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A Passion for Profit

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IF YOU HAVE A COLLECTOR'S EYE for art, books, musical instruments, stamps or wine, it's possible you have an equally discerning eye for their future value. Esoteric investments can offer attractive opportunities for hobbyists to expand their financial horizons. Along with low correlation to today's volatile stock and bond markets, niche investments may offer above-market returns, low liquidity and the thrill of stumbling across a rare book or bottle of wine with extraordinary value.

Picasso: Stan Honda/AFP/Getty Images; Stradivari: Don Emmert/AFP/Getty Images

Paintings by Picasso, 200-year old Bordeaux from Chateau Lafite and violins crafted by Stradivarius all fetch top dollar on the rare occasions they come up for sale. They have at least one other thing in common: There won't be any more genuine items exactly like them ever created.

What's the investment potential of unique alternative investments, and what trends affect their long-term value? Here's a look at five categories:

VIOLINS ARE A SIGNIFICANT part of the multibillion-dollar rare stringed-instrument market -- ranging from $20 models mass-produced in China to the $6 million La Pucelle Stradivarius crafted in 1709.

Because transactions involving these instruments occur infrequently and often in private, no index tracks returns. But, according to New York dealer Machold Rare Violins, the estimated annual return for fine instruments -- like those from the hands of the master Stradivarius -- is 10% to 15%. A London hedge fund specializing in rare instruments, Fine Violins Fund, has targeted returns in the more modest range of 8% to 12%.

In the past three decades, institutional investing on a global scale in fine instruments -- particularly violins -- has boosted returns. Taiwan's Chi Mei Foundation, for example, recently amassed a $25 million collection of rare violins, including five prized Stradivari.

ARTWORK OCCASIONALLY GRABS the public's attention, with sales like Picasso's 1905 painting Garçon à la Pipe for $105 million, the highest price ever, or actor Hugh Grant's sale of an Andy Warhol portrait of Elizabeth Taylor (Liz) for $21 million, after buying it for $3.6 million in 2001.

Art has its own return gauge, the Mei-Moses Index. Started by two professors at New York University, it has kept tabs on more than 10,000 art transactions. The average annual returns for postwar and contemporary art were 12.6% in the past decade; returns for art generally were 8.5% -- roughly the same as the S&P 500. Over the really long haul -- 1875 to 2000 -- the Mei-Moses indicates artwork topped fixed-income investments, but significantly underperformed stocks. (Note that capital gains on art are taxed at 28%, versus 15% on securities.)

Perhaps reflecting some of the category's shortcomings, funds designed to invest in art are struggling. Dutch bank ABN Amro recently cancelled plans to launch a fund of funds targeting art investments.

THERE ARE MORE THAN 30 MILLION stamp collectors worldwide, yet few of them view their hobby as an investment vehicle. What kind of potential do stamps offer?

A U.K. study of British stamps -- which includes some of the most sought-after -- found that they traditionally have offered lower returns than stocks. According to the Stanley Gibbons 100 Index, the mean monthly return since 2002 for 100 of the world's most frequently traded stamps has been 0.58% (about 7% annually), while the average return on the FTSE 100 Index has been 1.11% monthly (or 14% annually). A U.S. study published by the Southern Economic Journal in 1995 tracked the returns of 43 American stamps between 1947 and 1988, and put the average annual return at 7.6%. The S&P 500 returned 11.9% a year in the same period.

Still, there is the potential for an extremely valuable find. Consider the Swedish Treskilling Yellow stamp, which sold in 1996 for a record 2.5 million Swiss francs (roughly $2 million). Its value derives not from Stradivarius-like craftsmanship or Picasso-like style, but from an error. The Treskilling series was printed with a blue-green color, but for unknown reasons the stamp that fetched $2 million was inadvertently printed in yellow.

FINE WINES HAVE LONG been collected for more than drinking. A Bordeaux 1787 Chateau Lafite brought its owner $160,000 in 1985. Its age made it unique, but it also had "Th.J" etched on its glass, signifying it once belonged to President Thomas Jefferson. Thus, it was more than a rare vintage wine; it was purchased as Jefferson memorabilia.

According to a study by economists at the University of Wyoming, wine can be a sound investment. Although it didn't use absolute numerical return data, the study found that annual returns for Bordeaux wines were between "7.5% and 9.5% higher than would have been predicted by factors that account for risk." A 2001 study by Benjamin Burton, an associate at Lehman Brothers, and Joyce Jacobsen, an economics professor at Wesleyan University, reached a different conclusion on Bordeaux. For the period

1986-1996, they discovered a portfolio of the wines earned a 7.9% annual return, compared to a robust 13.5% return for stocks. A recently proposed change in British pension tax law would elevate wine to its own asset class.

FOR A SMALL BUT GROWING number of people, investing in rare books can be not only fulfilling, but financially rewarding. One study ("Investment Tomes," Feb. 1, 2007, Thomas Healey, Worth magazine) found that original copies of 244 literary classics returned an average of 12.3% annually between 1982 and 2002. This was superior to stocks and Treasury notes over the same period.

The highest price paid for a printed book was $8.8 million for John James Audubon's *Birds of America*, sold by Christie's in 2000. The priciest manuscript or hand-printed book was Leonardo Da Vinci's *Codex Leicester*, bought by Microsoft's Bill Gates for $30.8 million in 1994.

Book returns are anything but predictable, however. One study found that the original version of James Joyce's *Portrait of the Artist as a Young Man* had one of the five poorest returns in the 1980s, yet in the 1990s boasted the top percentage return and the second-highest dollar return.

What's Your Preference?

Some alternative investments boast market-beating returns, others' returns are merely psychic.

Alternative Asset	Years	Annual Returns
Fine Violin	1980-2005	10.0%
Artwork	1990-2000	8.5
Collector's Stamps	2002-2006	7.0
Bordeaux Wines	1986-1996	8.0
First Edition Books	1982-2002	12.0
S&P 500	1900-2005	11.0

Sources: Various

WHAT CONCLUSIONS CAN WE draw from our alternative-investment tour?

One dynamic that sets these investments apart is the notion of fixed scarcity. Contrast, for example, shares of Berkshire Hathaway (ticker: BRK.A) with Stradivarius violins. Berkshire, the most expensive U.S. stock at around $122,000 as we write, has over one million shares outstanding; this number isn't fixed -- it can go up through issuing more shares. The number of Stradivarius violins, on the other hand, can never rise. The same is true of Picassos, Swedish stamps, 200-year-old bottles of wine and original manuscripts.

Another conclusion is that offbeat alternative investments aren't for everyone, especially if the goal is rapid appreciation. Some of these assets can take years to sell, if they sell at all. When coupled with high transaction costs stemming from authentication, restoration, preservation, insurance and broker commissions, investing in a Stradivarius should not be an impulsive act.

But, if you're looking to diversify your portfolio with investments that exhibit low correlation to the rest of the markets, and offer the prospect of competitive returns -- plus a little more excitement than what you get with traditional assets -- then niche investing could be a smart option.