Lessons from the Barnes Foundation

September 25th 2002

Because of its financial difficulties, the Barnes Foundation is thinking about moving is World famous collection of Cézanne, Matisse, Renoir, Picasso and Van Gogh from Merion to Philadelphia's downtown in the hope of attracting private partners and patrons of the Arts.

"If we stay in the suburb Lower Merion, we could face bankruptcy." warned the president of the foundation, Bernard Watson. The museum will lose around $800 000 this year. And the foundation has less than one million dollar left out of its initial founding.

Many charitable funds, like the Pew Charitable Trusts and the Lenfest Foundation, committed themselves to contribute parts of the $150 million needed for a new building in Philadelphia. But there is an important obstacle: the founder, Dr Albert Barnes, has strictly forbidden any move of pieces of its collection from the initial museum in Merion. The foundation has asked the American justice system a way to lift this requirement. They are still waiting for the green light.

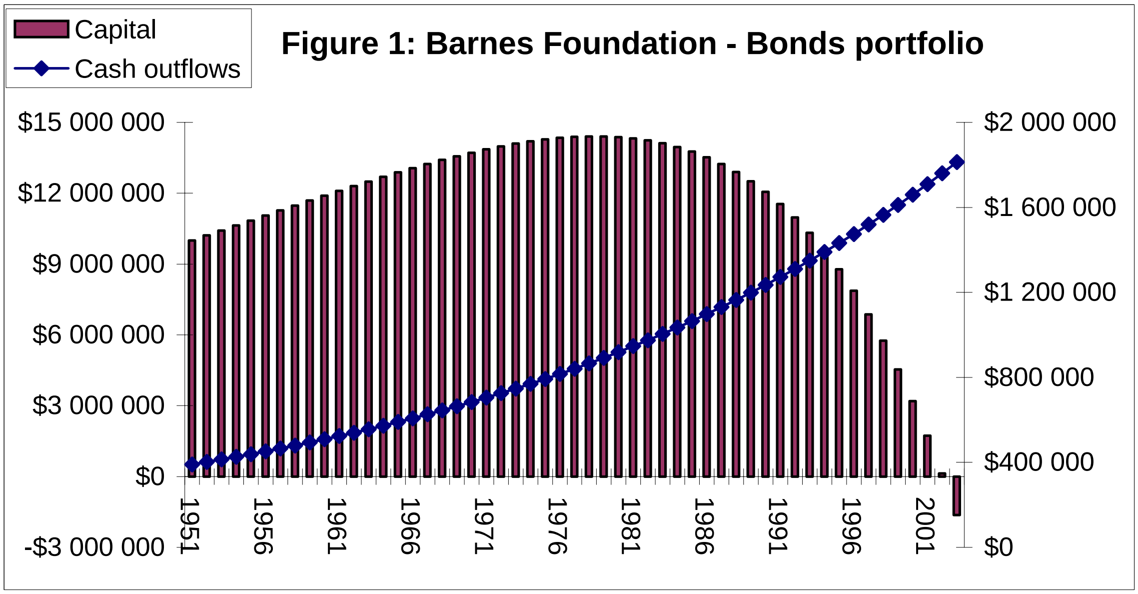
The Barnes foundation is famous for its impressionists and post- impressionists paintings. The collection is estimated at $8 to $25 billion. Because of strict restrictions from Dr Barnes, the museum can accommodate only 400 visitors per day and only three days a week. The initial donation of $10 million is depleted since 1999. One other wish of Dr Barnes – in the end fatal to its foundation – was that the capital had to be invested only in government bonds.

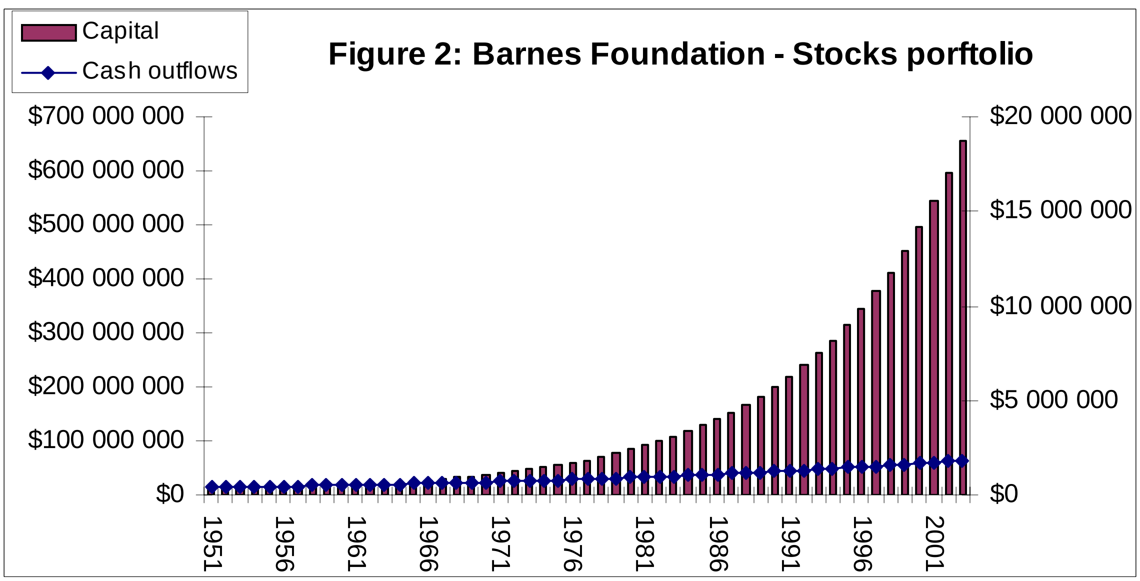
Albert Barnes, who did not like the high *bourgeoisie* of Philadelphia, wanted his foundation to be accessible to every stratum of society. He made a fortune by selling a blockbuster drug at the beginning of the century. He then got very interested in art and started acquiring masterpieces from Renoir and Cézanne and then works of *avant-garde* artists like Picasso, Soutine and Matisse. In 1922, he created its foundation to help the general public understand and value great works of art. The Philadelphia society made fun of its choices, mostly the then contemporary ones. Quite wounded by such snobbishness, he decided to impose rules to prevent the foundation to ever move to Philadelphia. He died in a car accident in 1951, leaving his fortune to the museum.

How can the greatest private collection of artworks be in such a financial precariousness? The answer is simple: a portfolio of bonds instead of stocks. The great mistake of Dr Barnes was to underestimate the destructive power of inflation. In 1951, $10 million dollars in capital was enough to pay all the operating costs of the museum. Let's say that in 1951, annual operating costs were $385 000, Mr. Barnes thought that since bonds yields were at 6%, he had more than enough capital to cover all costs forever. But over the years, salaries and other costs increased by around 3% a year. So 50 years later, annual costs are $1.8 million. Beginning in 1983, the portfolio is not yielding enough money and the capital had to be depleted. In 1999, the capital was all gone (figure 1).

Now if Dr Barnes had been more provident, he would have invested his capital in stocks instead of bonds. What would have been the difference of an annual return of 10% instead of 6% for the foundation?

Believe it or not, the $10 million in capital would be worth $650 millions today instead of being all gone (figure 2). And that's after counting all the annual cash outflows to operate the museum. It is interesting to note that the Getty Museum in Malibu got its donation in equities (Getty's portfolio). Even after building the most expensive museum in the World - more than $1 billion - five years ago, the foundation still has a portfolio valued at $5 billion. But that is another (and very interesting) story…





What lessons should an investor learn from the enormous mistake of Dr Barnes? It's simple: in spite of all market fluctuations, corrections, panics and other disasters that affects stocks, equities are still the ONLY shelter against inflation and in the long run represent the best of all investments, even if revenues are needed. Paradoxically, the Dr Barnes taught he was prudent in forcing its capital to be invested only in bonds. In fact, it turned out to be the riskiest choice for the long run.

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