Fine Wine Investment Report: 2016 Review

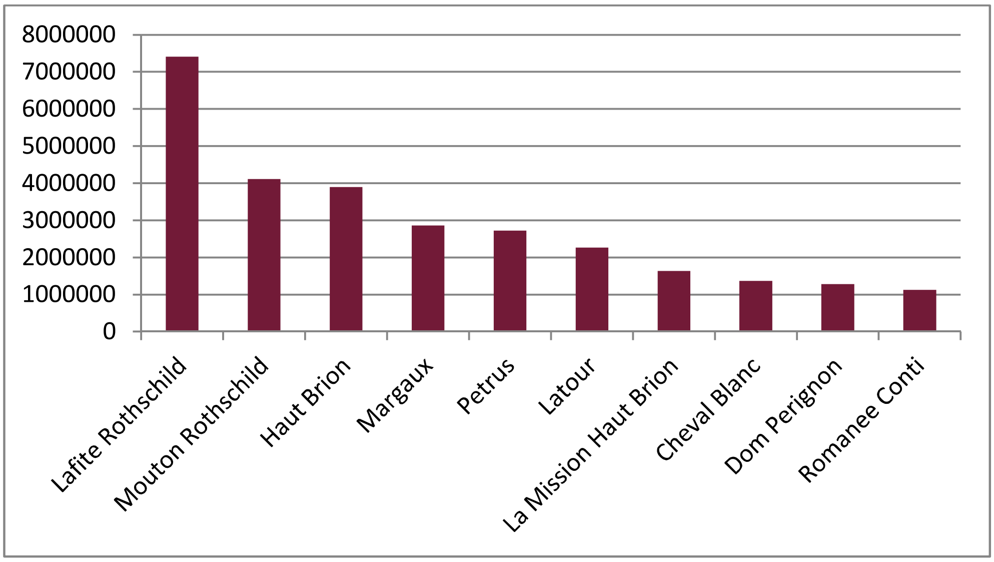
BI Investment Group, February 2017

- **Resurgent trading and strong price performance**
- **Bordeaux still the dominant player at 60% of BI turnover**
- **Strong DRC-led performance for Burgundy**
- **Champagne introduction to LiveTrade proves effective**
- **Weak GBP following Brexit helps maintain and amplify existing positive trend**
- **But - weak GBP set to affect 2016 En Primeur prices**

As we usher in the year of the Rooster the time is apposite to look back on the fine wine market in 2016. A little over a year ago confidence was tentatively returning to the sector as volumes gently notched up and prices edged benignly higher. In short, it was shaping up to be precisely the period of stability that we had all sought after almost 4 years of unsightly scramble and tumbling prices. Yet, we now look back on 2016 as one of the most eventful trading periods and strongest price performances of the past decade. A remarkable outcome in and of itself but all the more so given how unexpected it all was. The key, and linked, themes under-pinning this exceptional activity were: strong export markets, currency led price rises and a robust En Primeur campaign.

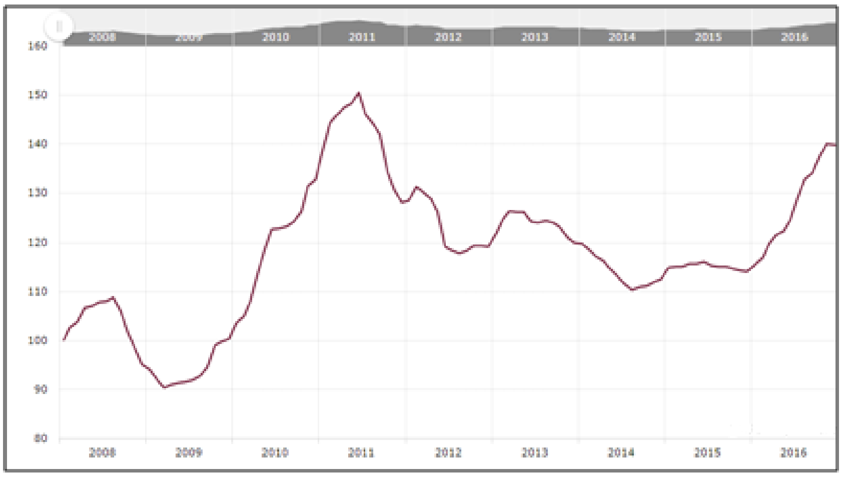
Bordeaux Bounces Back

Bordeaux was as ever the dominant player but saw a relative resurgence to almost 60% of total trade by value. 8 of the top-10 selling producers were Bordeaux (a predictable roll call) with only Dom Perignon and DRC acting as interlopers. And with LiveTrade increasing its share of total trade by double-figures, the importance of established Bordeaux to the fine wine market was powerfully reasserted. Indeed, looking just a little further afield we note that a full ¾ of turnover was attributable to just 35 'brands' revealing how concentrated, commoditised and stable the upper echelons of the international wine market are.



Top 10 selling producers by GBP value 2016

Given strong demand and a correspondingly tight supply picture it will come as no surprise that prices were forced significantly higher in 2016. The LiveTrade Index (**pictured below**) finished the year at 140, a dizzying 22% increase. Now within striking distance of the highs achieved in spring 2011 the Index has bounced a full 26% from the lows of 2014. With over 75% of LiveTrade wines returning 20+% the re-bound was broad based as well as deep. That said, 2016 was at times reminiscent of the China led boom of 2007/8 as wines of the Lafite stable traded to their own privileged rhythm. Away from Lafite, Haut Brion and Mouton performed best of the other 1st growths and Duhart, Las Cases and Leoville Barton took top places amongst the second-tier. At the other end of the league table Petrus, Cheval and Palmer all performed well but were far behind the favoured brands. A vintage analysis of LiveTrade transactions meanwhile reveals an interesting dynamic with the strongest years arising both in contemporary 'off-prime' vintages (such as 2011, 2008 and 2006) and 'mature drinking' vintages (such as 1995, 1996 and 1998). This very much supports our view of the market which was largely sustained by drinking demand through the tough-years of 2011-14 and has been joined by robust buying in contemporary vintages as Asian consumption markets, relative value considerations and EP releases all took effect latterly.



The BI LiveTrade Index 2008-2016 (www.biwine.com/livetrade)

Importance of Exports

In terms of purchasing by region it was largely a picture of continuity as Asia-based clients again represented the largest single cohort at just under 50% of total sales. There are of course large inter-brand differences with, for example, 2/3 of Lafite sales (and nearly ¾ of LT sales) going to Asia-based buyers. (This contrasts markedly even within the 1st Growths where, for example, well under half of Ch. Margaux sales were Asia bound.) However in the main, one of the key trends of 2016 was the strength of demand in export markets, resulting in one of the highest ratios of non-EU Export vs UK Storage in many years.

The Rest of the World

Away from Bordeaux, 2016 had strong figures for both Champagne and (DRC-dominated) Burgundy with 10+% increases in turnover on the year previous. That said, the top performers in outright growth terms were the likes of USA, Argentina and South Africa which experienced stellar increases in demand, albeit on much smaller numbers. In contrast it was an altogether more challenging year in the Rhone and Italy, both of which struggled in the absence of compelling vintage releases. Finally, poor numbers from white Bordeaux reinforced the extent to which this wine style remains in the doldrums.

Brexit: Friend or Foe?

Of course no review of the market can begin to explain 2016 without reference to Brexit and associated FX oscillations. The weakness of GBP provided the UK trade with a rare opportunity (comparable in the short-term with the zero-rating of duty in HK) as non-GBP prices effectively tumbled and with it sales surged, inventories were driven lower and finally prices moved higher (wine prices denominated in USD/CHF etc tell a very different story of course).

Source: Bloomberg.com/markets/currencies

But before characterising the rally as a purely currency phenomenon it is worth recalling that over a third of year's increase came prior to the referendum vote and almost 5% came late in the year by which time GBP had largely stabilised against USD/EUR. All of which is to say that Brexit is best seen as an amplifier of an underling trend rather than the originator of it. Wherever one places the emphasis of Brexit the most pertinent short-term effect was a sharp spike in the ratio of exports vs storage and a corresponding diminishment of UK stock. There is (and will be) of course a cost to currency depreciation that will be felt most keenly later this year with the release of the highly regarded the 2016 Bordeaux. EP 2015 was a significant success with sales more than doubling on 2014 and defending these levels at the new price level will be a real challenge.

Outlook for 2017

Prices appreciated significantly in 2016 but our outlook for the wine market remains overwhelmingly positive. Key reasons for this upbeat outlook can be summarised as:

Inventories - The strong activity through 2016 was underpinned by the UK-Asia export trade. The effect has been to substantially deplete the position of UK stock holders. Couple this with the continued lack of investment pools, we have one of the tightest supply environments, especially for mature stock, we have seen in many years. This can only mean that spikes in demand will quickly feed through to prices.

Reawakening of key markets – Trade to mainland China and the Far East slowed considerably during the downturn of 2011-15. 2016 was marked by a strong upswing in trade to these areas indicating that previous stock over-hangs have been cleared and that future demand will be met from European sources.

Prices from Europe – Buyers from the UK will be provided with further incentive to purchase back-vintages later this year with the release of En Primeur 2016. It is understood to be another high quality harvest but with GBP:EUR falling 15% in 2016 the release prices of the new wines are likely to be high versus physical vintages.

Investment – Investment money nearly always lags the 'insiders' and we see 2017 as a year in which significant investment could enter the market.

Context – overall investment confidence remains very low - levels not seen since the financial crisis itself and in 2011 - which is typically associated with times ahead of asset bounces. Allied to this are the historically high cash balances among the fund managers as they look for better opportunities. Finally, it is worth considering that few, if any, places beyond assets offer the potential for a decent returns. European interest rates are zero bound and we don't see them rising in the foreseeable future. It seems that putting money to work is the only game in town.