

## PRACTITIONER'S POINT: INVESTING IN RARE US COINS



**Gary Knaus** is president of Numismatic Investments Corporation, which analysed the US rare coin market and discovered price anomalies that may afford long-term, arbitrage-like investment opportunities. Beyond being a collectable, Gary shares his views on the investment benefits offered by this alternative asset class...

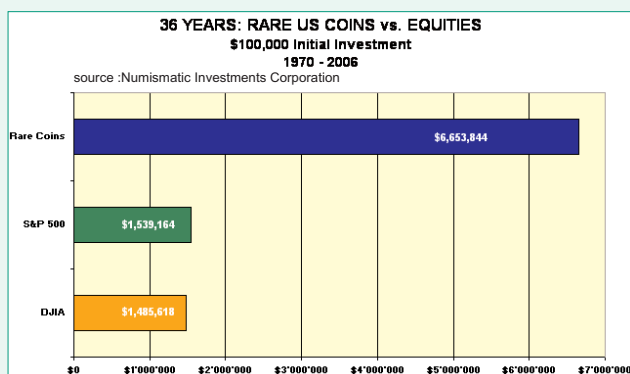
**Would you say investing in rare coins is a well kept secret? How did you uncover the price anomalies?**

Rare coins have traditionally been the domain of collectors, receiving only sporadic attention from the mainstream investment community. In the late 1980's several rare coin investment funds were established by Wall Street firms - which drove prices to dizzying heights. These stratospheric prices pushed collectors to the sidelines and without their support the market eventually collapsed. Since then, investing in coins has been largely confined to wealthy, knowledgeable individuals working in concert with coin dealers.

Over the past two decades, the US rare coin market has witnessed a remarkable transition. Almost all investment grade coins have been certified, authenticated and graded by independent third party firms, up-to-date price data is readily available, and the surviving populations of coins can now be estimated. We performed an assessment, and were able to successfully group coins into over- and under-priced buckets. We used this to develop a model, which is being successfully implemented to offer portfolios of prospectively undervalued coins to sophisticated investors.

**Are US rare coins "investor friendlier" than their European and global counterparts?**

Yes. The rare US coin market offers unparalleled transparency, security and liquidity. With certification by one of the two leading services (PCGS or NGC) an investor can be assured that the coin is genuine and in the condition stated on the secure plastic holder (called a "slab") that encases it. There are more than 10,000 coin dealers in the US and two electronic dealer exchanges that at any time typically have open bids for USD 700mn in rare coins. The annual US volume of rare coin transactions is estimated at more than USD 4 bn, perhaps even as high as USD8 bn. By contrast, the European and Asian markets are highly fragmented, comparatively small, and do not have the liquidity or transparency afforded by the US market. For example, those markets have not embraced certification - forcing investors to either become experts or to rely heavily on coin dealers to ensure the coins are authentic (in the condition offered and priced appropriately).



**"It has been claimed that even over shorter investment horizons rare coins typically perform at a level comparable to equities while providing both tangible asset diversification and reduced portfolio risk." Why aren't more investors drawn to coins?**

As shown in the adjacent graph, rare US coins have historically appreciated at levels exceeding those of equities. Industry research also suggests that rare US coins tend to exhibit marked appreciation during times of high inflation and deflation; acting as a possible hedge against sharp changes in interest rates. As this asset class has a relatively high return per unit of risk, adding them to a well diversified investment portfolio can reduce portfolio volatility.

Research I undertook reveals that on a 10-year moving average basis, rare US coin and equity returns were negatively correlated (-0.68) - so coins have the potential to act as a long-term hedge against equity market downturns.

Most investors are unaware of the benefits afforded by adding a modest amount of rare coins to their investment portfolio. I believe this is largely due to

investment advisors having little or no knowledge of this asset class and their resulting hesitation to recommend this and other non-mainstream alternatives.

**What are the risks involved?**

Investing in rare coins can be a profitable venture for the informed, but a minefield for the unwary. Exploiting opportunities is relatively straightforward with a reputable coin dealer or firm that specialises in rare coin investment portfolios. Only accept coins that have been certified and graded by a tier one firm (such as PCGS or NGC) and check prices online (such as: <http://www.pcg.com/prices/>) to verify that the amounts you are paying are reasonable.

**What are the short and long term returns that can be expected as a result of investing in rare US coins? What are the other inherent benefits of this asset class?**

Industry researchers have reported gains (internal rates of return), over a five to 62 year period, that range from a low of 9.83% to a high of 12.5%. Historically - the rarer, key date coins, in mint condition tend to perform best. As an example, over the past three years these very select coins have appreciated almost 46% in value. But achieving those returns is easier said than done: the highest quality rare coins are very difficult to obtain in the market, with many not coming up for sale for years or decades. Fortunately, the work we did on market price anomalies has allowed us to identify generally obtainable, prospectively undervalued coins whose overall returns are close to those achieved at the high end of the market.

In addition, US investors can utilise the IRS 1031 like-in-kind exchange rule to build portfolio value while deferring capital gains taxes. Coins can also be leveraged as collateral for other investments and loans, and unlike equities coins can't drop below their bullion or face value.

**Do investments in rare US coins experience cyclical behaviour patterns?**

Other than during the late 70's and 80's, periods that were marked by wild speculator driven price swings, rare US coin prices have not been as volatile as equities. For the past year, coin prices have been in the doldrums, which many view as a buying opportunity. Today's prices remain 64% below their all time high of 1989, which provides a basis for believing that long-term price appreciation is possible.