – buoyed further by the Trump stimulus and continued global Quantitative Easing – did not exactly come to an abrupt end in 2018. Instead numerous factors, including an increasingly hawkish US Fed, US-China trade tensions and concerns over the reversing of monetary stimulus outside the US led to a widespread fragility of investor confidence which continues heading into 2019.

In contrast, fine wine performance showed little to no impact from these broader market events – the Livex 1000 index, which is regionally diversified and we tend to see as the most relevant reference point – was up 10% in 2018. Combined with a clear intention from financial investors to explore alternative assets (a number of surveys cite >50% of investors looking to increase exposure) this performance has led to a heightened level of interest in fine wine as an asset class.

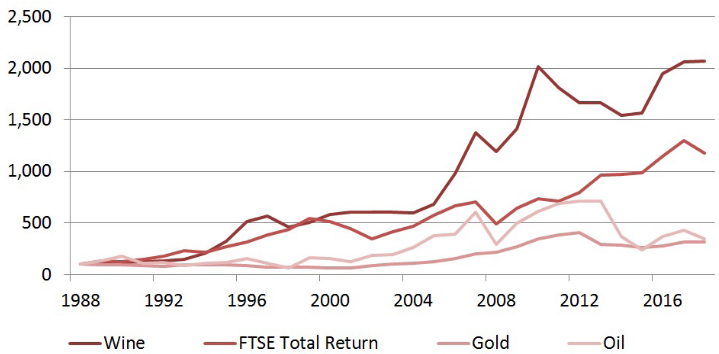
The performance of fine wine as an asset is well known to be strong. However, alongside that performance, it is often reported that wine enjoys an uncommon stability of returns, records a low correlation with financial asset classes, and tends to see little impact in the context of disruptive market events.

In this paper we look at these points in more detail, ultimately examining the case for wine to bring valuable diversification to an investment portfolio.

Outright Performance

A refresher on wine's long-term attractive performance is a natural starting point. Equities are usually seen as the performance benchmark over long term horizons, exhibiting superior returns compared to other asset classes. Below we show the longest-running wine index, the Livex Fine Wine Investables Index (noting that it comprises only Bordeaux wines), back to its earliest reference date in 1988, against the FTSE All Share Total Return index (FTSE All Share, with dividends re-invested into the index), as well as gold and oil for reference.

Figure 1: Long Term Performance Comparison



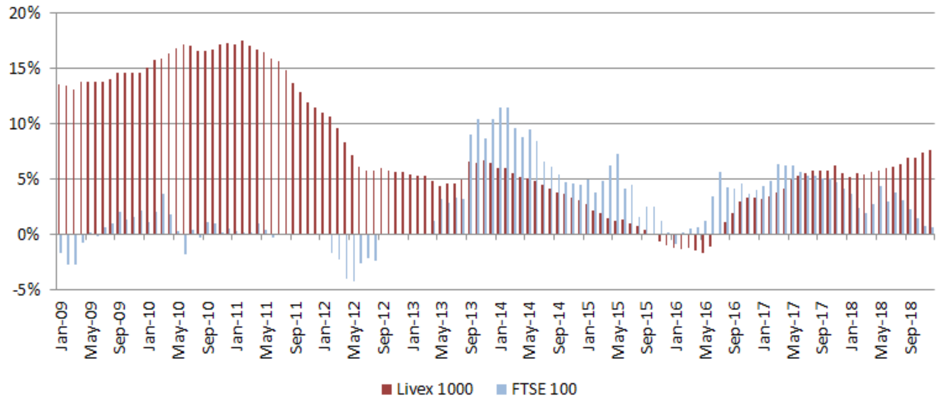
Source: Bloomberg, Livex. Data shown in local currency terms.

Wine's compound annual growth sits at around 11%, comparing favourably to Equities at 8% and Gold / Oil in the 4-5% area.

Volatility

An oft-quoted anecdotal fact about wine investment is that a 5 year period has never produced a negative return – indeed a particularly relevant point given this is seen as a suitable "hold" period. While not entirely true, it is however correct that wine has rarely seen negative returns across that time horizon, as shown in the chart below (for the remainder of this paper we switch to the Livex 1000 index as it is more reflective of the investment market today):

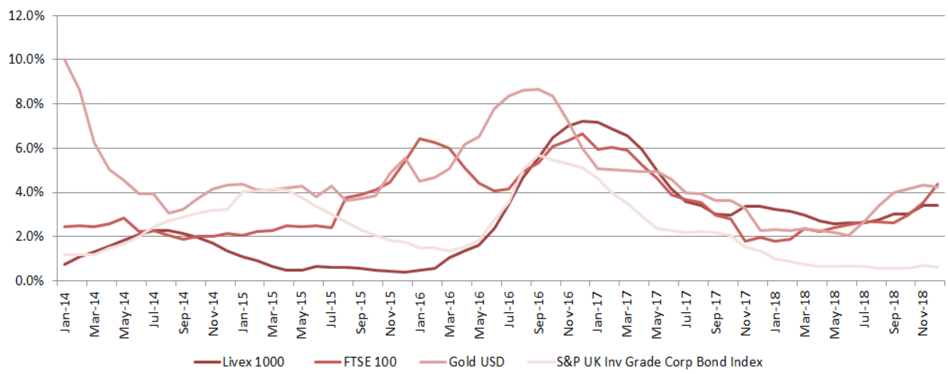
Figure 2: Rolling 5yr Compound Annual Growth Rates



Source: Livex, Bloomberg, BI Analysis

Perhaps unsurprisingly in this context wine usually exhibits volatility similar to or lower than equities and gold and comparable to bonds.

Figure 3: Rolling Annual Standard Deviation



Source: Livex, Bloomberg, BI Analysis

It is logical that this is driven by wine having the uncommon characteristic of a favourably evolving positive supply-demand imbalance – this in part explains why, despite having some commodity-like characteristics, it displays relatively low volatility, unlike gold which generally exhibits volatility in excess of equities.

Correlation

When considering portfolio diversification, correlation between the asset classes is of course a very important aspect – in ordinary course, but in particular in times of market disruption. Any seasoned market participants will know that each disruptive market phase has its own unique characteristics and therefore correlation dynamics. However, by analysing multiple such phases, we can still draw conclusions as to the likelihood of a portfolio element showing aligned performance.

In the table below, we show the monthly correlations between key asset classes across important disruptive market phases from the last decade, as well as wine's performance during the relevant phase. We include the correlation with GBPUSD as a reference point.

Global Financial Crisis (Aug 2007 - Mar 2009)

	FTSE	GOLD	BONDS	GBP/USD	WINE
FTSE		-0.30	-0.67	0.93	0.09
GOLD	-0.30		-0.67	-0.30	0.44
BONDS	-0.67	-0.67		-0.06	0.06
GBP/USD	0.93	-0.30	-0.06		0.26
WINE	0.09	0.44	0.06	0.26	
			Wine Performance:		*+1.8%*

Eurozone Crisis (Jan 2012 - Mar 2013)

	FTSE	GOLD	BONDS	GBP/USD	WINE
FTSE		-0.02	0.75	-0.42	0.33
GOLD	-0.02		-0.28	0.65	-0.10
BONDS	0.75	-0.28		-0.29	-0.10
GBP/USD	-0.42	0.65	-0.29		-0.35
WINE	0.33	-0.10	-0.10	-0.35	
			Wine Performance:		*-0.8%*

"Taper Tantrum" (Jun 2013 - Sep 2013)

	FTSE	GOLD	BONDS	GBP/USD	WINE
FTSE		0.68	0.32	-0.19	-0.40
GOLD	0.68		0.15	0.46	-0.51
BONDS	0.32	0.15		-0.66	-0.91
GBP/USD	-0.19	0.46	-0.66		0.29
WINE	-0.40	-0.51	-0.91	0.29	
			Wine Performance:		*+0.7%*

Q4 2018 Sell-Off (Oct 2018 - Dec 2018)

	FTSE	GOLD	BONDS	GBP/USD	WINE
FTSE		-0.92	0.21	-0.67	-0.59
GOLD	-0.92		0.18	0.37	0.39
BONDS	0.21	0.18		-0.34	-0.67
GBP/USD	-0.67	0.37	-0.34		-0.34
WINE	-0.59	0.39	-0.67	-0.34	
			Wine Performance:		*+0.8%*

Source:Livex, Bloomberg, BI Analysis

There are very interesting takeaways from these tables:

- Wine exhibits the lowest correlation with the other assets, whether looking from a perspective of number of incidences of correlation over 0.5 / -0.5 or total absolute correlations

- In most cases wine shows a negative correlation with other asset classes and showed a positive return over the relevant period

- For wine, the negative correlations are more significant than the positive correlations, obviously a favourable pattern

There is little to suggest that the reasons for this limited correlation include wine representing an explicit "safe haven" asset as such – it is probably better understood as relating to the following factors:

- As an alternative asset class traded distinctly from financial markets, wine tends not to see sustained selling / asset "dumping" with the same momentum as financial assets

- It is generally accepted that (Ultra) High Net Worth as a capital segment sees "insulation" from wider market disruption and this segment is well represented (both from an investor and consumer perspective) in fine wine as an asset class

- Despite not displaying safe haven behaviour, it is certainly the case that the inherent (rarity) value of and consumability of fine wine of the quality seen in investment portfolios means any sustained selling momentum is often countered by supportive Bid activity

Concluding Remarks

The analysis in this paper strongly suggests that a fine wine portfolio can play a valuable role in investment diversification across market cycles. Perception of the asset class can sometimes be that consistently attractive relative returns must be accompanied by greater volatility (and so inferior Sharpe ratios etc), but this is not the case. Wine's unique profile (even amongst Collectibles more broadly), particularly in having a naturally favourable and dynamic supply-demand imbalance, is likely overlooked in this context.

In terms of outlook specifically related to the analysis herein, there can be little doubt that the diversification and expansion of the "investment grade" fine wine asset pool across the last decade is a positive – assuming portfolio composition is along similar lines of course. Another overlooked but significant positive factor is the nature of the consumer / investor base today vs. historically – fewer investment-concentrated areas of the market, more geographically diverse on both fronts, and with an investor balance shifted more towards High Net Worth than Institutional. These factors clearly guarantee neither performance nor low volatility, but they certainly provide support to what is already a historically favourable picture.

Finally, an analysis of this kind naturally overlooks the role and / or potential magnitude of the impact of portfolio managers, comparing instead straight indices. The wine market continues to see a noteworthy ability for outsized profit from analysis and stock-picking, even when trading spreads are considered as a counterbalance. Overlaying this factor is more significant to performance than volatility and therefore an important element of the real-world picture.