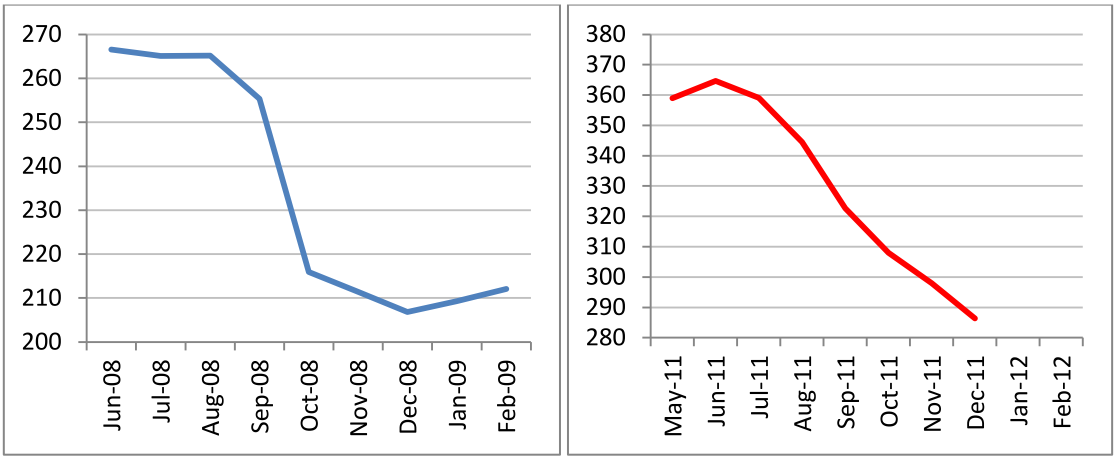
## <u>Outlook for 2012</u>

The second half of 2011 saw the leading fine wine index (Liv-ex 100) end it's almost arrow like Bull Run since early 2009, with 5 consecutive months of steep falls. In the midst of the uncertainty that surrounds the wider financial markets following the emergence of the European Sovereign Debt crisis – the wine market, often lauded as a 'micro economy' highlighted it's not immune to economic troubles. This however is not the first time the wine market has suffered a downturn, and as any financial analyst will tell you, markets never move in straight lines. The fine wine market has suffered systematic 'crashes' in both 1998 and as recently as 2008, when the fall of Lehman Brother's impacted the Liv-ex 100 to a 60 point crash in the final five months of the year. There are striking similarities between the current market downturn and that suffered in 2008. Therefore a closer analysis of the data might well provide some insight into what we can expect in 2012.

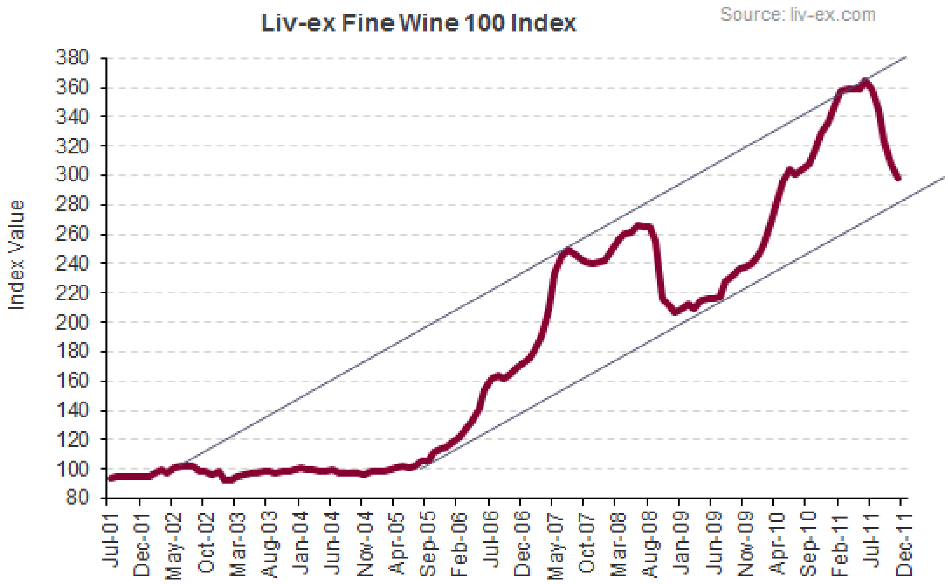
<u>Below is a graph comparing the Liv-ex 100 across the same months in 2008 and 2011:</u>




**Data courtesy of liv-ex.com*

**'Best buying opportunity since 2009' or normalisation?**

The falls are similar in their gradient and timing suggesting that perhaps we are seeing a repeat; if this was the case then the market rebound that started in early 2009 and which continued throughout that year could be replicated in 2012. This is a suggestion that the Liv-ex Blog made at the beginning of December in their article 'Down but not out'. The following graph was produced to illustrate this point, assisting to provide an accurate projection of the prospective path the index may head in 2012.




It is likely that throughout January the market will see some resistance with expectant positive growth in February and the upcoming months, highlighting the potentially prodigious buying opportunity at present. One of the biggest consequences for the 2008 market crash and subsequent rebound was that the short term profit taking was advantageous for collectors and investors. Some of the most speculative gains that have been made from the fine wine market in recent years derived from buyers taking the opportunity to buy stock at depressed prices levels in early 2009. Current market conditions mirror this period, once again offering strong buying opportunities.

Given the available historical data, analysis concludes that although falls in the market as seen in the last 6 months are rare, they are typically followed by periods of sustained growth. This is certainly an opinion shared by Andrew Della Casa, director of The Wine Investment Fund, who forecast a '*prediction for double digit growth this year*'.

To establish an accurate judgement of whether 2012 will replicate 2009 we must further examine conditions which affected the market previously.

**Simply a case of History repeating?**


The Fall of Lehman Brothers was symbolic of the financial crisis that gripped the world economy in 2008

**In 2008:** The precipitous fall in the wine market was sparked by the fall of Lehman Brothers and the general banking/credit crisis. These negative market factors were then quickly offset by the continued market development in the Far East and in particular the start of prolonged buying from Hong Kong.

**In 2011:** The market downturn in fine wine came amidst the European Sovereign Debt Crisis & mounting euro zone problems. Another factor was slowdown in buying from the Far East, with speculation from merchants of a saturation point of stock being reached in Hong Kong. The potential upsides offsetting the market decline, returning the indices to positive growth, are the demand from mainland China easing the backlog of stock in Hong Kong as well as positive market inflows from a number of wine investment funds. In addition to this the recent reduction in fine wine importation duties across India are due to positively impact the market.

**Series of meetings between EU leaders looked to tackle eurozone crisis in 2011 – but how much of the wine market dip can be contributed to this?**

Whilst many have labelled the fine wine market a micro-economy, the downturns in 1998, 2008 and 2011 have all coincided with wider financial market troubles. The immunity of fine wine prices has therefore been exposed to some extent, but the resilience of the wine market and it's relative low volatility have encouraged investors to hold wine not only for risk-adjusted returns but as a store of value. With the year ahead certainly a test for the market, what will be the factors that play a key role on both the upside and downside – and from a risk perspective where does that point the likely growth?

**UPSIDE FACTORS:**

1. **China**

**Fine Wine shops increasingly opening in big cities such as Beijing**

As a growing consumer market, the size of China means a small percentage change in the consumption and imports of fine wines can have a large impact on pricing. With both imports and consumption increasing year on year, and French wines accounting for half of the market, 2012 is set to see demand increase. The Far Eastern market is driven by Hong Kong, as the world's only free port and leading wine hub, however recent reports have claimed Bordeaux stocks in the SAR (*special administrative region)* has reached saturation point. In a recent interview with Jackson Taylor (wineyields), Richard Harvey the international director of wine at Bonhams, said '*there is currently an excess of fine wine sitting in Hong Kong*'. Merchants in both Hong Kong and London suggest that the excess stocks are struggling to clear because of poor distribution networks and the inability to satisfy mainland Chinese demand. The recent slowdown is therefore viewed more as a structural problem in the short-term and has no bearing on the medium to long-term viewpoint of the region. Whilst it is unlikely the current 40% import duties into the mainland will be reduced in the near future, demand from the Chinese will still have to be satisfied helping ease any current problems with Hong Kong. The idea of import duties being reduced from their current levels aren't out of the ordinary but is more a potential factor than one to consider as a given.

**2. Net Injection of Funds**

Following the launch of the first Chinese wine investment fund (Dinghong Fund) in October 2011, structured wine investment loans and subsequent movements from UK based funds offering EIS – we will see a net injection of funds into the market in 2012. The anticipated '*wall of cash*' will certainly assist market recovery and with the general comments from the managers that the funds will be placed across a wider selection of fine wines, the continued strong performance of super-seconds and top end Burgundy is likely to continue in 2012.

**3. India**

Possibly one the biggest developments for the fine wine market in 2011 came with the news that Indian authorities had agreed a reduction of import duties on fine wine from 150% down to 50%. The new regulation is expected to be operational in 2012 and will be the largest fundamental change to the market since the Hong Kong abolition of duties in 2008. It is difficult to make a direct comparison between the two, as duties are still 50% more than Hong Kong, but for a region which has experienced growing demand and interest in fine wines – it will certainly help develop the market and imports will continue to rise. The reduction in import duties by 2/3 of its current levels will definitely be felt at ground level in India. Increasing the exposure of the Indian populace to top level fine wines and in turn increase the demand. If the rising middle and upper classes in India embrace Bordeaux fine wine as those in China have, then the increased interest will exacerbate the demand/supply imbalance. If you look closer at the Hong Kong model, the reduction of duties saw the region's number of wine merchants increase from around 3-400 to around 10 times that. This proliferation of professional merchants and traders in part caused the two/three year buying run which saw record returns in the market. Keeping a close eye on how professional merchants take advantage of the situation will be a barometer by which to judge the perceived effect the region could have on the market and prices.

**Risk to the DOWNSIDE:**

1. **China**

The economic super-power appears on both sides of the fence and this is a reflection of the importance this region now has to play. Wider financial market commentators have been predicting a downturn and slowdown of the Chinese economy for the last few years and whilst the superpower continues its economic rise, negative speculation from The West will continue. In 2011, economic data from China only fuelled these remarks and encouraged many to believe China was set to deteriorate. The subject of China and its risk in relation to fine wine was excellently covered recently by Jackson Taylor who surmised that '*In the end, China may be going through difficulty, but it's not going anywhere'* – this was a fair assessment and one that brought a balanced argument to a close. Whilst China's economy has slowed from the highs of 12% growth in GDP to a '*mere*' 8.7% in 2011 and survived the scare of record inflation in August 2011. The fact is the Chinese government has a lot of room to manoeuvre when it comes to fiscal and monetary policy to control a slowdown in their economy in comparison to their European and American counterparts. Let's not forget that the Chinese government's aim is 8% GDP growth pa and a 0.7% outperformance is nothing to sneer at. The outlook for China in 2012 is positive from Goldman Sachs, believing that China will once again be the strongest part of the global economy. Only a significant slowdown of the Chinese economy will influence the fine wine market and with this the most unlikely of outcomes, it seems China is a minimal risk to the downside in 2012.

**China's economy is export reliant – will a slowdown of the global economy affect exports?**

2. **Euro Zone falters**

2012 will be a big test for the continued viability of the euro zone. Failure of the measures introduced by EU leaders to tackle the problem, may significantly impact on the single currency and it would be hard to imagine this not affecting the price of fine wines. This is the worst case scenario and much like China it is not the anticipated outlook for 2012. Reflecting on 2009 for guidance, a long arduous-recovery from the economy was all that was required to precipitate strong market performance in the fine wine market.

**Fine Wine not immune to short term volatility – but still retains an edge over other assets**

2011 proved the fine wine market doesn't just move in a straight line but as in 2009, 2012 will show why it still has the advantage over other asset classes. A rebound of 10-20% is the most likely outcome in 2012, which would keep the market in line with historical returns over the medium and long term (5 years+) of around 15% per annum. The accelerated performance in 2009 and 2010 pushed the longer term averages above this level and to some extent the recent downturn has normalised the market to a level that is more sustainable.

In any investment market there is always the possibility of volatility in the short term but as long as the underlying reasons for investing in the asset class remain then the longer term outlook will be positive:

Underlying reasons for investing in fine wine:

- Finite supply (perfectly inverse supply curve)
- Tangible asset
- Increasing demand
- Immune to inflation
- Consumable product

The downturn in 2011 was not the result of the failure of one of the above reasons and therefore as they still remain in 2012, the investment merit of fine wine continues to be strong. Current market conditions are strongly in favour of the buyer and so the time to buy has never been better for investors.