Fine Wine:
An Alternative Asset for All Seasons

By Aaron Rowlands
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AN ALTERNATIVE ASSET FOR ALL SEASONS

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A fine wine portfolio can mean different things to different people. For some, it is a chance to indulge in a passion by collecting some of the world’s finest and rarest wines. Others will recognize how fine wine can form an important part of an investment portfolio, which has led to its increased acceptance among alternative assets.

The main reasons why investors turn to fine wine and other alternative assets include enhancing the return potential of their portfolios, increasing diversification, and/or hedging against market risks (see table 1).

Fine wine’s ability to deliver strong, consistent returns during the turbulent year of 2022—a period when traditional 60/40 portfolios suffered amid inflation, deteriorating economic growth, and geopolitical tensions—demonstrates its investment potential (see table 2).

We believe fine wine remains an attractive long-term component of a portfolio. In this article, we look at fine wine’s credentials as an alternative asset and its role in an investment portfolio.

WHY ALTERNATIVES?
The global alternative investment market is growing rapidly. Although estimates vary, most studies point to an expanding market. An October 2022 report from Preqin stated expectations for the global market for alternative investments to grow to $18.3 trillion in five years, about double its $9.3-trillion size in 2021.¹

Alternative assets typically include any asset other than traditional equity, bond, and currency investments. One type covers financial instruments that take alternative approaches to investing such as hedge funds, private equity, debt, or distressed funds. Another category involves real or physical assets including commodities, precious metals, infrastructure, or real estate. Cryptocurrencies and non-fungible tokens are another more recent market that has made inroads with a wider audience.

Yet another category falls under the term “collectibles” and includes items such as art, antiques, watches, classic cars, and fine wine.

The current period of uncertainty stemming from the war in Ukraine, inflation, and cost-of-living concerns is prompting more investors to manage risk through diversification. Before this period, many investors looked to alternatives as a

### BENEFITS AND CHALLENGES OF INVESTING IN DIFFERENT ALTERNATIVES

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Benefits of Investing</th>
<th>Challenges/Risks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real Estate</td>
<td>• Diversification</td>
<td>• Substantial initial investment</td>
</tr>
<tr>
<td></td>
<td>• Relatively stable income return</td>
<td>• Mismatch between pricing and valuation</td>
</tr>
<tr>
<td></td>
<td>• Relatively low volatility (if holding direct real estate)</td>
<td>• Limited transactional information</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Involves substantial operational and maintenance fees</td>
</tr>
<tr>
<td>Commodities</td>
<td>• Diversification</td>
<td>• Volatility</td>
</tr>
<tr>
<td></td>
<td>• Inflation protection</td>
<td>• Risk in losing more than initial amount invested (derivatives)</td>
</tr>
<tr>
<td>Hedge Funds</td>
<td>• Diversification across multiple hedge fund strategies available</td>
<td>• Long-term commitment required</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Unfamiliarity with different strategies</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Management fees</td>
</tr>
<tr>
<td>Fine Wine</td>
<td>• Long-term stability in different macro environments</td>
<td>• Possible difficulties securing allocation</td>
</tr>
<tr>
<td></td>
<td>• Less correlated to equity market</td>
<td>• Liquidity</td>
</tr>
<tr>
<td></td>
<td>• Real asset</td>
<td>• Market still in early stage of development</td>
</tr>
<tr>
<td></td>
<td>• Unique supply and demand mechanism</td>
<td></td>
</tr>
<tr>
<td>Art</td>
<td>• Diversification</td>
<td>• Liquidity</td>
</tr>
<tr>
<td></td>
<td>• Possible tax benefits</td>
<td>• Price discovery</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Limited market data</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Price realization</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Unregulated market</td>
</tr>
<tr>
<td>Cryptocurrencies</td>
<td>• Potential for rapid growth</td>
<td>• High risk due to significant swings in pricing</td>
</tr>
<tr>
<td></td>
<td>• Easy to access and trade</td>
<td>• Highly speculative</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Limited track record</td>
</tr>
</tbody>
</table>

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source of growth amid an extended period of low interest rates and high equity valuations that followed the Global Financial Crisis and COVID-19.

This increased demand could add to the performance potential of many alternatives, especially collectibles. These real assets generally have a fixed supply and growing demand exerts upward price pressure.

**POTENTIAL BENEFITS OF ALTERNATIVE ASSETS**

**Diversification.** Alternative assets can help de-link an investment portfolio’s performance from the ups and downs of the economic cycle. Alternative assets often have different drivers of performance compared to traditional 60/40 portfolios, which means they may have lower correlation (or sometimes negative correlation) to equity or bond investments.

**Hedge against market risks.** Different drivers of performance for alternative assets often mean the risks facing equities or bonds will not impact them in the same way. This is not to say alternatives are insulated completely from market risks but that their different market dynamics can provide a degree of insulation in the event of a sudden shock to the macroeconomic environment.

**Potential enhanced returns.** Alternative assets can offer new frontiers for investors to identify alpha opportunities and boost the return potential of their portfolios. The market for many alternatives often is less developed and less efficient than traditional financial markets—opening the door for selective investors to uncover growth and arbitrage opportunities.

**RISKS**

Despite the possible benefits, collectible alternative assets carry their own set of risks. They often are less regulated than mainstream markets and can have shorter track records or less data available for transparent decision-making.

The plummeting prices of most cryptocurrencies during 2022 illustrates the risks involved in some alternative asset classes. It is important for advisors and investors to conduct rigorous research before selecting which alternatives match their specific requirements.

**FINE WINE’S CREDENTIALS**

Typically, the value of a bottle of wine is based on the following factors:
- Supply and demand
- Brand recognition and prestige
- Vintage quality and volume
- Critic scores
- Drinking window
- Relative value versus other wines
- Costs associated with production and distribution

These internal market dynamics are the primary drivers of fine wine’s prices—enhancing its suitability for alternative asset investing in different macroeconomic environments. Fine wine’s main advantages are described below.

**RETURN POTENTIAL**

The primary purpose of investing is to create and build wealth by generating a return on investment. In this regard, fine wine has posted some appealing figures. The Cult Wines Global Index, a benchmark measurement of the global fine wine market that has tracked wine prices since the beginning of 2014, showed a return of 82.20 percent through the end of March 2023 (see figure 1). This return equates to a compound annual growth rate of 6.70 percent.

Fine wine’s return potential stems from a supply–demand imbalance that increases over time after a wine is released. Investment-grade wine improves as it ages, meaning demand typically grows as it approaches its drinking window. Wines also become scarcer with time as bottles are drunk, broken, or improperly stored. The combination of decreasing supply and stronger demand establishes the core engine of price appreciation.

An expanding global market also can fuel periods of enhanced growth. Technology and a greater awareness of fine wine (whether as a drink or an investment) in new markets such as Asia can bring more potential buyers into the market. The supply of fine wine

### Table 2

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<thead>
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<tbody>
<tr>
<td></td>
<td>2022 Return</td>
<td>12-month</td>
<td>3-year</td>
<td>5-year</td>
<td>5-year Volatility*</td>
</tr>
<tr>
<td>Cult Wines Global Index</td>
<td>17.40%</td>
<td>10.12%</td>
<td>37.77%</td>
<td>51.89%</td>
<td>1.08%</td>
</tr>
<tr>
<td>S&amp;P 500 (TR)</td>
<td>-18.11%</td>
<td>-7.73%</td>
<td>66.84%</td>
<td>69.94%</td>
<td>5.38%</td>
</tr>
<tr>
<td>FTSE 100 (TR)</td>
<td>4.70%</td>
<td>5.42%</td>
<td>49.14%</td>
<td>31.07%</td>
<td>4.04%</td>
</tr>
<tr>
<td>Nasdaq Composite (TR)</td>
<td>-32.54%</td>
<td>-13.28%</td>
<td>62.49%</td>
<td>81.00%</td>
<td>6.33%</td>
</tr>
<tr>
<td>iShares MSCI All Country Asia ex Japan ETF</td>
<td>-21.66%</td>
<td>-9.54%</td>
<td>13.65%</td>
<td>-12.46%</td>
<td>5.73%</td>
</tr>
<tr>
<td>Gold (in USD)</td>
<td>1.55%</td>
<td>4.33%</td>
<td>17.13%</td>
<td>49.66%</td>
<td>4.08%</td>
</tr>
<tr>
<td>Bitcoin</td>
<td>-39.93%</td>
<td>-37.45%</td>
<td>344.03%</td>
<td>310.39%</td>
<td>22.12%</td>
</tr>
<tr>
<td>Bloomberg Commodity Index</td>
<td>-64.22%</td>
<td>-15.19%</td>
<td>70.57%</td>
<td>20.62%</td>
<td>4.62%</td>
</tr>
</tbody>
</table>

*Fine wine = Cult Wines Global Index; **U.S. Treasury Bonds = iShares 7–10 Year U.S. Treasury Bond Index. Volatility = Rolling five-year standard deviation of monthly returns. **
cannot increase easily to meet a jump in demand.

Only a handful of certain regions around the world are recognized as top wine-producing regions and production levels are regulated tightly by local appellation rules. An influx of demand alongside constrained supply drives prices higher, leading to periods of strong returns for those holding in-demand bottles such as Burgundy and Champagne wines (a 70.12-percent and 54.08-percent increase, respectively, from December 31, 2019, to December 31, 2022).³

**Real asset.** Like other rare collectibles, fine wine benefits from scarcity and value as a consumer product and collectible, which helps support demand during different market environments.

**Lower liquidity.** Collectible alternatives typically are characterized by lower liquidity than mainstream markets or even other alternatives. This means they can be harder to buy or sell quickly. Although this does have downsides, reduced liquidity also can provide an advantage by insulating assets from panic selling. Fine wine holdings typically are not sold off to the same degree when there is a shift in the macroeconomic outlook.

**Non-leveraged.** The fine wine market typically does not use leverage. Therefore, investors are not forced to sell holdings to meet margin calls, limiting the degree of panic selling and removing a need to sell into a down market.

**A REAL ASSET DURING INFLATION**

Fine wine’s pace of growth has outpaced inflation rates during periods of both low and high inflation, which we saw in 2022 (see figure 3). This is important because during periods of high inflation, some investors will chase higher returns with higher-risk investments. However, increasing your portfolio risk may not align with your long-term investment priorities, making real assets a useful option.

Wine’s ability to form a stable store of value during inflation and other market shocks stems from its nature as a collectible and a consumer product. Demand for fine wine goes beyond just market speculation because rare, quality wine has an intrinsic value as a high-end beverage.

Additionally, the associated costs of producing a bottle of wine—packaging, transport, etc.—filter through to the price of the wine. Consequently, when prices of these elements are rising due to inflation, the price of wine also can trend...
higher. Wine holdings are more likely to absorb periods of inflation than other assets whose inherent value is more speculative.

LOW CORRELATION
Fine wine holdings can help de-link a portfolio from swings in wider financial markets (see figure 4). The primary drivers of fine wine prices are the internal market dynamics, meaning prices don’t necessarily rise and fall in line with wider sentiment. This contributes to the Cult Wines Global Index’s negative correlation with equities and other risk assets, i.e., investments that do well during times of positive macroeconomic sentiment.

Not all alternatives offer the same diversification; some assets are more closely linked to macro sentiment than others. For example, oil and other commodities are impacted directly by geopolitical events and the economic outlook; i.e., low growth expectations typically lead to lower oil prices due to falling demand and vice versa.

Traditionally, bonds have been viewed as a portfolio diversifier in a 60/40 portfolio based on the old axiom that bond prices will rise when stocks fall. However, the two assets also can be positively correlated, which is what we saw in 2022, when both declined, or earlier in the mid-2010s when central bank stimulus buoyed both stock and bond prices.

If stocks and bonds are positively correlated, investors will need to look elsewhere to provide true diversification. Fine wine’s lack of correlation to equities and its track record of consistent positive returns makes it an appealing diversifier in different market backdrops.

FINE WINE’S IMPACT ON A PORTFOLIO
Table 3 describes a series of model portfolios that illustrate the twin benefits of including fine wine in an investment portfolio. Portfolio modeling can shine light on how fine wine holdings have impacted a diverse portfolio rather than just show its track record in isolation.

Fine wine can satisfy the description of a favorable alternative investment: Its stability and low correlation can make an investment portfolio more defensive against market risks and its track record of providing returns through different market backdrops demonstrates its ability to generate alpha.

Of course, fine wine and other alternatives bring unique investment challenges, such as lower liquidity, storage, or fixed increments to invest. However, compared to some other alternatives, fine wine can offer relative flexibility.

For one, wine offers a relatively accessible entry point; investors can gain access to fine wine markets in the United States starting at $10,000. Many other real assets must be sold at once, whereas wine investments can be sold easily in variable sizes at different times.

As with any investment, past performance does not mean results will be
CULT WINE INVESTMENT PROCESS

Cult Wine Investment invests exclusively in wines that respect strict investing criteria and that have potential for appreciation in value. We maintain a high level of diversification across regions, producers, and vintages.

- **Strategic allocation.** Cult Wine Investment begins with a top-down approach to define the optimal allocation across regions and vintages to the portfolio.
- **Tactical allocation.** We then apply a bottom-up approach by drawing on our quantitative analysis and research to select individual wines and producers that we view as offering the best relative value and growth prospects. Our proprietary statistical and probability models help us identify specific wines that can deliver superior returns while respecting our strict risk parameters for investment.

The portfolio of wines is actively managed to maximize risk/reward and is rebalanced on a regular basis to ensure adherence with our risk parameters and an optimal allocation to meet our return objectives. This process and framework is reviewed and validated by our investment committee. The decision process can be summarized as follows:

Wines are bought when we deem that they offer potential risk-return expectations based on the above criteria.

Portfolio components are subject to constant reevaluation in terms of price, growth potential, and fit within a portfolio. Wines are sold when they no longer fit the portfolio objectives or when we recommend shifting the overall allocation of a portfolio. Additionally, we may sell wines based on an investor’s request or to meet liquidity needs.

Portfolios consist of investment-grade wines primarily from Bordeaux, Burgundy, Rhone, and Champagne in France; Tuscany and Piedmont in Italy; and Napa Valley, South America, and Australia in the New World. These wines must meet our investment criteria and must be certified with full provenance. Our management and research teams draw on an extensive knowledge of these wine markets based on direct communication with producers, negociants, third-party wine industry sources, as well as tasting wines directly.

Our research and investment management teams also keep extensive in-house databases of fine wine market prices, performance, stock, and critic scores. Using this data, we have developed proprietary models to determine fair value of individual wines, optimal allocations of portfolios, and other quantitative tools.

Cult Wines’ global investment committee meets quarterly to review the investment strategy, review both tactical and strategic allocations, and decide any changes needed.

The investment committee combines the experience and expertise of the most senior members of the investment management team (IM) together with research, buying, and trading departments. The IM actively manages portfolios using sophisticated quantitative analysis, considers macroeconomic issues, and uses extensive data in the output. The IM also uses machine learning and predictive analytics led by artificial intelligence as inputs into the decision-making process alongside the experience and knowledge of our portfolio managers.

**Who owns the wine?**
Every investor has full ownership of the wines. All wines are placed in individual customer sub-accounts and held in secure bond at an independently owned warehouse operated by London City Bond.
The Cult Wines Global Index history shows that the performance of fine wine, like any investment, does experience ups and downs and will do so again. Given the prevailing outlook, fine wine works best as a long-term component of a portfolio through shifts in macro-economic conditions. The Cult Wines Global Index has generated positive Sharpe ratios in each of the past five years, demonstrating its potential as a diversifier in a portfolio.

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ENDNOTE
2. See https://www.cultx.com/indices.