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SOLUTIONS FOR FINE WINE

Fine Wine Versus Equities Analysis

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Does Fine Wine Investment (FWI) still qualify as a viable alternative investment asset class to traditional investments?

- The argument to include FWI in investment portfolios has diminished since the 2008 global financial crisis (GFC), but remains a valid and attractive proposition
- Fine Wine market is trading below long-term uptrend and investors can look forward to attractive profit potential when trend normalization is restored
- The low correlation between FWI and Equities and the lower volatility of FWI remain attractive attributes for why FWI should be included in a diversified investment portfolio

FWI – a long-term absolute return perspective

By looking at the trading history of the fine wine market in the last decade, one may notice FWI demonstrated an excellent track record that is appealing to absolute return investors. According to the Liv-ex 1000, FWI has consistently delivered positive absolute return over every next 5-year holding period since 2004. Figure 1 below also highlights that the average 5-year forward performance since 2004 is 74.03%!

Figure 1

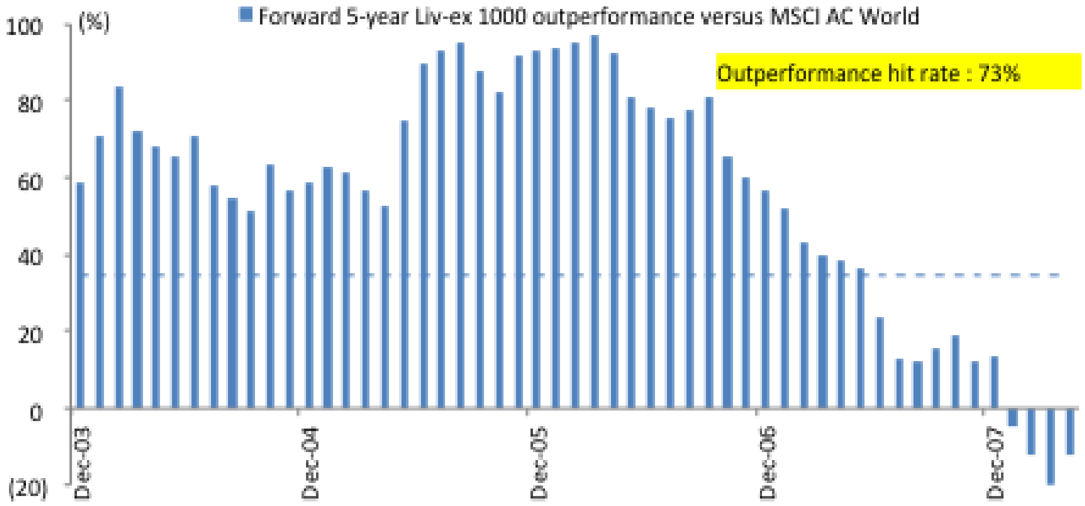
Liv-ex 1000 forward 5-year performance since 2003

Note: Price performance in Sterling. Source: Liv-ex

It is also worth noting that FWI generated significant outperformance to global equities over any 5-year investment horizon during 2004 to 2008 with hit rate as high as 73%, as shown in figure 2 below. The average 5-year return of 74.03% compared favorably to that of global equities at 39.44%, i.e., an average outperformance of 34.59%.

Figure 2

Outperformance of FWI versus global equities



Note: Price performance in Sterling. Source: Liv-ex, MSCI

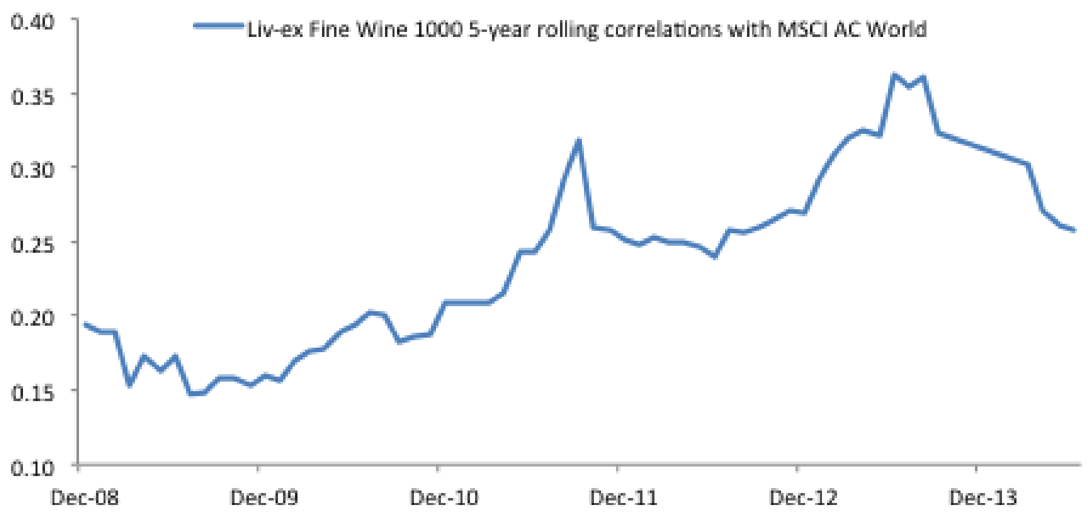
The 5-year return started to deteriorate since the period beginning in 2008 (in both absolute and relative terms) despite the frenzy run up in the fine wine market in 2011. This was in sharp contrast to the substantial returns seen in the previous years and was largely due to the bear market we have been experiencing since 2002.

FWI provides diversification benefits to global equities portfolio

Besides outperformance over global equities, FWI also gives diversification benefits as the correlation of FWI to global equities is currently just above 0.25.

Figure 3

FWI outperforms global equities with low correlation



Note: Price performance in Sterling. Correlation is calculated based on the monthly changes of the

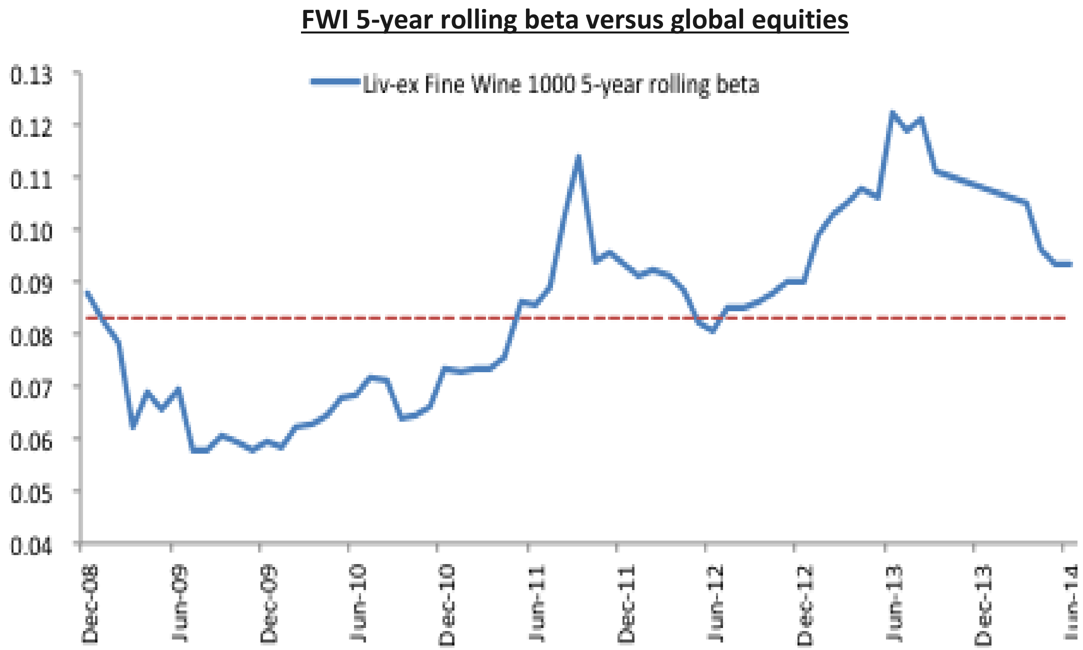
Liv-ex 1000 index and MSCI AC World. Source: Liv-ex, MSCI

Note: Correlation is calculated based on last 60 monthly changes of Liv-ex 1000 and MSCI AC World. Source: Liv-ex, MSCI

In the last three years, the overall negative returns of FWI and the increasing correlation of FWI with global equities markets have greatly diminished the appeal of FWI. With hindsight, GFC seemed to be the defining event that has changed the investment behavior of FWI. Since the GFC, correlation between FWI and global equities increased after an initial dip. A similar pattern is observed for the beta of FWI albeit still at a low level.

The good news is that both the correlation and beta have peaked about a year ago and they are now both trending down (see figure 3 and figure 4), once again boosting the argument to include FWI as an alternative investment with less volatility.

Figure 4



Note: Beta is calculated based on last 60 monthly changes of Liv-ex 50 and MSCI AC World. Source: Liv-ex, MSCI

The outperformance of FWI over global Equities using 2004 as a starting point has almost been fully eroded (see figure 5). While the economic conditions in major economies such as the US and Japan have improved, stock markets have already had substantial gains and the bull market is arguably entering advanced stages. In contrast, FWI is now trending below average (see figure 6) and the odds of a potential gain from “reversion to mean trend” has become favorable should trading enivronment for the fine wine market turn more supportive. Thus, it is highly probable that between the two asset classes the relative performance in the coming few years will shift back to FWI.

Figure 5

Cumulative performance of Liv-ex Fine Wine 1000 and global equitie

Note: Price performance in sterling. Source: Liv-ex, MSCI

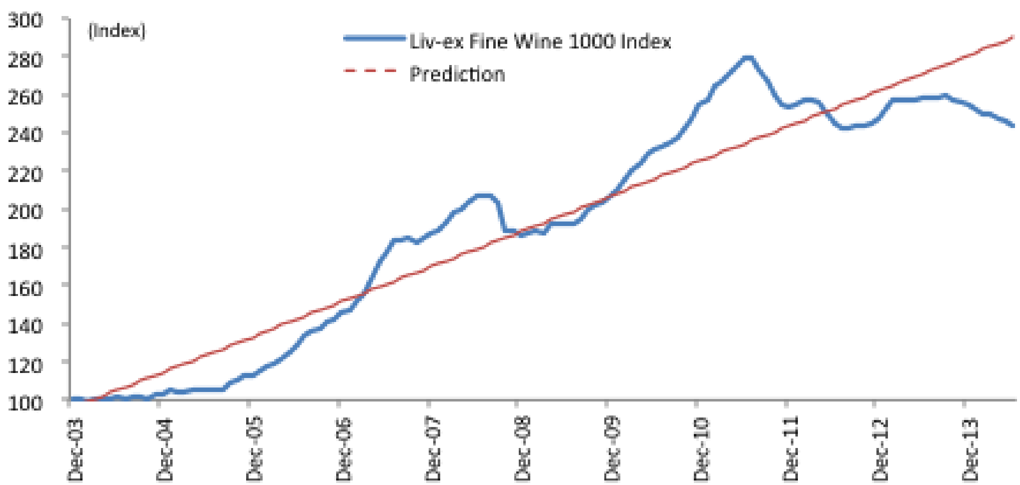
The recent trends suggest that the stellar outperformance of FWI over global equities has been put into doubt. Still we think the perspective returns remain attractive versus other asset classes; the diversification benefits of adding FWI to a global equities portfolio, though apparently has become less, still hold.

Reasons for optimism:

1) The FWI market has corrected heavily since having peaked in 2011; it has remained in a correction mode since. Figure 6 highlights that the Liv-ex Fine Wine 1000 Index is now meaningfully below the long-term growth trend line. The Liv-ex indices have stabilized and we think this sets up a good support level for the indices going forward.

Figure 6

Liv-ex 1000 is now well below long term trend and is poised to rebound



Note: Price performance in Sterling. Source: Liv-ex

2) Even if we conservatively assume 70% of the historical returns, FWI return still counts amongst the most attractive.
   - Average absolute 5-year return: 74.03%
   - Median absolute 5-year return: 85.63%

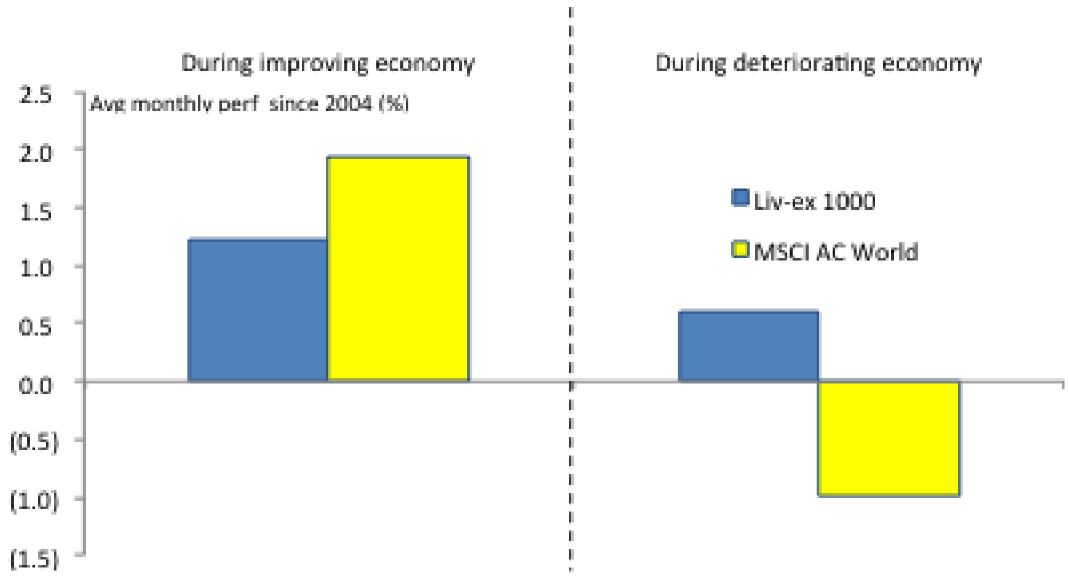
   If we assume future returns to be 70% of the average historical return of 74.03% for any 5-year holding period, i.e., 51.82%, FWI is still likely to rank amongst the best return asset classes.

3) The fundamentally favorable supply / demand equation for FWI has not changed, if not becoming even more favorable.

4) Another important factor for FWI is its ability to outperform global equities during periods of economic deterioration (when OECD CLI is trending down). FWI has proven to provide superior returns and diversification benefits at the same time. Average monthly performance of FWI during periods of economic deterioration was 0.6% while that of World Equities was -1% (the right-hand-side chart of figure 7).

Figure 7

<u>Average monthly performance during improving and deteriorating economy</u>



Note: Annualized performance based on the time period indicated by the OECD composite leading indicator.
Price performance in Sterling. Source: Liv-ex, MSCI

APPENDIX

What is Liv-ex Fine Wine 1000 Index?

The Liv-ex Fine Wine 1000 tracks 1,000 wines from across the world using the Liv-ex Mid Price. It is calculated monthly and was rebased at 100 in December 2003.

Wines that make up the component indices

- **Bordeaux 500:** the ten most recently physical vintages for 50 top Bordeaux chateaux (2001-2010)
- **Bordeaux Legends 50:** a selection of 50 Bordeaux wines from exceptional older vintages (from 1982)
- **Burgundy 150:** the ten most recently physical vintages for 15 white and red Burgundy, including six Domaine Romanée Conti labels
- **Champagne 50:** the most recently physical vintages for 12 Champagnes
- **Rhone 100:** the ten most recently physical vintages for five Southern and five Northern Rhone wines
- **Italy 100:** the ten most recently physical vintages for the five 'Super Tuscans' and five other leading Italian producers.
- **Rest of the World 50:** the ten most recently physical vintages for five wines from Spain, Portugal, the USA, and Australia.

How the Index is calculated

- In order to qualify for the index, wines must have attracted a regular market on Liv-ex. They must also be physically available in the UK market, so recent vintages that are only trading on an En Primeur basis are ineligible. The wines included in the index are reviewed on a quarterly basis by committee.
- The Liv-ex 1000 is calculated using the Liv-ex Mid Price for each component wine. The Mid Price is the most robust measure for pricing wines available in the market and is calculated by finding the midpoint between the current highest bid price and lowest offer price on the Liv-ex trading platform. Each price is then verified by our valuation committee to ensure that the number is robust after taking into account all data at our disposal, including merchant offer prices and historical Liv-ex transaction prices.
- Each component is reflected by one 12x75 case, with the exception of Domaine Romanée Conti (primarily a bottle market) where each component has been reflected by one 75cl bottle.
- The index is price weighted at launch as follows: Bordeaux 500 – 46%; Bordeaux Legends 50 – 22%; Burgundy 150 – 14%; Champagne 50 – 3%; Rhone 100 – 4%; Italy 100 – 7%; Rest of the World 50 – 4%.

Details: http://liv-ex.com

What is OECD composite leading indicator?

The OECD system of Composite Leading Indicators (CLIs) is designed to provide early signals of turning points in business cycles - fluctuation in the output gap, i.e. fluctuation of the economic activity around its long-term potential level. This approach, focusing on turning points (peaks and troughs), results in CLIs that provide qualitative rather than quantitative information on short-term economic movements.

Details: http://stats.oecd.org/Index.aspx?DatasetCode=MEI_CLI

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