JF TOBIAS

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Fine Wine Market Decode: April

Market Sentiment: Enquiries to Sell

For the last nine months, a string of macro-economic issues has placed the market under siege. At JF Tobias, we forecast downwards pressure and watched a steady race to the bottom prove this correct.

As a recession looks certain in the wake of Covid-19, what of the other issues affecting the market before the pandemic?

As the impact of the protracted Hong Kong riots further proved how vital the East has become to UK and European trade, the gradual de-escalation in tensions in December was widely welcomed. Now, with the implementation of social distancing and anti-gathering measures, it appears "peace" has been restored to Hong Kong.

With the social movement fading into the background as civilian efforts tackle the ongoing pandemic, this is a halted war for the medium-term.

If the riots were localised, Brexit proved a significant backdrop for two years. On uncertainty, Sterling fell to record lows. Following the Tory election majority, and with uncertainty largely removed, Sterling began to appreciate significantly, forcing wine prices lower.

Where are we now? Despite only two meetings between trade negotiators so far, Boris has outlined plans to stick to the original exit date.

With progress planned for June, Brexit will likely here begin to become an important factor in terms of Sterling; climbing higher on a deal looking likely, uncertainty over the deal weighing it down. This is one to monitor closely in the short-term.

If it feels like ancient history, it was only three months ago that China and the US signed a "Phase One" trade deal, declaring a cease fire in the trade war. Now, Covid-19 has replaced the trade war as a much greater threat to global economies.

With neither able to risk further destabilisation to their economies, we are forecasting this cease fire will extend through 2020, as China and the US try to engineer something like a V-shaped recovery in the final quarter of the year. A halted war for the short-term.

Market Sentiment: Enquiries to Buy

With the Eastern market starting down the road back to some semblance of normality, global trade volumes are slowly increasing and the rate of decline in prices appears to be reaching a plateau. Could this be the long-awaited bottom?

Perhaps we may be forgiven if this combination prompted us to begin to speculate as to what a market recovery could look like. With this in mind, we would like to tentatively discuss two major themes, market corrections and "the bounce". Here's hoping that the next few paragraphs don't jinx us all.

The reason behind today's recounting of the string of macro drivers is to make sure that the current state of the wine market is not simply painted with the COVID-19 brush. There has been downward pressure in the wine market for 9 months at the very least, with the virus adding a final twist rather than being responsible for the entire move.

Furthermore, we would also make the suggestion that this market decline is, in fact, not a series of unfortunate events but an overdue correction that has been brewing for some time.

Fine Wine Market Correction

While it has required a negative macro-economic jolt or two to start, this correction can be interpreted as both necessary and a natural part of the normal market cycle. The wine market has tracked up with incredible reliability for many years with values reaching incredible heights, prompting both trade and private market participants alike to begin to question the sustainability of these prices. These murmurings are indicative of an overextended market and that a reversal in the trend may be on the horizon.

Despite the infrastructure of the wine market lacking some of the complexities of other financial asset classes, wine is a tradeable asset and therefore its market can be compared to that of any other commodity. With this comes classic market forces and behaviour that can be viewed and interpreted with the same perspective.

To put this into practice, during a bull market prices run higher and higher with those involved happy and fat, wishing the run never ends. For the wine market, this was 2013 to the summer of 2019. Then comes a point where market participants begin to question whether the price reflects the true value of the commodity.

Divergence begins to occur, rumours of an overpriced asset circulate the industry, but no one wants to believe it, and most don't. In 2019 the wine trade began to question the astronomic pricing of Burgundy and other top-tier wines. In addition, the wine press suggested for the first time that perhaps the En Primeur system was losing its way, with pricing becoming exorbitant, the Chateau too greedy.

Then an economic jolt, the start of a correction, and the smart money starts to get out of the market realising the asset has been overbought, while the rest of the market remains confident. Then as those who closely follow the industry begin to realise, momentum shifts.

Now, with the pendulum swinging bearish, downward momentum builds and the market begins selling off at ever-increasing speed, boosted by those last members of the public joining late and adding their cumbersome weight to the move.

The Hong Kong riots were the catalyst for this correction, the jolt that began the move, but we want to reiterate, they were not the cause. The cause was a market that had become overpriced, with the true values of the wines becoming distorted beyond a reasonable level.

While it may feel like every macroeconomic roll of the dice has gone against the wine market for the last 9 months, these events have merely acted as an accelerant to a natural part of the market cycle.

"The Bounce"

If we are indeed approaching the bottom of this movement, we should consider the type of recovery the market could make. In times such as these, the term bandied around is "the bounce"; a volatile price move that recovers ground quickly and returns the price to some form of normality. You may have seen this type of resurgence within the equities markets through the last month or so.

We want to suggest that those in the wine market suggesting a rapid bounce will occur are incorrect. The wine market is a slow-moving and relatively illiquid market place when compared with most financial assets. The volume, size and speed of transactions are simply not present in the market for a sizeable bounce to occur. The speed of the market was demonstrated in the 9-month sell-off period we have just endured. For many professionals it was the worst wine market they have ever experienced and yet it still took 9 months to correct fully.

So with this mind, what reaction can we expect? In the simplest assessment, there are typically three types: V, U, and L.

V is the rapid bounce which we have discerned is not likely. So is it U, the slow accumulation, or perhaps L, a flattened non-reaction? We would like to suggest that the reaction will be split. The stock that is of genuine quality, top scores, top vintages, the actual top echelon has the capacity to recover. It is stock that is bought by both speculating investors and those end consumers

that are insulated from the global economic environment. As a result, these hold the capacity to return to higher ground.

However, stock that sits outside of this very top tier we believe will stagnate. It was this stock that was priced beyond its true value, with prices drawn upwards by a rising tide raising all ships.

This correction will impose some clarity into the market, separating out those items that are now discounted to their value, and those that have had their value returned to an accurate level.

This we believe will reaffirm both our sales advice and our buying methodology of value investing. Sell anything less than the best as it constitutes dead wood, and buy only true quality.

Currency Corner: FX Decoded

In the global fine wine market, relative currency strengths play a big part in performance. Red swatches show those currencies that have gained in value against the base currency; blue those that have fallen lower in value.