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Introduction: Investing in Hard Assets

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Investing in hard assets

Hard assets, such as art, antiques, gems and collectibles, are yet another way to diversify your holdings. Because hard assets often retain their value as inflation rises, they can provide balance to other asset classes that suffer more from rising costs. However, because their value depends so heavily on supply and demand, economic conditions, and the quality and condition of a given piece itself, you may have trouble predicting if and when the money you invest in them will provide a return.

Collectibles include everything from high-priced antiques and works of art to stamps, coins, books, and many other objects. Gems include diamonds, rubies, pearls, and certain other colored precious and semi-precious stones that can be purchased as loose stones (typically in parcels) or as jewelry.

What makes collectibles and gems valuable?

Some collectibles are valuable because they are creations born of talent, skill, and fine workmanship (for example, paintings, sculpture, musical instruments, glasswork, jewelry, furniture). Each item is inherently unique, and its value may be specific to that individual item. Other types of collectibles are valuable because they are rare or because scholars have attributed some significance to them (for example, coins, stamps, books, antiques).

These types of collectibles tend to hold their value over time, generally keeping pace with inflation. Many have the potential to appreciate in value. The value of these types of collectibles depends on many factors. A work considered an artist's best would probably have more value than one of his or her mediocre works. Value may be added if an artist produced relatively few works. Items in better condition are generally more valuable than those that are in poor condition or that have been restored. The age of the item, its historical value, and its current popularity among collectors may all be factors in determining value.

But there's another type of collectible that has no intrinsic value, such as baseball cards, memorabilia, bottles of wine, action figures, stuffed toys, and dolls. The worth of these collectibles is strictly in the eye of the beholder.

They are only valuable if there is someone who is willing to buy them; they may be valuable today and worthless tomorrow. Though a savvy collector may profit from this type of collectible if his or her timing is right, serious investors typically seek collectibles that are less subject to changing tastes.

Gems are valuable because they are natural resources in great demand and are limited in supply; some are extremely rare. Also, in some cases (diamonds, for example), the supply is managed to keep prices stable.

The value of a gem is influenced by many factors, such as whether it is rough or cut, loose or set, flawed or perfect, as well as its weight and color. A gem's history can also affect its investment value, as can the prevailing taste of the marketplace.

Though gems of the highest quality often have the highest value, gems of lesser value are generally easier to sell.

Caution: The term "investment grade" is normally applied to gems of the highest quality. However, be aware that the term is not clearly defined and may be used to describe gems of lesser quality.

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Caution: Diamonds are the only gems that are evaluated, graded, and certified by internationally recognized organizations, such as the Gemological Institute of America (GIA), the European Gem Laboratory (EGL), and the American Gemological Society (EGS).

Why invest in gems and collectibles?

Some collectibles increase in value, though they tend to appreciate slowly over a number of years (often several decades). Gems also can increase in value long-term as supplies become diminished. On the other hand, both can decrease in value, and they do not generate income while you own them. So, making money is generally not a good reason to invest in collectibles and gems.

Collectibles and gems can, however, act as a hedge against inflation. This is why many investors are sometimes tempted to add them to their portfolios during economic downturns. Some investors also value gems for their portability. Finally, collectibles offer an important intangible benefit that most other types of investments don't--personal enjoyment.

Tradeoffs as an investment

They require specialized knowledge

One of the keys to investing in collectibles and gems is to know what you're doing. This requires a commitment of time and effort on your part. You should understand objective standards for gem quality, as well as the gemstone marketplace, to gauge value. With art and antiques, even if you become reasonably knowledgeable, it can be difficult to determine an object's true value, and fakes sometimes can fool even experts.

If a knowledgeable investor is willing to do some legwork, he or she may buy at auctions and estate sales. Otherwise, investors must enter the wholesale/retail market. Because retailers, galleries, and dealers typically mark up prices significantly, investors should seek a reputable and trustworthy person with whom they can do business.

There are many simulated and treated gems and collectibles on the market, and there are many unscrupulous sellers as well. Even with training and experience, it can be hard to recognize whether a gem, antique, or artwork is genuine or has been enhanced, forged, or tampered with. Here are some things you can do to manage this risk:

- Educate yourself as much as possible about the piece you are buying and the market
- Deal with a reputable and trustworthy dealer
- If you're buying a diamond, get a certification document
- Hire an independent appraiser

Tip: You can find a qualified appraiser by contacting the American Society of Appraisers or the International Society of Appraisers.

They require care and storage

You may need to transport, properly store and secure, maintain (e.g., clean, repair or restore), and insure your gems and collectibles.

They can lack liquidity

It may take some time to sell your collectibles or gems, and you may have to sell at a less-than-desirable price if you need the money quickly. In addition, there is no organized or regulated marketplace where investors can buy and sell gems or collectibles. Gem wholesalers may be reluctant to buy from you as they generally buy from their suppliers. Jewelers may also be reluctant to buy from you, and if they do, they may pay you even less than wholesale prices.

They may involve opportunity cost

Many gems and collectibles require large outlays of capital. While you may derive great joy from owning them, that money cannot be invested in other vehicles that offer greater growth potential.

Subject to special capital gains tax rate

Net capital gains from selling collectibles (including gems, which tax law treats as collectibles) are taxable at a maximum rate of 28 percent.