

Parallels Between Finding and Enjoying Wine and Making Good Investments

By Bryce Sanders

Past performance is no guarantee of future results. The 1855 Classification is familiar to any wine fan with an interest in red Bordeaux, one of the most collectible categories of wine on the planet. In the mid-19th century, the Bordeaux Chamber of Commerce classified over 60 wines into five tiers, or crus. Wine lovers like this because it provides structure. Amazingly, there has been no official reclassification for 151 years, with one exception: Mouton Rothschild was elevated from deuxième (second) cru to premier (first) cru in 1973. Château Latour is a premier cru wine, while Pontet-Canet is a cinquième (fifth) cru wine—just as they were 150 years ago. Yet over the years, properties have been bought and sold, winemakers have come and gone, and techniques have changed. That means savvy wine buyers must rely on more than the cru to evaluate the wine—they must also be aware of contemporary performance.

Diversification helps reduce risk. Burgundy, home to some of the most collectible wines in the world, uses only one red wine grape, pinot noir. (Beaujolais doesn't count for serious wine fans.) If the area has bad weather during the growing season, the winemakers have a serious problem. The same problems crop up in sector mutual funds. If the health care sector doesn't do well, portfolio managers are in a tough position, because their options are limited. On the other hand, take another red wine, Châteauneuf du Pape. From the Rhône Valley of France, this wine is allowed to use 13 grape varieties in the blend. If one or two varieties don't do well, winemakers can use any of the others to compensate. It's easy enough to see the comparison with a mutual fund category like large-cap value, which allows a lot of room for compensation as well.

The manager makes the difference. Prices can vary enormously from vineyard to vineyard. They may be growing the same grape type on adjacent properties, experiencing the same weather and growing season. Yet one wine will be far more highly valued. Why? And most wine fans know about at least one vineyard that was making average wine that has been bought and turned around. Suddenly the formerly run-of-the-mill wine starts to win awards and prices shoot up! How did they do it? Often their secret is bringing in a new winemaker. Consider two mutual funds investing in the large-cap growth sector. They're working with the same universe of stocks and the same market climate, yet some will outperform others. Why? On Wall Street, it's often the fund manager who gets the credit!

The importance of analysts. Robert Parker is a familiar name to wine enthusiasts, since he's possibly America's most famous wine critic. He tastes hundreds, if not thousands, of wines annually and awards them scores based on a 100-point scale. If he gives a wine 90 or more points, it flies off the shelf! That's why wine drinkers love to find a wine before Parker gives it his blessing—when it is just as delicious but still unknown and relatively cheap. Point out that your firm has its own staff of stock market analysts who try to do just that with stocks: they look for undervalued stocks that you can then discuss with your clients. It's one of the ways you bring value to the relationship, by finding the best-quality buys before the rest of the world knows about them.

Buy when they are out of favor. Ever see a good stock have a sharp decline on a bad day? You've probably said to yourself, "The stock is down 5%. Management didn't suddenly become 5% stupider today. This is a buying opportunity!" There is a parallel in the wine world. Major Bordeaux châteaux essentially produce wine every year. The price varies enormously based on the growing conditions and opinions expressed by wine critics around the world. Yet it's still grapes from the same vines on the same land being made into wine by the same winemaker.

If you are buying for personal consumption, you can get tasty wines at a fraction of the price by buying so-called off or classic vintages. For example, Haut-Brion is a premier cru château in Bordeaux. The 2003 vintage costs about \$300 a bottle. It's rated 95 out of 100 points by Robert Parker's Wine Advocate. The 2001 vintage, which is rated 94 by Wine Advocate, sells for about \$150 a bottle. . The 2001 is probably a pretty good bottle of wine—at half the price.

Buy and hold. Fine wine traditionally takes time to mature. The old rule of thumb was to buy red Bordeaux and wait 10 years before drinking it. This allowed the wine to develop complexity. The Saint-Estèphe region of Bordeaux has been known for producing the wines slowest to mature. Some Saint-Estèphe wines were thought to need 40 to 50 years in the bottle before they were ready. Talk about investing for the long term!

While buy and hold is also the traditional advice for the stock market, it can be hard to keep clients from getting impatient when they can view stocks and mutual funds priced online daily. You can always calm your wine-loving clients down by asking them if they would drink their expensive Bordeaux wine before it was ready? Probably not—it would be a waste! You can also lead into another analogy about when and from where to take profits. A wine fan might drink wines from lighter, more classic years with relatively little age on them while waiting for the wines from the great years to mature. Similarly, investors can take some profits now while waiting for other stocks with more potential to make their move.

Knowing what's in the bottle = showing your value. In France the great vineyards of Burgundy have government-imposed restrictions on variables such as yield—how many bottles may be produced from a specific amount of land. These vineyards may have older vines producing great wine and newer vines producing good wine but not quite up to the level of the vineyard's reputation. Production from the younger vines might be declassified and sold as ordinary Burgundy table wine—Bourgogne ordinaire—at a fraction of the price. It's the same grape type from the same land, and its production is overseen by the same winemaker, but the label and the price are quite different.

For example the Burgundy producer Domaine Leflaive produces some of the best Puligny-Montrachets, a white wine made from Chardonnay grapes. The wine labeled "Puligny-Montrachet" is the village wine and sells for about \$65 a bottle in the 2004 vintage. The "Bourgogne Blanc" is only about \$40 a bottle in the 2004 vintage. As I recall, the Domaine Leflaive back labels show a map of their holdings—and they don't

show any land outside Puligny-Montrachet! This example can be used to illustrate that your expertise can uncover many parallel situations in the investment world, such as new mutual funds sharing the same award-winning portfolio manager as a famous fund that is closed to new money. Let your clients know they can rely on you to know "what's in the bottle" in the financial world.

Is wine a good investment? Wine fans will talk about the increase in wine prices between initial release and the time the wine appears on shelves as futures (pay now, get delivery about two years later). They might consider it a better investment than the stock market. There's even a Bordeaux Index developed by Decanter magazine in England! This subject presents a great opportunity to discuss transaction costs with your prospect and show that you are reasonably priced, comparatively speaking.

First, let's assume it's legal to buy and sell wine in your state. Let's say a wine fan bought wine at auction and paid 15% as a buyer's premium, and the bid-to-offer spread was 5%. Now let's assume the person is paying a seller's premium to sell the wine in the same region. If the wine owner doesn't sell immediately, he or she will probably have to pay for storage, maybe about \$20 a case per year. (Provenance—or tracking the condition, storage, and ownership of wine—is important.) A case of wine bought at auction for \$1,000 might involve \$150 commission to buy, \$150 (or more) to sell, \$50 for a 5% spread, and \$40 to store it for two years. That's \$390! The wine's price needs to rise 39% before a profit will be seen! (We haven't even considered applicable sales tax, either!) Now, how much do you charge for managed money?

New issues. Cult wines are the "new issues" of the wine world. Everyone wants the hard-to-get wines. You hear stories of California cult wines that cost upwards of \$1,000 a bottle—if you can find them at auction! It's an expensive game to play. To use an investment analogy, people were said to "chase the hot dots" during the dot-com boom. When people talk about cult wines at \$1,000 a bottle, isn't that chasing the "hot dot" too?