CW

CULT WINES

SOLUTIONS FOR FINE WINE

FINE WINE INVESTMENT OUTLOOK 2021

THE QUEEN'S AWARDS FOR ENTERPRISE:
INTERNATIONAL TRADE
2017

WWW.WINEINVESTMENT.COM

Executive Summary

Fine wine investments are on firm footing for the year ahead. Their stable track record and growing geographic diversity mean we hold a positive outlook for 2021 but recommend a selective approach focusing on certain regions and producers.

The past year underscored that fine wine is a resilient investment. The Liv-ex 1000, an index that tracks the price of 1000 of the world's most-traded fine wines, returned 1.3% year-to-date at the end of November 2020, rebounding after a relatively modest decline in the first half of the year when coronavirus volatility peaked. Despite challenges from the pandemic and global trade disputes, fine wine managed a favourable return while displaying low volatility relative to most financial markets.

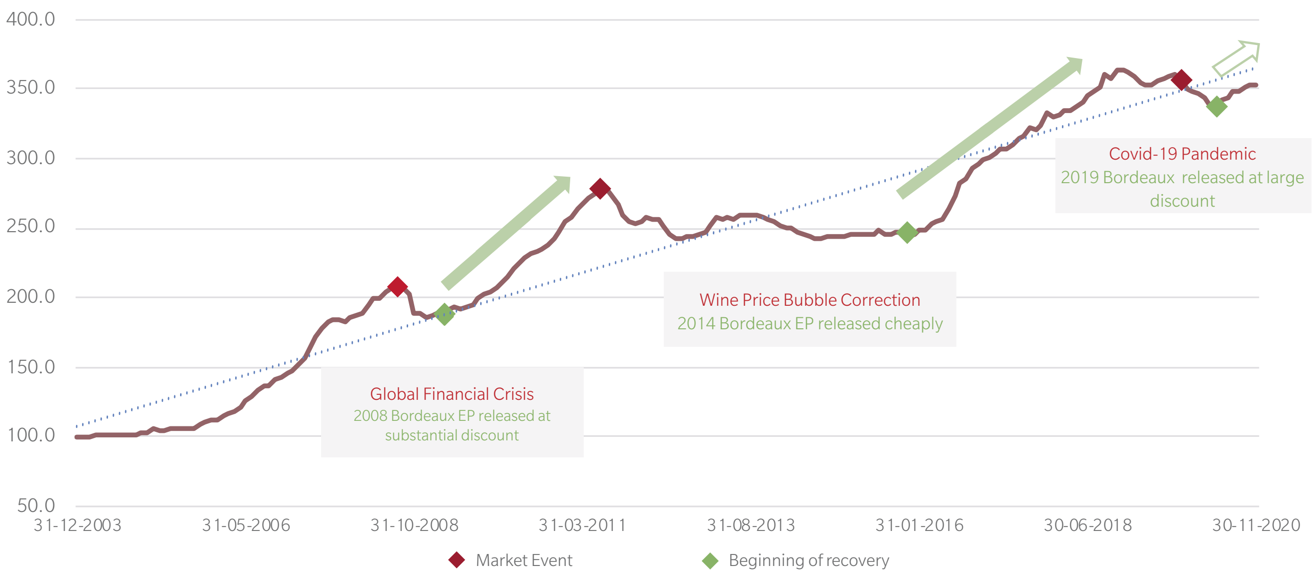
We think fine wine can build on its recent performance and have identified two dynamics at the heart of our outlook:

1 - Greater Growth Potential

In last year's version of this report, we anticipated a rebound in 2020 following weakness at the end 2019. The outbreak of COVID early in the year delayed this rebound, but the emerging recovery in the second half of 2020 could continue and potentially gain pace in the new year. Even after the strong end to 2020, Figure 1 below shows that the Liv-ex benchmark remains well below its long-term trend (7.7% compound annual growth rate since January 2004), meaning we see room for the rebound to accelerate.

Figure 1 – Fine wine has room to grow

Liv-ex 1000, rebased at 100, Dec 2003



Data source: Liv-ex as of 30 Nov 2020

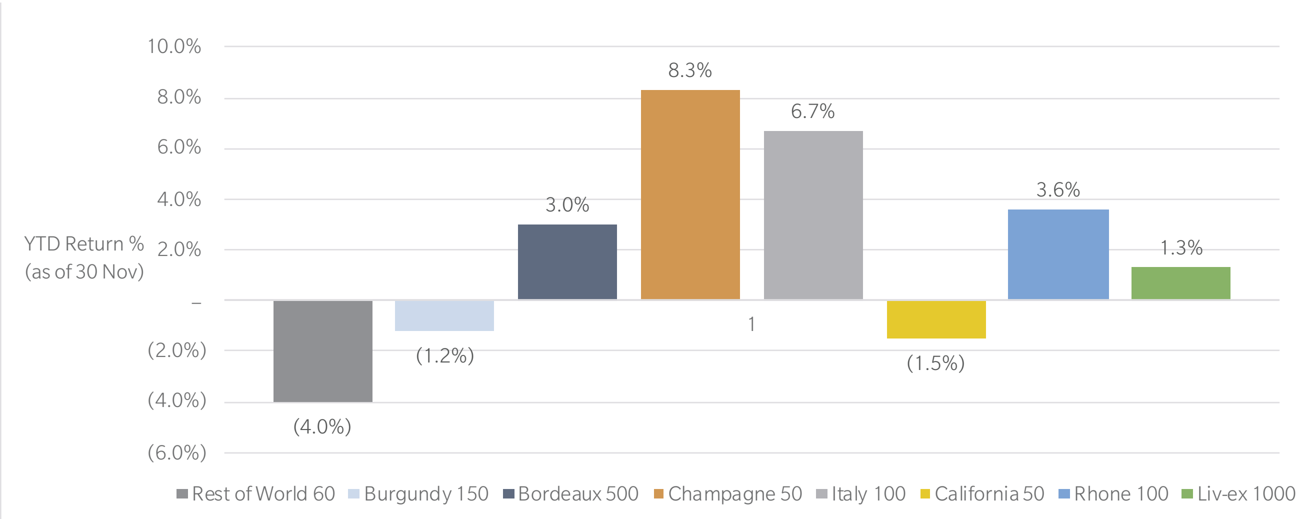
2 - More Choices Globally

We expect the global fine wine market to continue to diversify and expand as new regions and producers gain attention. Some of the top performing regions in recent years have been Italy, Champagne and Emerging Markets rather than the more established Bordeaux and Burgundy (see Figure 2).

The past year also saw the continued rise in automated trading. This strengthened fine wine resilience in the face of COVID-related shutdowns as well as increased the diversity of the global market. With a larger choice of global wines and improved liquidity, investors have more opportunities for continued performance in different backdrops. However, investors should also be more selective as not all regions, producers and vintages will perform the same.

Figure 2 – Champagne and Italy outperformed in 2020

Fine wine performance by region as of 30 Nov 2020



Data source: Liv-ex as of 30 Nov 2020

Key Themes We Are Watching

The fine wine market had to cope with a range of macro uncertainties in 2020. Here, we discuss how the key issues of the economy, Brexit and global trade could impact fine wine and its individual regions in the year ahead.

COVID and the economy - Sharp recovery or ongoing disruption?

Fine wine's stability forms the core of our positive outlook for the year ahead. We believe it can perform whether the global economy sees a strong rebound from the difficult 2020 or continues to suffer from the pandemic's ongoing effects. In either scenario, we expect interest rates to remain low, and in some cases negative, for a period of time. This pushes investors to seek other sources of return, such as fine wine.

- **Economic rebound**
  News that multiple vaccines could get rolled out early next year provide hope that the hospitality sector will normalise in 2021, unleashing further potential for fine wine to recover toward its long-term growth trend.

  Fine wine's low correlation to equity markets could also attract investor interest as equities could suffer bouts of volatility even as the economy improves. Global stocks surged from their lows in March due to massive central bank and government stimulus. However, these measures may get rolled back as economic activity returns to normal. Also, the wider recovery may not be felt evenly with some industry sectors rebounding sharply but others lagging. Fine wine is more removed from these shifts in the real economy.

- **COVID effects linger**
  We think investors should remain cautious regarding the economic outlook. Additional lockdowns could occur in 2021 due to the vaccines' impact likely being gradual and modest at first. Additionally, even when the COVID pandemic is under control, its effects could still hurt economies for years to come. The stimulus programmes may have merely delayed some of the business failures and layoffs, which would impact spending.

  In this more challenging backdrop, some segments of the fine wine market may suffer more than others and identifying relative value will be essential.

  Fine wine is a tangible asset which helps its appeal endure shifts in the macro backdrop. Production of investment-grade wine is strictly controlled by various Appellations d'Origine Controlee (AOC) in France and their equivalent in other countries. This is not to say wine investments would be immune to further economic hardship but that their limited and fixed supply should maintain its relative stability.

Brexit – Deal or no-deal?

The UK's transition period is set to end of 1 January 2021 and as of the time of writing, a new trade deal has not been agreed. There remains hope that a last-minute deal will be struck in December, which would be the best-case scenario for fine wine as it would improve clarity and continuity.

However, the UK government plans to introduce VI-1 forms for all wine imports from EU, similar to current requirement for wines from outside the EU. Although this requirement has been delayed until 1st July 2021, concerns over its impact remain. The Wine and Spirits Trade Association (WSTA) estimates this could cost around £70 million per year for businesses and result in higher wine prices for UK customers. The WSTA continues to advocate that the VI-1 form requirement be removed entirely, but the situation currently remains another question mark for the year ahead.

In the event of a no-deal, EU wines imported into the UK will be taxed according to the UK Global Tariff, which vary from wine to wine. However, World Trade Organization (WTO) rules would apply, meaning it is highly unlikely either side could implement additional tariffs on wine imports as the same customs duties must apply for all WTO members for a particular product. While a no-deal scenario would provide additional obstacles and uncertainty, we don't expect the fine wine market to see significant Brexit-related pricing volatility in the short term.

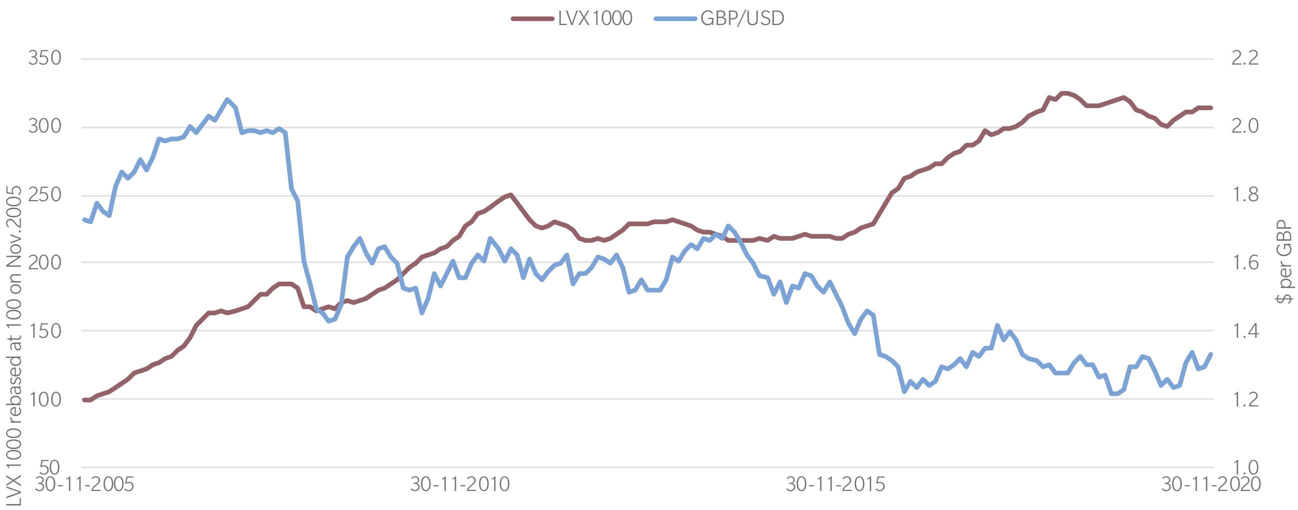
In our view, the exchange rate forms the most important variable. If a new trade agreement is not reached, the British pound is expected to decline relative to other major currencies.

One impact from this would be negative. Wine imports from the EU and elsewhere would become more expensive for UK buyers, which could hurt UK demand. This might filter through to market pricing, including the Bordeaux en primeur (EP) campaign, which relies heavily on British demand.

However, a weak pound also has positive effects on fine wine prices. Significant stocks of fine wine are denominated in pounds as the UK remains a global wine trading hub. Therefore, a weak pound could spur foreign demand, supporting global prices. Fine wine tends to behave as a good hedge to sterling weakness, historically. Figure 3 below reveals that fine wine has performed well in the past during periods of sterling weakness.

Figure 3: Fine wine can perform amid GBP weakness

GBP/USD exchange rate and Liv-ex 1000 performance



Data source: Liv-ex, Investing.com as of 30 Nov 2020

Tariffs - Room for improvement in trade relations

Trading relationships globally will again be an important factor in 2021. Market optimism is improving due to hope that a Joe Biden presidency will mend the US-EU relationship and potentially repeal the 25% tariff the US imposed on wine imports from France, Germany, Spain and the UK in late 2018. While we exercise caution on predicting political moves, we do expect US merchants to return to European markets since the political change at least removes the threat of any additional tariffs in the medium term. Bordeaux would receive a boost in this scenario after it was hit particularly hard by the reduced US demand in the last two years, including at the EP 2019 campaign.

Elsewhere, China implemented tariffs on Australian wine of 107.1% to 212.1% on 28th November as part of a wider escalation in trade tensions between the two countries. If these tariffs remain in place over the course of 2021, Australian fine wine could suffer. However, we expect a limited wider impact on fine wine pricing. Other regions with free trade agreements with China could be beneficiaries.

This fits with our overall view that any short-term impacts from tariffs on the fine wine market as whole will likely be modest. Instead, any changes in tariff regimes could be felt more at a regional level.

Regional Analysis

No matter the backdrop, we believe market performance could see continued variance across different regions and producers. The added diversity creates opportunity, but it also calls for a research-focussed analytical approach. Below, we will look at each major wine region individually and discuss where we see the best opportunities.

Bordeaux

Key Outlook: Underweight – Finding relative value essential with 2020 EP as the next focal point

The Bordeaux 500 index, a comprehensive index of the 500 leading Bordeaux wines, showed a 3.0% annual return at the end of November, recovering from a year-to-date low of -2.74% at the end of March. The Fine Wine 50 index, which is a measure of the last 10 physical vintages of first growth wines, also bounced back above its pre-pandemic level.

Digging deeper, we find discrepancy within the region with some producers still in negative territory while others posted healthy returns. We also find a range of performance across vintages with wines from 2005 and 2008 netting a positive year-to-date performance while 2009, as well as more recent vintages, remained in negative territory.

One reason for this level of granularity is the increased competition from other wine regions. For the first time, Bordeaux made up less than half the total fine wine market in 2020 with 46.9% of the trade volume, down from 54.6% in 2019. With more investment-grade wines emerging from Italy, Rhone and elsewhere, investors can be more selective on specific Bordeaux vintages from certain producers.

We think this trend will continue. The 2019 EP campaign suffered from COVID disruptions as well as reduced US demand due to tariff concerns. Producers responded with wide-ranging discounts that reinvigorated the market by making many Bordeaux wines cheap enough for investors to find clear value opportunities.

Much of the outlook for Bordeaux hinges on the upcoming 2020 EP campaign and whether we see a more 'normal' event if travel and global trade improve in the coming months. The reception of the 2018 vintage in bottle will also be important. If the 2018s score well when they are released in bottle, this would support prices and spur demand for unsold stock in Bordeaux, giving producers and negociants more control of how much stock to release and at what price.

If conditions are favourable, chateaux could probably justify price rises of up to 15% compared to last year, in our view. The question then turns to where EP prices would need to be to still offer attractive relative value opportunities, with the key determinant being how the vintage is judged. Initial indications are favourable, but if producers are too aggressive with price increases, it could push demand toward physical vintages offering more compelling value.

We are tactically overweight some of the older vintages such as 2006, 2008, and 2014 that were less heralded at the time of their release due to their favourable risk-adjusted return potential in the near term. Some producers' more recent vintages, such as 2015 and 2017, also look attractive having adjusted in price since becoming physical.

Burgundy

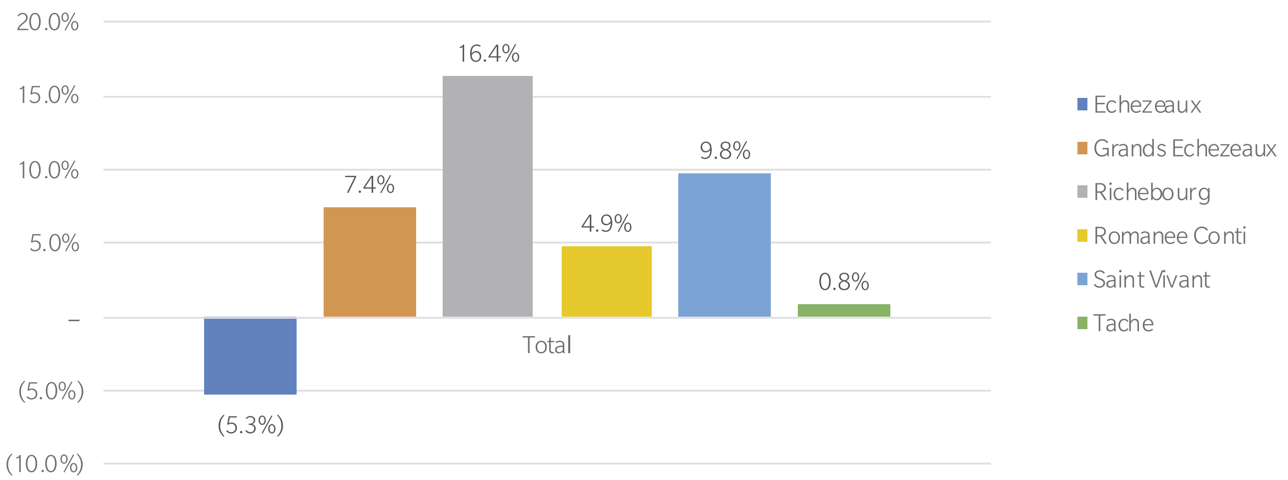
Key Outlook: Overweight – 2nd tier producers could lead region's rebound

Burgundy performance lagged in 2020 with the Burgundy 150 index still in negative territory at -1.2% at the end of November. After strong rise in recent years, the region also saw its trade share shrink from 19.1% in 2019 to 17.2% so far this year.

Like Bordeaux, Burgundy also experienced variation across different wines. Many top Burgundies suffered during the first quarter of the year amid COVID concerns with some then seeing stronger recoveries than others. For example, the index covering Domaine de la Romanée Conti wines (DRC) sat at a positive 4.6% mark at the end of November. Within the DRC, Richebourg and Saint Vivant had posted positive gains across their 2006-2015 vintages while Echezeaux showed a year-to-date loss of -5.3%, as shown in Figure 4.

Figure 4: Varied DRC performance

Year-to-date return as of 30 Nov 2020



Source: Liv-ex as of 30 Nov 2020

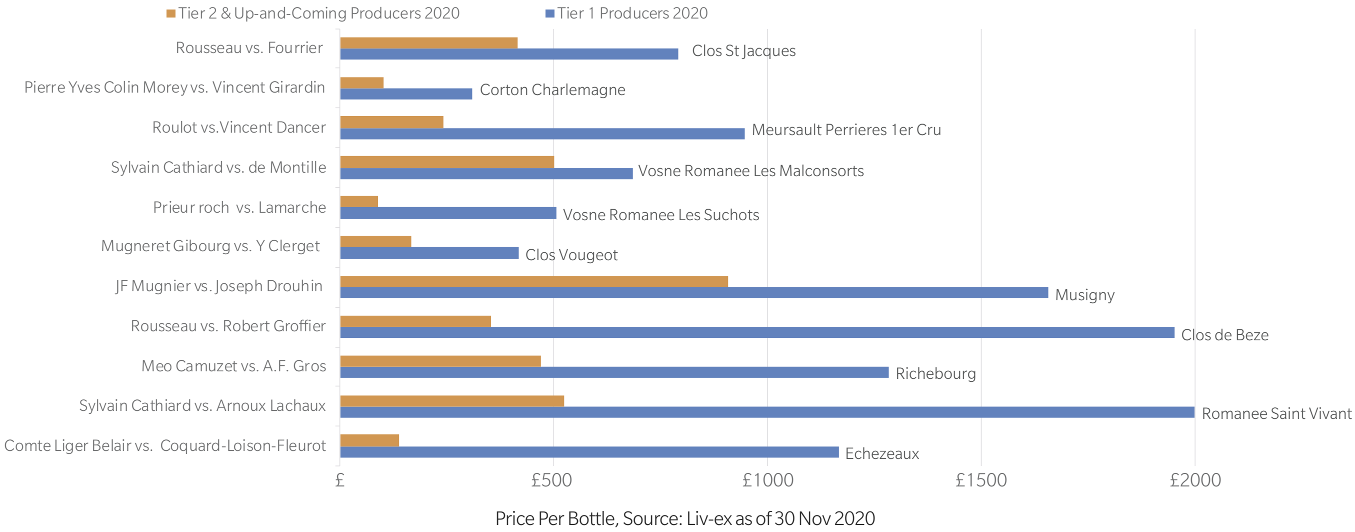
Looking ahead, we expect Burgundy to recover should the macro backdrop improve. The mixed performance over the past two years stemmed primarily from market indigestion following the so-called 2016-2018 'Burgundy bubble,' which was caused by high demand combined with relative rarity after a series of low-volume, quality vintages. This pushed some buyers toward other regions offering better value. Prices then fell after higher production levels for the 2017 and 2018 vintages resulted in more stock left over.

The next focal point is the upcoming 2019 Burgundy en primeur release. Indications are that supplies could be on the low side as the wines are released onto the market over the first few months of 2021. Early reports suggest the vintage is of high quality, which could create opportunities for investors as strong demand alongside limited supply could support prices across the Burgundy market.

In November, Burgundy enjoyed its highest monthly share (23.3%) of total trade, suggesting demand is recovering following the period of underperformance. Demand from Asia, where COVID has been kept under relative control during the second half of the year, drove this rebound, lending support to the view that Burgundy can rebound further if Western economies normalise.

Figure 5: Tier 1 and Tier 2 price gap creates opportunity

Price comparison by producer



Performance variation across vintages and producers will likely continue, however. Cult Wines' Burgundy index outperformed the Burgundy 150 over the past five years due to our focus on finding interesting second tier wines and up-and-coming producers. We continue to adopt this tactic as we currently see a noticeable price gap between many tier one and tier two names, as shown in Figure 5. In the case of Romanée Saint Vivant and Clos de Béze, the price gaps between the selected tier one and tier two producers have more than doubled in the past three years. A stabilising macro backdrop will likely see this value opportunity close over the course of the next year.

Champagne

Key Outlook: Overweight – Further performance rests on Grower Champagnes and back vintages

Champagne enjoyed the best annual performance with an 8.3% return as of November 2020. Having also delivered a strong performance during the global financial crisis in 2008, Champagne has cemented its reputation as a defensive investment with low correlation to wider fine wine market.

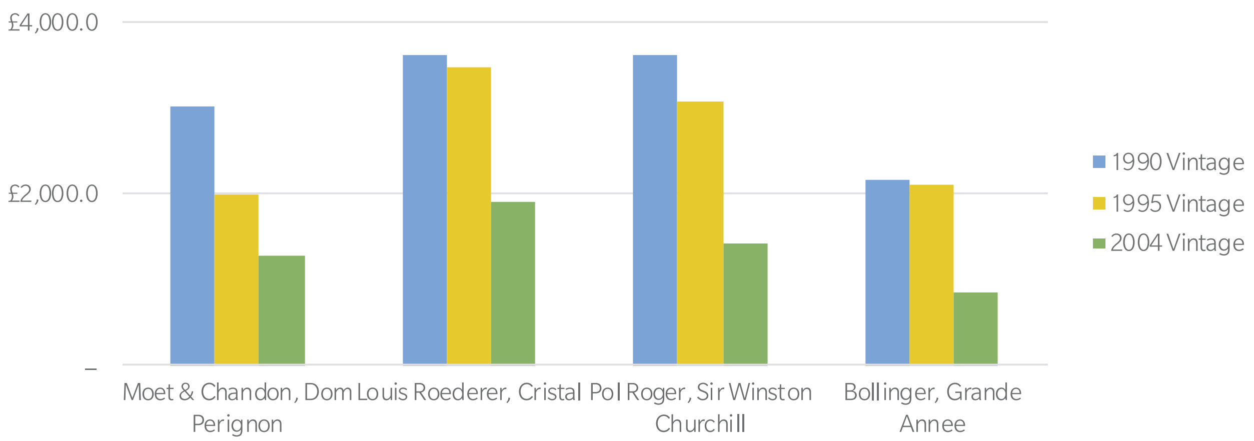
Several factors underpinned Champagne's performance during the recent crisis, including high liquidity illustrated by a bid/ask ratio near one. Champagne was also exempt from US tariffs, so demand did not suffer the same as other French regions. Often considered as a seasonal wine due to its celebratory nature, Champagne benefitted from an unusual off-season jump in private sales during the pandemic, causing its market share in May to rise to 11.4%, far above its normal share in May around 5%.

However, we think it is unlikely conditions will align for a repeat of Champagne's 2020 outperformance. The region found support by a jump in sales by value as consumers turned to higher-end Champagne in growing numbers this year. However, overall sales, including non-premium Champagnes, are expected to fall by a third to 200 million bottles, according to a Financial Times report. Despite the sales spike in the summer, the annual value could end up around £3 billion compared to roughly £4.5 billion in 2019. Champagne's higher average production compared to other 'investment-grade' wine regions means that prices will not find across-the-board support from scarcity.

For this reason, we think quality back vintages hold the best performance potential going forward. As we reported earlier this year, back vintages of premium Champagne appreciate over time as supply is being consumed, creating that scarcity (see Figure 6). This view started to bear fruit in late in the year with several vintage Champagnes from the early 2000s rallying in November.

Figure 6: Value comes with age

Price comparison of back vintages of selected Champagne producers



Data source: Liv-ex as of 30 Nov 2020

Our outlook for Grower Champagnes in 2021 is also more positive compared to the recent vintages from the established large producers. Suppliers of Grower Champagne, which are producers making wine with grapes from vineyards they own, are limited compared to the large 'Grande Marque' producers. This can lead to strong price appreciation in most sought-after Grower Champagnes, such as Egly-Ouriet or Jacques Selosse. After the famous Grande Marques drove Champagne's overall price growth in 2020, many names in the Grower category now appear relatively undervalued, in our view.

Rhone

Key Outlook: Overweight – Regional expansion can continue

The Rhone 100 index produced a strong 3.6% year-to-date return for investors at the end of November as the region continued to expand its presence in international fine wine markets.

We have been overweight the Rhone market in recent years as we recognized it as a source of diversity and excellent relative value for its top tier wines. Although its recent outperformance against Bordeaux and Burgundy mean this price gap has closed slightly, Rhone wines have not yet received the full attention that we think they deserve. The region has more potential following a period when it lagged the more established regions in the mid-2010s.

Rhone's annual trade share has remained steady over the past three years at around 3%, according to Liv-ex data. It managed to remain around this level in 2020 despite trade tariffs as American buyers maintained a strong interest in Rhone wines. We think this is a positive signal for 2021, especially if the trade situation improves.

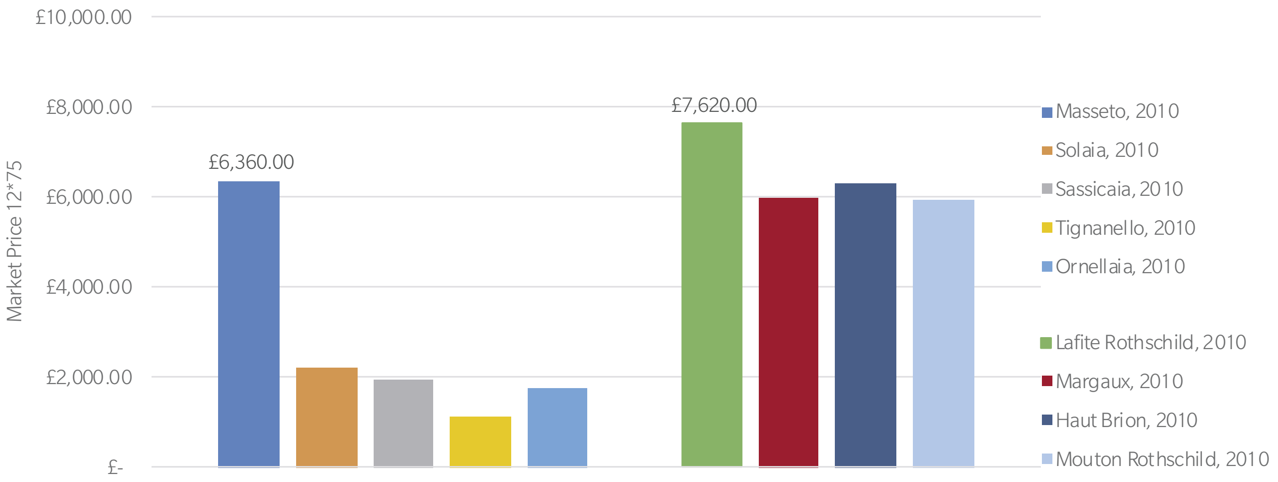
Italy

Key Outlook: Overweight – Strong vintages can maintain region's performance

The Italy 100 index posted the second highest return of the Liv-ex sub-regions with a 6.7% YTD gain at the end of November. Looking at the past two years, Italy comes out as the top region with a 12.7% return over a 24-month period when the Liv-ex 1000 performance was marginally negative. Italy's trade share more than doubled from 7.3% in 2019 to 15.6% in 2020 with interest for recent Super Tuscan vintages and Barolo wines leading the way.

Figure 7: Attractive relative value?

Price comparison - 2010 Bordeaux First Growths vs. 2010 Italian Super Tuscans



Data source: Liv-ex as of 30 Nov 2020

Italian wines can carry this momentum forward into 2021 as the expansion in international demand has been matched by critical praise. The 2016 Barolo vintage released earlier this year is receiving widespread acclaim, and the website James Suckling included 20 Italian wines in its annual Top 100 list this year. As Italian wines gain recognition, the total value of bids and offers on Liv-ex jumped by 150% over the past five years, reaching £5 million in 2020.

Italy is also exempt from the 25% US tariff on some wines from some EU countries. Although US-EU trade relations may improve, it is not clear if this tariff will be repealed, so Italy continues to hold this advantage for US exports over some of its French counterparts for the time being.

The combination of growing international demand and high-quality wines drive our overweight position in Italy heading into 2021. Our focus is on quality Piedmont region vintages, specifically 2015 and 2016 Barolo, as well as the upcoming release of 2016 Brunello di Montalcino vintage which has generated high praise from critics.

Emerging Markets

Key Outlook: Overweight – German and South American wines drawing attention

Emerging wine regions saw a range of performances in 2020. Overall, Liv-ex's Rest of World 60 (ROW 60) index lagged with a -4.0% return. However, there was noticeable variation across countries with much of the weakness coming from the US (discussed separately below). Australia also suffered toward the end of the year after China implemented tariffs of 107.1% to 212.1% on the country's wines. The overall trade share of the ROW 60 leapt from 3% in 2019 to 6.4% in 2020.

Heading into 2021, the future looks bright for many areas of emerging markets because the improving quality and range of their investment-grade wines is getting noticed by wine critics. Distribution channels are also widening, boosted by the rise in automated trading which has increased liquidity and accessibility.

Many recently released wines from Argentina and Chile received their highest ever scores this year with several featuring in James Suckling and other top wine lists. This bodes well for their future value. Figure 8 below demonstrates the return potential of high-quality back vintages of top Chilean wines.

Figure 8 – Price growth of top Chilean wines

Comparison of 2015 and 2020 prices of back vintages

Wine Names	Price in 2015 (12*75)	Price in 2020 (12*75)	5yr Change %
Mondavi & Chadwick, Sena, 2005	£720.00	£998.00	39%
Mondavi & Chadwick, Sena, 2010	£668.00	£936.00	40%
Mondavi & Chadwick, Sena, 2011	£600.00	£920.00	53%
Rothschild & Concha Y Toro, Almaviva, 2005	£1,020.00	£,680.00	65%
Rothschild & Concha Y Toro, Almaviva, 2007	£798.00	£1,310.00	64%
Rothschild & Concha Y Toro, Almaviva, 2008	£780.00	£1,350.00	73%
Errazuriz, Vinedo Chadwick, 2006	£804.00	£1,474.00	83%
Errazuriz, Vinedo Chadwick, 2007	£952.00	£2,626.00	176%
Errazuriz, Vinedo Chadwick, 2008	£890.00	£2,110.00	137%

Source: Liv-ex as of 30 Nov 2020

Amid this support, we retain a tactical overweight stance to emerging markets, preferring wines from Chile, Spain and Germany. Several German wines also saw favourable attention from critics with the 2019 Riesling vintage garnering high praise as one of the best in recent memory.

United States

Key Outlook: Neutral – COVID impacts weigh on market

Much of the decline the ROW 60 index stemmed from a difficult year for US wines. The California 50 index turned in a -1.5%. Much of the price declines can be attributed to the COVID pandemic with revenues falling by over 50% for some producers. Losses were felt at the high end of the market. For example, Harlan Estate's 100-point 2013 and 2016 vintages dropped by more than 10% on the year while lower-priced vintages remained more stable.

Encouragingly, the US annual trade share rose to 6% of the total market, up from 2.3% in 2019. On a monthly basis, the US took over 10% of the total October trade, a single-month record for the region.

While this should help longer term, we expect more mixed results in the year ahead. The market continues to diversify which can cause some price fluctuations in the upper tiers of the market. The US is currently experiencing a pronounced second wave of the outbreak, meaning short-term sales revenues will likely suffer further. This could lead to excess stock building up in storage, which in turn could lead to further price pressure next year. Hence, we hold a neutral exposure to the US market.

CULT WINES

SOLUTIONS FOR FINE WINE

UK OFFICE
The Clockwork Building,
45 Beavor Lane,
London W6 9AR
T: +44(0)207 1000 950
E: info@cultwinesltd.com

SINGAPORE OFFICE
9 Battery Road,
#09-01 MYP Centre,
Singapore 049910
T: +65 6909 8170
E: singapore@cultwinesltd.com

HONG KONG OFFICE
1001B – 2, Kinwick Centre,
32 Hollywood Road,
Central, Hong Kong
T: +852 2818 0899
E: hongkong@cultwinesltd.com

CHINA OFFICE
2441 CITIC Square,
1168 Nanjing West Road,
Shanghai 200041
T: +86 21 6085 3559
E: china@cultwinesltd.com

wineinvestment.com
Co. Reg No. 6350591

THE QUEEN'S AWARDS
FOR ENTERPRISE:
INTERNATIONAL TRADE
2017