Financial Returns, Price Determinants, and Genre Effects in American Art Investment*

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Abstract. Past studies on art investment generally have found that returns are low and risk is high. In this study we find that the return to art investment is more in line with traditional investments and thus the cost for consumption associated with art seems fairly small. Employing a large sample of paintings by 66 American artists sold at auction between 1971–1992, average returns are found to be over 9 per cent and 3 per cent in nominal and real terms, respectively. The model employs a log linear price regression estimated by pooled cross section and time series data, and allows rates of return as well as hedonic values for various painting and auction attributes to be estimated. These include size, media, age of execution, authenticity of the work, and auction month and house. In addition, rates of return are differentiated by artist, time period of investment, price range and genre of the painting. The findings indicate significant sensitivity of rates of return to these stratifications.

Key words: returns to art investment, hedonic price regressions for paintings

1. Introduction

With the recent record breaking prices of art, especially of Van Gogh’s $82.5m Portrait of Dr. Gachet, there has been increasing interest in the potential returns to art. However, in addition to providing financial return, art also offers an aesthetic return. These returns vary from artist to artist and from piece to piece, suggesting much heterogeneity in this investment arena. Price and return differences across art pieces can be explained by subject matter, style, size, condition of the piece, differences across artists, the age of the artist at the time of painting execution, and where and when the piece is sold. Although some of these characteristics of art may contribute to the realization of extraordinary returns, most research, which does not control for these features, finds that the financial returns to art investment compare unfavorably with stocks and bonds. However, it may be possible to diversify across various paintings and artists to create comparable or greater portfolio earnings to those of stocks and bonds.

In this study, we investigate price determinants and investment returns for paintings in the context of an hedonic price regression for American artists using auction data from 1971 to 1992 which is a period of general growth, although including three U.S. recessions. The findings are more supportive towards paintings

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as an investment with rates of return only slightly below traditional stock and bond alternatives. In addition, variations in prices across a wide variety of paintings is associated with characteristics of an individual painting and the market environment of the sale. It is obvious that some paintings are more pleasing to the eye than others, explainable by the colors and medium used, as well as by the subject matter of the painting. Although the data do not allow for control of color schemes or individual painting subject matter, artists are known for certain subject matters or styles. We use this information to determine whether the artist’s choice of subject matter will affect the returns to his paintings. First we review several past studies which relate to our model and findings.

Anderson’s (1974) paper is of particular importance to this paper because we draw from his theoretical framework in developing our painting price model. Anderson examines data from Mayer (1971) and Reitlinger (1961, 1970) on paintings from 1780 to 1970. His model relates painting prices to time and several painting characteristics including subject matter, size, auction house, reputation of the artist, artistic merit, degree of conformity with the artist’s typical style, and age of the artist at the time of execution. In estimating the model, he surprisingly finds that most of the descriptive variables are insignificant and narrows his model to time, size, and artist repute. His mean nominal return of 3.3 per cent is far below the Times-Sotheby Index returns, which ranges from 3 to 35 per cent from 1950–1969, depending on the school and the individual artist. Recognizing that painting attributes and history may affect returns, Anderson holds the quality differences for paintings constant by using the repeat-sales method, resulting in a mean nominal return of 4.9 per cent. Anderson also finds that lower priced paintings earn higher returns which may compensate the higher risk in investing in less well known artists by higher returns.

Baumol (1986) employs the Reitlinger repeat-sales data for a sample in which the holding period exceeds 20 years in order to exclude any speculative purchases. He finds a nominal rate of return of 0.55 per cent from 1650 to 1960, which is 2 per cent below the possible returns on bonds available to risk averse investors. Baumol concludes that the art market is unlikely to “possess anything like long-run equilibrium prices, let alone reliable forces that drive prices toward them . . . that price movements are unpredictable, and that it is impossible to select with any degree of reliability the combination of purchase dates and art works that will produce a rate of return exceeding the opportunity cost of their investment”. Baumol attributes low art investment returns to the aesthetic consumption return generated by art which Stein (1977) approximates at 1.6 per cent. This still leaves Baumol’s returns 400 basis points below the opportunity cost reflected by long term bonds.

Frey and Pommerehne (1988, 1989) support Baumol’s findings, even after extending the sample period, increasing the number of different countries, including transaction costs, checking the identity and price statements, and controlling for the possible different returns before and after World War II. They use data from