Investments of passion: performance and luxury spending trends

Luxury research

And now for the fun stuff. So far in *The Wealth Report* we've talked about big and important themes like global wealth distribution, the world's most important cities, property markets and investments.

In this chapter we look at exciting things like luxury goods, classic cars, art, jewellery and fine wine.

Of course, this being a serious research publication we naturally look at such purchases from an investment perspective. The latest results from the Knight Frank Luxury Investment Index, which tracks a theoretical portfolio of 10 investable luxury assets, show that many of these investments of passion have seen their values continue to rise.

Although, according to the results of our Attitudes Survey, the personal pleasure they provide is the main reason most UHNWIs like to collect beautiful and pleasurable things, one suspects that even the most epicurean collectors would prefer that their treasures grow in value.

Coloured diamonds are the latest addition to our index. Given that jewellery has historically been a common way to store and transfer wealth in many cultures, diamonds are perhaps one of the most multifunctional assets in the index. We list some of the most high-profile sales in our special feature on p64.

Pearls, which until recently were considered rather old-fashioned, are also rising rapidly in value. This trend is being helped by the almost total lack of supply of new natural pearls coupled with strong demand from the Arabian Gulf, where many of the world's finest pearls were originally harvested.

Indeed, much of the recent demand for luxury goods and investments has been driven by wealth creation in regions with burgeoning economies like Asia and the Middle East. It is therefore intriguing to see that the UK tops our new Big Spenders Index, compiled for *The Wealth Report* by Ledbury Research.

The index tracks the countries likely to see the strongest growth in spending on big-ticket luxury items by their own UHNWI populations and visitors from abroad. It would be fair to say that the UK secured poll position off the back of the many visitors who flock to London's luxury stores and increasingly out-of-town designer outlets like Bicester Village – the second-most visited destination in the UK for wealthy Chinese tourists and part of a string of similar 'villages' around the world.

01

Rule Britannia
The UK tops *The Wealth Report's* new Big Spenders Index, produced for us by Ledbury Research

02

Vroom, vroom
Classic cars were once again the top-performing asset class in our Luxury Investment Index, rising by 16% during 2014. Overall the index rose by 10% last year and has grown by a healthy 205% over the past 10 years

03

Shining bright
Coloured diamonds now feature in our index. On average their value has risen by 167% since 2005

Hey, big spender

The results of a new index compiled for The Wealth Report by Ledbury Research's Luxury Analysis team

MADELAINE OLLIVIER, LUXURY ANALYST, LEDBURY RESEARCH

The general outlook for luxury spending continues to be positive. Almost a third of respondents to *The Wealth Report*'s Attitudes Survey expect their wealthy clients to spend more on luxury goods in 2015, compared with just 8% who expect it to decline.

But how does the short-to-medium-term outlook compare for individual countries, and where in the world might luxury brands look to expand? The new Big Spenders Index, compiled exclusively for *The Wealth Report*, provides some of the answers by identifying the locations likely to see strong growth in big-ticket spending by their own ultra-wealthy populations and visiting UHNWIs.

Topping the list for 2015 is a very well-established centre of wealth, the UK. The country scores well, in terms of both the fortunes of its domestic UHNWI population, thanks to the relative strength of the UK economy, and our tracking of the drivers and indicators of high-end spending. The finding underlines the importance of the UK for luxury brands, which sold over £8bn of goods in the country last year, according to Ledbury's estimates.

China fills the second slot in our ranking table. The Chinese are already the single biggest consumers of luxury goods around the world, accounting for some 29% of the global luxury spend, according to consultants Bain & Altagamma.

Although recently much has been said about the impact of the Chinese government's anti-graft measures on luxury demand, Ledbury has consistently argued that the fundamentals of the Chinese luxury market remain very attractive, given the burgeoning wealthy population and rapidly growing middle class. China's high ranking in the Big Spenders Index reflects the underlying robustness of its UHNWI population.

While overall sales performance of luxury goods in the Greater China region has been muted over the past year, there is no denying that there is still a strong demand for luxury brands, which isn't going to change.

However, what is certainly changing is where Chinese consumers are choosing to buy luxury (the vast majority of Chinese luxury spend is outside mainland China), the selection of luxury brands they are buying, and the profiles of the consumers themselves, which are rapidly evolving because of the varying attitudes that exist towards luxury within the different Chinese cities.

India, one of the lower-profile BRIC economies, is in fifth place in our rankings. Over the past year the rise in wealth and the number of wealthy has been impressive – the number of UHNWIs is increasing rapidly, according to our Wealth Model. Aligned to this wealth growth is an equally substantial increase in luxury consumption: the value of champagne imports rose 19% year on year, according to the most recent data from Le Comité Interprofessionnel du Vin de Champagne, despite total exports being flat.

We expect international luxury goods to be particular beneficiaries of this new wealth in India, rather than more traditional, local brands. For example, research by the Kotak Mahindra bank has shown that among the wealthy, the traditional Indian wedding gift is fast evolving away from silver plates towards top Western designer brands.

We also anticipate that wealth creation, and luxury consumption, will be neither quite as controversial nor quite as hampered by social inequality or austerity agendas as has been the case in Brazil and indeed, latterly, China. With India's long-standing caste system, wide gaps in incomes and wealth are an accepted norm in the country, according to Kotak Mahindra.

Reflecting on the regional make-up of the top countries, it is interesting to see Europe, Asia and the Middle East all well represented. Africa is noticeably absent this year, reflecting some weakening on the continent, notably in commodity-fuelled wealth, which had propelled the success of a number of countries.

The Big Spenders Index 2015

Top 10 highest-scoring countries according to the Big Spenders Index, based on scores in the following categories

Luxury store footprint · Wealth growth · Premium travel and spending · Spending on luxury imported items · Big-ticket luxury goods spending · UHNWI population

RANK	COUNTRY	Luxury store footprint	Wealth growth	Premium travel and spending	Spending on luxury imported items	Big-ticket luxury goods spending	UHNWI population
1	UK	9/10	5/10	8/10	7/10	5/10	5/10
2	China	10/10	7/10	2/10	6/10	7/10	7/10
3	Qatar	7/10	10/10	9/10	10/10	2/10	2/10
4	Canada	9/10	8/10	5/10	10/10	3/10	4/10
5	India	8/10	10/10	10/10	5/10	1/10	4/10
6	Saudi Arabia	8/10	5/10	9/10	10/10	4/10	3/10
7	Switzerland	10/10	8/10	6/10	6/10	3/10	4/10
8	Mexico	9/10	8/10	6/10	9/10	1/10	4/10
9	Hong Kong	9/10	9/10	9/10	2/10	2/10	3/10
10	Kuwait	6/10	7/10	8/10	10/10	2/10	2/10

Source: Ledbury Research

SET FAIR Yacht sales are on the rise

Almost a third of respondents to *The Wealth Report*'s Attitudes Survey expect their wealthy clients to spend more on luxury goods in 2015

LUXURY SPENDING TRENDS

Drawing on extensive monitoring of luxury markets around the world, Ledbury Research picks out interesting developments within the main luxury goods categories

APPAREL

Wearable technology and luxury overlap

With the wearable tech trend continuing, fashion brands have been collaborating with tech companies to help break into the market. But fashion brands are also choosing to make their own wearable, style-conscious tech. Ralph Lauren is pioneering this strategy through its newly unveiled line of smart clothes dubbed Polo Tech. Embedded technology in the clothes allows users to monitor their bodies on their smartphones.

ACCESSORIES

Pre-owned luxury

Pre-owned luxury goods sales are booming. The second-hand market for luxury apparel, accessories, watches and jewellery is valued at some $19bn (Bain & Altagamma). Leather goods and clothing make up $4bn of that, and the segment is growing faster than the luxury industry overall (Bloomberg). Some products sold on these marketplaces achieve prices higher than retail, as customers bypass waiting lists for items such as new Hermès bags.

WATCHES AND JEWELLERY

Women's watches boom

Women have traditionally been more interested in smaller, unobtrusive styles unable to accommodate the complexity and multifunctionality of traditional men's watches. But a fashion for slightly larger watches and jewellery, combined with the growing purchasing power of women, particularly in luxury strongholds such as China, is helping drive sales. The share of female watches in the market has risen to around 35% from 20% in 1995 (Bain & Altagamma).

FINE WINES AND SPIRITS

China's slowdown particularly affects Cognac sales

French wine and spirits exports fell 7.3% to €4.8bn in the first half of 2014, hit by a 28% fall in sales to China. Cognac exports to China fell 12% (Fédération des Exportateurs de Vins & Spiritueux de France). The Chinese government's continued austerity campaign is thought to be part of the explanation for the drop in Cognac sales as the spirit is associated with gifting. Scottish whisky sales are, however, reporting an uptick in other emerging Asian markets as the spirit is associated with status.

CARS

India lags

Manufacturers had been hoping that India would follow in China's footsteps for luxury car demand, but most have seen disappointing sales and sluggish demand. Only 250 supercars are estimated to have been sold in the country in 2014 (HIS). Import duty hikes and currency declines aren't helping, but a more fundamental obstruction comes from India's roads. However, manufacturers could benefit from impending releases of luxury SUVs.

YACHTS

Market recovers

At the 2014 Monaco Yacht Show, shipbuilders, brokers and outfitters all said that the market was improving – 35% more superyachts were sold in the first half of the year compared with the same period in 2013 (Camper & Nicholsons International). This is despite some caution in the industry because of the political uncertainty within Russia and the Middle East, traditionally seen as the strongest markets for superyachts.

Sparkling returns

The latest results from the Knight Frank Luxury Investment Index (KFLII), which now includes coloured diamonds

ANDREW SHIRLEY,
THE WEALTH REPORT EDITOR

There is no doubt that so-called investments of passion are still catching the imagination of the wealth management sector and the media. I continue to be pleasantly surprised by the press coverage devoted to KFLII since it was launched two years ago.

One question I have often been asked is why we don't include gold or diamonds in the index. Gold to me has always seemed more of a conventional investment that tends to sit mainly in a bank vault, while the pricing indices available for white diamonds were too broad in their scope for inclusion.

Now, however, a group of industry experts has formed a research foundation specialising in coloured or "fancy" diamonds, along with a new index tracking their performance. Because of their rarity these generally pink, yellow or blue stones command very high prices at auction and seem to fall more readily into the category of investments of passion. (See our special focus on diamonds on p64 for more details.)

So how has this newcomer to KFLII performed compared with the other asset classes that we track? Since January 2005 The Fancy Color Diamond Price Index has increased by 167% in value, which interestingly is almost exactly the same rise as the wider jewellery index that we use.

Christie's jewellery consultant Raymond Sancroft-Baker, who compiles the index on behalf of Art Market Research, says that demand for top-quality coloured gemstones is also very strong. "We've seen a million dollars a carat paid for a Burmese ruby recently, and £200,000 a carat for a Kashmir sapphire."

The market for pearls is also extremely buoyant, says Mr Sancroft-Baker. "There is a lot of demand from the Gulf States, who are buying back their heritage. I recently valued a pair of natural pearl earrings at a million pounds."

Once again classic cars have been the strongest performer in KFLII over both the long and short-term, with the value of the HAGI Top Index rising by an astounding 487% over the past 10 years and growing 16% in 2014. This actually represents something of a slowdown, following the index's staggering 47% surge the year before.

HAGI founder Dietrich Hatlapa says the market is returning to normal – although a 1962 Ferrari 250 GTO Berlinetta did set a new world record when it went under the hammer for $38m at the Bonhams Quail Lodge sale in August.

In general, however, classic Porsche models performed most strongly in 2014, while more-modern supercars from the 1970s and 80s, like the Lamborghini Countach and Ferrari F40, are growing in popularity, adds Mr Hatlapa.

After a few years of relatively languid performance, art appears to be bouncing back, with annual growth of 15%, according to data from Art Market Research. "The art market has fully recovered from the economic crisis," says Harvey Mendelson, of art advisory firm 1858 Ltd. *Chariot,* by Giacometti, was the most expensive auction sale of the year, making almost $101m at Sotheby's record-breaking November sale of modern and impressionist art in New York.

However, instability in certain parts of the world is having an impact on specific sectors of the market. At a Sotheby's evening sale of high-value Russian art in London only 32% of the 37 lots on offer found buyers.

Coins were the only other asset class to achieve double-digit growth in 2014 with gains of 13%. A rare Edward VIII, 1937, gold sovereign made £516,000 when it was auctioned by Baldwin's in May.

Our benchmark philatelic index – the Stanley Gibbons GB250 – grew by just 3% over the year, but the market for Chinese and Commonwealth stamps continues to grow strongly, says Keith Heddle, Head of Investments at Stanley Gibbons. The sole remaining example of a British Guiana 1856 one-cent black on magenta set a new world record when it was auctioned for $9.48m by Sotheby's New York in June.

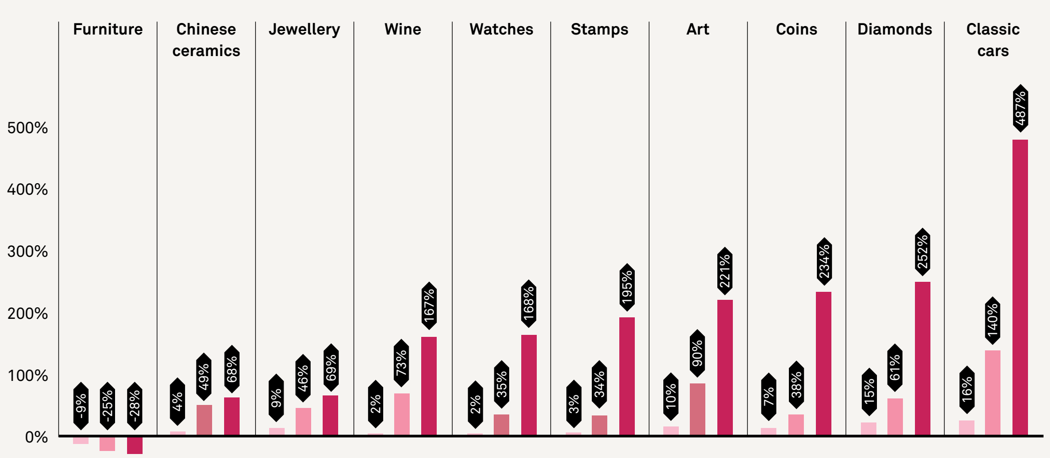
The 1933 Patek Philippe Supercomplication pocket watch was another record breaker when it sold for 23.2 million Swiss francs at Sotheby's in Geneva, the highest price for any timepiece sold at auction. The overall watch market, however, remained stable with annual growth of 4%.

Knight Frank's Fine Wine Icons Index was up 7% on the year, with strong growth for certain US and Italian vintages. But the top end of the Bordeaux market is yet to stabilise, although it should finally bottom out in 2015, says Nick Martin of Wine Owners, which compiles the index.

The value of antique furniture continued to fall in 2014.

Overall, KFLII grew by a further 10% in 2014 and has risen by 205% over the past 10 years. Although this doesn't take into account any storage, maintenance, insurance or dealing costs, it does help explain the ongoing interest in luxury investments.

Performance of the Knight Frank Luxury Investment Index by asset class, Q4 2004 to Q4 2014*

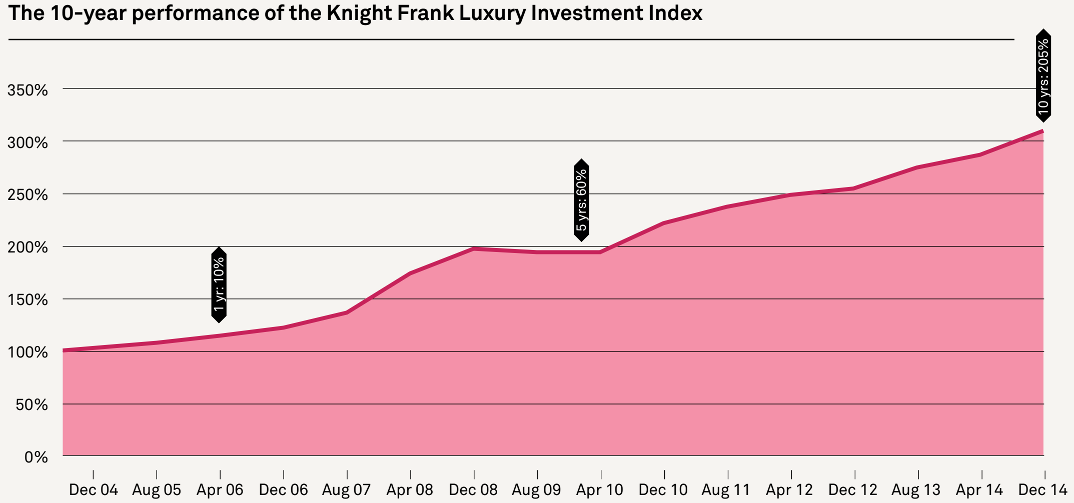


12-month performance
5-year performance
10-year performance

Sources: Art Market Research – Furniture, Chinese Ceramics, Jewellery, Watches, Art. Stanley Gibbons – Stamps, coins. HAGI – Classic cars. Wine Owners - Wine. Fancy Colored Research Foundation – Diamonds.

*Except coloured diamonds, Jan 2005 to Oct 2014

The 10-year performance of the Knight Frank Luxury Investment Index



The Knight Frank Luxury Investment Index (KFLII) is a weighted index based on the performance of 10 indices provided to Knight Frank by the third-party sources listed.

Going, going, gone

Some of the record-breaking or most significant luxury investment auction results of 2014

01 Edward VIII gold sovereign. Sold by Baldwin's for £516,000 **02 1962 Ferrari 250 GTO Berlinetta.** Sold by Bonhams for $38m **03 'Chariot', by Giacometti.** Sold by Sotheby's for $101m **04 British Guiana 1856 one-cent black on magenta stamp.** Sold by Sotheby's for $9.48m **05 1933 Patek Philippe Supercomplication pocket watch.** Sold by Sotheby's for 23.2 million Swiss francs **06 The Mellon Blue Diamond.** Sold by Sotheby's for $32.6m

Multifaceted investment opportunity

To coincide with the introduction of coloured diamonds into the Knight Frank Luxury Investment Index, industry expert **CLAIRE ADLER** explores the growing appeal of diamonds as an investment of passion

There is nothing quite like holding a 30-carat D-flawless diamond in the palm of your hand. This tiny thing could assure the financial security of a couple of generations of an entire family.

Robust returns on diamonds of more than one carat, mounting demand from Asia and the prospect of mines running dry are pointing to the increased attractiveness of precious natural diamonds as an investment asset. Global diamond supply is expected to plateau by 2020 and drop off significantly in the following decade, according to mining giant De Beers.

"Since 2009 the price of polished diamonds measuring one carat or more has risen 5%," says Ari Epstein, CEO of Antwerp World Diamond Centre.

Bruce Cleaver, Executive Head of Strategy at De Beers, now anticipates a rise in diamond prices. "With growth in diamond demand expected to outstrip growth in supply, there are different possible outcomes, but we believe higher diamond prices would account for a significant amount of the gap," he says.

The concept of diamonds as a store of wealth is not new. Diamonds are arguably the most transportable form of wealth in existence.

While diamond aficionados may be madly in love with the stones they buy, they also regard them as a means to increased wealth. In 2006 billionaire jeweller Laurence Graff bought the 78.1-carat Maharajah diamond. It had not been seen in 50 years because it had been in a bank vault. "The translucency, the life in that stone, is beyond anything I have ever seen," Mr Graff said at the time. The next day, he sold it for an undisclosed profit.

Fancy colour diamonds (a technical term in the industry for stones of exceptional colour), which are far rarer than white diamonds, are performing particularly strongly. The 9.75-carat Mellon Blue set a new world auction record for the carat price of a blue diamond when it made $32.6m at Sotheby's New York in November 2014.

The concept of diamonds as a store of wealth is not new. Diamonds are arguably the most transportable form of wealth in existence

Most sales, however, do not take place at auction, so tracking the change in price has been difficult. But a new index created by The Fancy Color Research Foundation, which records deals at all stages of the chain, offers more transparency.

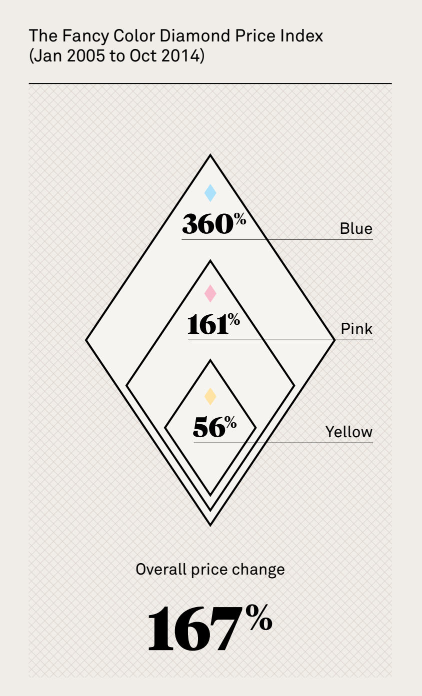
Overall, fancy pink, yellow and blue diamonds have increased in value by 167% since 2005, according to the new index.

Individuals looking to invest in diamonds can buy stones from diamond traders and pay for storage and insurance, or buy shares in diamond companies. The Singapore Diamond Investment Exchange and Los Angeles-based Investment Diamond Exchange partner with banks offering private clients purchasing, valuation and certification services.

Asset management firms including Diamond Capital Fund sell shares in stores of physical diamonds. Sciens Colored Diamond Fund, owned by UHNWI John Rigas, invests in red, pink, blue, green, orange and yellow diamonds sourced from mines for individuals and institutions.

"Since the 1950s the price of the diamonds we invest in has never dropped," says Mahyar Makhzani, Co-Managing Director at Sciens Colored Diamond Fund.

Investing in diamonds poses challenges. Unlike gold, diamonds are not fungible – one carat is not equal to another carat. Although the internet has brought about increased pricing transparency, there is no standardised pricing index that classifies the many thousands of different qualities of diamonds, which incorporate a spectrum well beyond the traditional four Cs of cut, carat, colour and clarity, while also offering easy access to individuals beyond the diamond industry.



Source: Fancy Color Research Foundation

The Graff Vivid Yellow, ©Sotheby's

Monaco-based diamond expert Ehud Arye Laniado believes increased transparency will prove transformative. "A fully transparent pricing system will unlock an opportunity for savvy consumers to view diamonds as a store of wealth in ways not yet possible, ushering in a new era in which informed buyers will be able to make confident purchasing decisions," says Mr Laniado, the principal of Mercury Diamond, which advised Cora International, a New York jeweller specialising in rare diamonds, on acquiring the 29.6-carat Blue Moon for $25.6 million.

London-based, Russian-born jewellery designer Yana Zaikin, founder of Emily H London, has noticed her UHNWI clients increasingly hedging their bets on top-quality diamonds, while adorning themselves in the meantime.

"Five years ago my clients preferred investing in gold rather than wearable diamond jewels," says Mrs Zaikin. "With currency fluctuations, they're now diversifying with diamonds. Some keep jewels in the safe, but most wear them. One bought three identical brilliant stones for three rings, which they keep in each of their homes, in Palm Beach, London and New York."

SPARKLING COLOURED DIAMOND BUYS

A pair of pear-shaped yellow diamond ear pendants (52.88 and 51.46 carats) sold for double their presale estimate at $5.4m at Christie's New York in December 2014

The oval fancy light pink Golconda diamond (21.3 carats) sold for $4.3m at Christie's New York sale of Magnificent Jewels in December 2014

The Mellon Blue Diamond (9.75 carats) set a new world auction record for the carat price of a blue diamond, fetching $32.6m at Sotheby's New York in November 2014

The Graff Vivid Yellow (100.9 carats) marked a world auction record for a yellow diamond when it sold for $16.3m at Sotheby's Geneva in May 2014

The Winston Blue (13.22 carats) was sold to Harry Winston for 21.4m Swiss francs in May 2014

The Blue Moon (29.6 carats) was acquired by Cora International LLC for $25.6m from Petra Diamonds in February 2014

The Graff Pink (24.78 carats) achieved $46.2m at Sotheby's Geneva in November 2010, the auction record for any diamond or jewel

The blue diamond Bulgari Trombino ring (5.30 carats) fetched £6.2m at Bonhams in April 2013