

diffusetap
Virtual Event Series

Capturing Art Alpha (without NFTs)

Guest Speaker:



Allen Sukholitsky
Chief Investment Officer
Masterworks

Hosts:



Kenny Estes
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DiffuseTap: Capturing Art Alpha (without NFTs)

Last time on DiffuseTap, Allen Sukholitsky, Chief Investment Officer of Masterworks, talked to us about how investors are missing out on investing in fine art as an asset class, what the returns look like in this space, and how the average person can invest in this space without having millions of dollars to spend.

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DiffuseTap

This networking session is part of our weekly virtual events series. Networking (you'll bump into at least a dozen high caliber fund managers) meets purposeful (you'll tap into brand-new sources of ideas)... straight from your armchair like a boss.

Meet the Speaker



Allen Sukholitsky, CFA, is Chief Investment Officer of Masterworks, an innovative investment platform that offers art investment products for retail and institutional investors. Prior to Masterworks, Allen was a Senior Market Strategist at Goldman Sachs, focused on investment strategy, portfolio construction, and investment implementation. He was also previously an Investment Counselor at Citi Private Bank, working with UHNW clients on asset allocation and manager selection. LinkedIn: [@allen-sukholitsky](#)

About Diffuse®

We are an alternative fund platform offering differentiated investment products. From digital assets to VC funds and beyond, we identify green field investment opportunities we feel will have market beating returns and turn them into professionally managed funds. For more information, visit www.diffusefunds.com.



KENNY ESTES: You're all here today to hear from Mr. Allen Sukholitsky. So Allen, do you want to introduce yourself a little bit?

ALLEN SUKHOLITSKY: Sure. My name is Allen Sukholitsky. I am the CIO of a company called Masterworks. I spent the bulk of my career at Goldman Sachs. Before that, I spent a long time at Citigroup. I've been in the investment management world for the entirety of my career.

More recently, I was surprised to find out that after spending many years researching what I thought was every asset class under the sun that anybody would ever consider investing in, there was this gigantic asset class that's been sitting under all of our noses for a very long time. In fact, it almost predates most asset classes. However, the vast majority of investors have never thought about investing in it. And so, I saw this huge opportunity to join a company that was making art investable.

AYLA KREMB: I'm going to jump right in there with the first question. Why invest in art in the first place, when there are so many ways to allocate your capital? What makes art particularly attractive?

ALLEN: Let's get started from the very beginning, which is how big the asset class is in the first place. The way that I often split up the universe of investments that we live in is, on the one hand, you have asset classes that have existed and that investors have been investing in for a very long time..

Those would be things like stocks, bonds, commodities, and even private equity and hedge funds, so on and so forth. They've existed for a while, and people have invested in them for a while. Then, on the other side of the spectrum, you have asset classes that are fairly new. By definition, investors haven't really been investing in them for that long. Those would be things such as cryptocurrencies.

What I couldn't believe about art, if you think about the spectrum that I just created, is that it has quite literally existed for centuries. And yet, almost nobody has ever considered investing in it. The asset class is \$1.7 trillion in size. To put that into context, it's about half the size of the U.S. private equity industry, which everyone knows is a very large industry. I would argue that anything that is half the size of private equity is probably very big. It's bigger than US private credit, which many investors have considered investing in. It's also bigger than US private real assets, which many investors have considered investing in.

Art is this strange asset class that is really big, and yet, most investors have never considered investing in it. In terms of how it's performed over time, it's actually been appreciating for several decades now at 14% per annum. To put that in context, the S&P 500 has been appreciating around 10%. So, I would argue that anything that's appreciated over 14% for several decades probably should be on an investor's radar. Maybe you decide not to invest in it for one reason or another. But regardless, it should at least be on your radar.

I come from a heavy background in investment research. The most exciting part I find about art as an asset class is its correlation profile. I have quite literally never seen a correlation profile in my career that



looks like the correlation profile of art. Here's what I mean by that. For a lot of investors, when they want to diversify their portfolios, they look for asset classes that have low correlation to stocks. That's because if it has a low correlation to stocks, it's a good way to diversify your portfolio.

Now, many investors actually stop checking whether the asset class they're thinking about investing in has a low correlation to all the other assets they own. They focus primarily on whether it has a low correlation to stocks. Why do they do that? Well, the reason most investors do that is because most of an investor's portfolio is comprised of US stocks. And if you find something that has a low correlation to stocks, you're already in a pretty good place from a diversification standpoint.

But what's so fascinating about art is that it has low correlation to more than 15 major asset classes that you would ever consider investing in. That includes large cap stocks, small cap stocks, U.S. bonds, international bonds, private equity, hedge funds, real estate, commodities, and many more. The correlation to each one of them is quite literally zero, and that's unique.

What does that tell you? It tells you that no matter what you already have in your portfolio, if you put art into it, it is not going to act like anything else in there. We believe it's going to be a good diversifier.

KENNY: I love it. Now, I'll ask you a super softball question. How do I go about buying art? I mean, of course I can go try to buy the Mona Lisa. Maybe it's a little cheaper now with some cake on it. But how is that viable?

ALLEN: We focus on contemporary art, specifically the blue chip segment of the art market. That's the type of art that we focus on at Masterworks. If you as an individual investor wanted to buy blue chip artists in that segment of the art market, traditionally speaking, each painting you might consider buying would cost you millions of dollars. So, even if you had the capacity to buy a \$10 million painting, there's a reasonable chance that you're not going to get a whole lot of diversification by just owning that one \$10 million painting.

So, we came up with a process several years ago that was pretty revolutionary. It's a very simple process, but it was revolutionary at the time. What we do first is we buy a painting with balance sheet capital. Then, we create an LLC, move the painting into that LLC, and file the LLC with the SEC. Again, the painting is the one thing in that LLC.

Finally, we make the LLC a public vehicle and allow investors to invest in it. So when investors buy shares in that LLC — which remember, holds only one thing in it, the painting — they are effectively buying shares in that painting. And so, what once was a multi-million dollar work of art that you could only access if you had multiple millions of dollars, can now be bought in the form of fractional shares.



AYLA: Fascinating. How do you place a value on these blue chip pieces of art? I'm sure that LLC might appreciate, but how do you give it a mark at some point?

ALLEN: Anyone who has been in the financial services world knows that if you want to get data for a particular stock or bond, or anything else that everyone's already invested in, that data is very readily accessible. You can go to your favorite data provider, like [Bloomberg](#) or [Refinitiv](#). In fact, you could go to a lot of public data providers, such as [Google Finance](#) or [Yahoo Finance](#). You have all of this data that is readily available, and we often take that for granted. Nobody even thinks twice about it. It's all just there.

But believe it or not, all of that [data for the art market](#) has not exactly existed in any one place before. So, the first project that Masterworks had when it started, was to hire dozens of analysts. Their job was to go through thousands of auction catalogs — many of them, by the way, were in paper format — page by page and put many thousands of transactions that have taken place in the art market, into a computer. They did that for roughly 60 to 70 years' worth of auction data, and they had to put every single one of those transactions into a database.

The catchy phrase that I like to use is, "We built Bloomberg for the art market." And to take the catchy phrase one step further: We are the only ones with a "license" to that "Bloomberg terminal." And when we want to value a piece of art, all it takes is to go into our database to find particular works of art that are comparable to that piece we're interested in buying. We have all of the information right there at our fingertips.

KENNY: The audience here is pretty heavy on the crypto side of things and digital assets. When they hear fractional ownership, they immediately think of NFTs or tokens. What do you think about that market in general? And also, why did you go with the public LLC as opposed to going for a token-based business model?

ALLEN: In terms of tokenization versus the traditional securitization route, we chose securitization because we felt like it was [more transparent](#). All of our filings with the SEC are publicly displayed on our website. For every painting that we have on offer, there is a link directly to the SEC's website where you can read a very long document that [looks like an S-1](#).

As a side note, if you ever want to become an expert on any particular artist's market or painting, you can go ahead and read that document and you will instantly become an expert on that artist's market. We have provenance information, which is basically a fancy way of saying who owned the painting before us, who owned it before them, and who owned it before that person.

Basically, we wanted to take a very transparent approach in a market that, if I'm being honest, I would say traditionally has [not been the most transparent](#). And so, we wanted to make it as transparent as possible. That's why we took the traditional securitization route.



It's interesting because we actually have a lot of crypto investors who invest in art. But at the same time, I don't think there is a lot of overlap between physical blue chip works of art and crypto. I think the one thing that they do share in common is that they are only recently being introduced to the investor community as an investment opportunity. That's probably all they share in common.

A lot of crypto investors actually do get excited about this idea, where they might say, "Hey, wait a minute. Art has always existed around us. How come nobody ever thought about investing in it? That might actually be another new investment opportunity to consider in addition to Crypto."

AYLA: Someone pointed out something interesting about the cost of an auction. What is the transaction cost for these LLCs when a piece of art gets sold, and when things become more valuable? Is it a fixed number, like 20%? What kind of fees are we talking about here?

ALLEN: Auction fees are actually quite high. You can say that roughly 20% is the average figure for an auction. Unfortunately though, if you are buying entire pieces of art, you would not only pay that 20%. There are a bunch of other fees, including transportation fees, insurance, and so on. And if you transact in the art market through a dealer, there are dealer fees as well. Once you start adding the fees up, it can get pretty expensive.

I have to say, we are now one of the largest buyers in the art market. I know we can't definitively prove that, but we have a pretty good case to make. But when we were just starting out, we sourced more of the art that we bought at auction because it was easier to access. Roughly 80% of the transactions we used to engage in were at auction. Fast forward to where we are today, we probably do only 20% of our purchases at auctions. It's far less than what we used to do.

The reason that's how our business works now is because, again, we've become one of the largest buyers. And so, there are a lot of individual collectors and institutions internationally who have works of art that they're thinking of selling. And because we're well known in the marketplace now, many of those individuals come directly to us to try to engage in private transactions. That way, we can reduce the fees that one might normally pay at auction.

KENNY: I love it. Last question. One of the big appeals of owning art is showing it off, preferably in your house. But in your case, how are these pieces of art physically stored? Are they on display somewhere?

ALLEN: Most of the time, the majority of the art is stored at the Delaware Freeport. If you are a major art collector in the United States, there is a very good chance that you are storing your art at the Delaware Freeport. It is a state-of-the-art storage facility that is climate controlled, humidity controlled — all of the above.



However, we also built a beautiful art gallery in our office in downtown New York City, and we are rotating different works of art through that gallery. There are usually 5 to 10 pieces in there at any point in time out of the 120 pieces we have so far. We rotate those pieces roughly on a monthly basis. And of course, we also invite investors to come and appreciate the art there as well.

The really fun part of my job is that I can come into the office, and there's a gallery right next to me. We have anywhere from \$20 to \$100 million worth of art hanging on the walls, and we can just go in to take a look at and enjoy them.



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Dennis Chookaszian

Corporate Director, CME Group

DiffuseTap: Institutional Grade
Governance

Sharing his decades-long expertise on corporate governance, Dennis talked about how to avoid a co-partnership going sour, the problem with overly idealistic CEOs, and the importance of keeping your board in check. [Read on](#)



Susan Brazer

CEO & Founder, LionShare Media

DiffuseTap: Media Metaverse
2022

Susan described the 2020 digital media landscape; the evolution of media distribution; how converging, emerging technology points to the metaverse; and the prospect of having an open, decentralized, and free Web 3.0 marketplace. [Read on](#)



Raj Mukherjee J.D.

VP/Global Head of Tax, Binance.US

DiffuseTap: Crypto Taxes
Decoded with Binance.US

Raj explained the complexities of the US crypto tax landscape, how he built a dynamic tax information system for [Coinbase](#) and [Binance](#) from scratch, and how investors can profit from crypto without getting caught in a taxation mess. [Read on](#)

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