Cellar & Co

Wine Market Review February 2020

A challenging year in view leading up to post EU environment

All key Liv-ex indices fell slightly in January, and all are down over 12 months, with the LX50 (Bordeaux first growths) at -4.7%. The movements are not large in scale however the mood in the market is far from relaxed. Start-of-year polls show little confidence: Liv-ex's own annual members survey elicited a majority view of a flat market in 2020, though far from homogeneous. The Gérard Basset 2020 Fine Wine Report (polling 40 leading traders and commentators) saw a decline in the Bordeaux segment in view. And both of these were published before the news of the impact of CoronaVirus on the Chinese and other Asian economies.

The headwinds affecting the market in Q4 of 2019 have been widely discussed, and these are likely to impact the scene for at least the first half of 2020. US tariffs on French wine are notionally temporary, thus giving buyers an incentive to delay purchases. The Chinese market remains highly uncertain for fine wine, though the country's long-term upward trend for wine consumption seems secure. Recently-announced border controls (on disease control grounds) in Hong Kong will depress fine wine activity in that market. And the Pound remains strong in relation to the Euro and the Dollar as the threat of a no-deal exit from the EU abates. Currency movements are neutral where stock is imported and immediately re-exported however UK landed stock is disadvantaged on the international market when the Pound is up.

Future trading arrangements with the EU remain unclear, the mood music emanating from Government suggesting a cross-border regime that will require changes to import and export procedures that are unlikely to be painless. Trade with the rest of the world is likely to be largely unaffected however.

Index 31/01/2020 (monthly close)	Level	MOM	YTD	1yr	5yr
Liv-ex Fine Wine 50	334.04	-0.30%	-0.30%	-4.73%	22.98%
Liv-ex Fine Wine 100	301.88	-0.22%	-0.22%	-3.24%	24.20%
Liv-ex Bordeaux 500	307.11	-0.48%	-0.48%	-3.49%	28.70%
Liv-ex Fine Wine 1000	346.07	-0.59%	-0.59%	-4.46%	40.81%
Liv-ex Fine Wine Investables	330.87	-0.60%	-0.60%	-3.56%	27.45%

Brexit – what we know, and what we don't

A seminar under the auspices of the Wine & Spirit Trade Association held at the end of January flagged up a range of concerns over the administration of cross-border trade with the EU: the spectres of additional documentation, laboratory testing on safety grounds and UK-specific labelling were all discussed. None of these clouds appeared to have a silver lining and all impact negatively on the UK's role as a global fine wine hub. The issue of (potentially) wider duty differentials, while an important consumer concern, was felt to be a second-order issue for the trade. The pudding is far from baked, however even today merchants are feeling obliged to consider damage- and risk-limitation strategies to defend their businesses.

Rightly, the core conversation is over our future relationship with the EU, our biggest supplier for wine in general and for fine wine in particular. Traffic with other wine producing regions – Australasia, South Africa and South America for example – will be largely untroubled by new arrangements. These are already categorised as 'Third Countries' for importing purposes and the relevant documentation and procedures are in place and well-rehearsed. Suppliers in those geographies will be gearing up for greater involvement in the UK market from now on.

Hypothetically, the bonded warehouse regime could play a greater role in expediting fine wine trade, acting as a micro-sized freeport. Under-bond stock is in a tax-free environment and is therefore 'export-ready'. The potential exists for harnessing this capacity to mitigate some of the foreseen additional regulatory burden.

For wine traders, the prospect of importer labels may prove to be the greatest long-term challenge. UK merchants' greatest asset is the wealth of customers reserves under management. If importer labels are incrementally applied to such stocks, the asset will be undermined. Just as today when an importer label, even from Italy or Sweden, impacts on fungibility, so too will a future UK importer label. We don't yet know what requirements will be imposed, and at what stage in the supply chain they will be mandated. Storage by UK traders, including on behalf of their UK customers, in EU-located bonded warehouses may well be a strategic option.

Let's talk about Bordeaux – again!

The decisionmakers in Bordeaux have a difficult judgement to make in pricing the 2019 vintage, to be presented to the world's trade and press at the end of March. Quite a number of well-known chateaux have enjoyed a run of five, and for some six, very good/great vintages since 2014. In each of the last five years proprietors have attempted to finesse the best possible release prices for their wines, while at the same time endeavouring to protect future earnings by planned stock retention. (Effectively, they have been investing in their own wines.) Much of this stock currently resides in Bordeaux, either in chateaux' cellars or in the stockades of Bordeaux merchants who preserved allocations that they knew they would not sell en primeur.

With the global market for Bordeaux virtually stalled owing to the economic challenge in the Far East, chateau owners need to consider how best to launch the new vintage onto the world. One option is to continue to withhold stock, avoiding adding further pressure in a market awash with supply. They will know that collectors bought heavily into the 2018s and may not rush into yet another great vintage. But should the market not recover its poise in a timely fashion the stock burden becomes ever greater. Kicking the can down the road is not always a sensible strategy.

Some commentators are beginning to speculate on another 2008 moment – where the very top chateaux, led in that year by Lafite, launched the vintage at prices significantly below those of the preceding, manifestly inferior, 2007. This was in April 2009, around the height of the global financial crisis. The effect was to pump-prime the en primeur sales campaign, buyers responding in their turn to the bargain prices, and the trade breathed a collective sigh of relief as the orders flowed in. Those end buyers enjoyed very significant capital advantage as prices rose steadily after release. Bordeaux, when asked if they didn't fear damaging the sales prospects of the 2007s, still in barrel at the time and still largely unsold, responded with Gallic logic: "we can't solve one mistake by making another. The 2007s will have to find their place in the market by themselves". Which they did, in time.

2019 Bordeaux – the story so far

Wise counsel is not to read too much into assessments of vintage quality until the wine has been in the cellar for six months. Seemingly great juice does not always translate into great wine, such is the complexity of the vinification, *élevage* and *assemblage* process. 'Many a slip twixt the cup and the lip', as the old proverb goes. Furthermore one-off judgements can be anecdotal, or may be swayed by emotion. And very few commentators will have had the opportunity to taste widely at this stage. The growers themselves will not have peered even into their closest neighbours' vats, so they have little perspective themselves. So, in the case of Bordeaux 2019 it's still too soon to say.

What we do know is that the season presented no serious challenges such as those that afflicted the two previous years, hail (2017) or mildew (2018). The weather was not as straightforward as in 2016 however, drier than average in spring, colder than average in June (but followed by a 40C heatwave in late July, itself followed by heavy rain) and some storms in September. But overall the conditions were not unusual for a maritime vineyard region.

Red grapes were harvested in fine weather from end September to mid-October with little pressure from rot. A good 'modern' level of ripeness was achieved, 13-14% for the Cabernets, a little more for the Merlots, so a touch more classic than exotic. Whites were picked from the end of August and were safely in the cellar before the autumnal rain. The prospect is therefore for a decent crop of very good, occasionally great reds, and some very fine whites. With correct pricing this could be an excellent vintage opportunity for buyers.

Climate change – can there be a vintage silver lining?

There has already been speculation that the run of success enjoyed by Bordeaux in terms of vintage quality is a consequence of climate change. Sometimes drought, sometimes untypical rain, and for many of the last several years, gloriously warm summers. Bordeaux - and other fine wine regions – have experienced these in the past from time to time, but is there a step-change in frequency, bringing a new vintage pattern? Both 2018 Bordeaux and 2018 Burgundy vintages are the product of outlier weather conditions, and both have received substantial plaudits from a number of quarters. *Vins d'exception*, as the French would say. The question is, how exceptional will they be seen to be in years to come.

If it proves to be the case that climate change is increasing the frequency of very good vintages in Europe, producers may be facing a very different threat, one of excess good fortune. The prestigious wine regions have built reputations on the timeless quality of their wines, but their current supremacy relies on stand-out great vintages, years that produce sublime bottles that live for decades, sometimes for centuries, in the collective historical memory. Should stand-out vintages become repetitious as a consequence of climate change, then their mystique will become tarnished. There can be too much of a good thing.

The jury hasn't even started sitting in this particular case and initial scrutiny suggests serendipity rather than pattern behind the run of success in Bordeaux. And where growers are pointing to evidence of climate change impacting on wines and winemaking, in most instances the discussion is of threat rather than opportunity. The need to 'relocate' vineyards to cooler climates (eg Australia), or to locations less reliant on irrigation (eg Chile). Or the need to adapt, possibly by planting more resistant varieties or crossbreeds. Whether the effects are positive or negative, climate change will inevitably impact on growers' behaviour and on wine styles. It will likely have a bearing on the patterns of regional ascendancy too.

Buying opportunities

With Bordeaux prices flat or deflating, it is difficult to make the case for acquisitions in the near term. The one exception is perhaps the obvious – 2016s. Recent high praise following the January 'Southwold' Tasting has led to a flurry of new interest. According to Liv-ex's 'Fair Value Methodology', which correlates price to critics scores, 2016 is not only the best of recent vintages on aggregate but also the best value. Best value estates are Clinet, Margaux, Pape Clement and Montrose. See more here.

We have highlighted the quality reputation of 2014 and 2017 white Burgundy in past reviews. 2018 has surprised with the freshness of the whites despite unusually warm conditions, but these are not in the same league as the earlier fine vintages. 2014 whites are almost unobtainable on the open market now; purchase of top 2017s appears an easy win. Original cases only, magnums and double magnums where possible, and Grands Crus from selected producers such as Marquis de Laguiche, Domaine Leflaive, Ramonet and Domaine Leroy will add value to any cellar.

Selling opportunities

A difficult judgment is to be made over mid-mature Bordeaux. The market is soft to say the least with Sterling values in gentle decline. Has the market reached its nadir, to rally again as soon as the Asian market recovers its confidence? UK pricing is sensitive to the strength of the Pound too, and a fall, perhaps triggered by unforeseen problems over future trade deals, would serve to turn the tide. Our view is that without such prompts the bear market will continue for the rest of the year, and recovery, when it comes, is likely to be very slow-paced. Time then to crystallise profits on investment grade Bordeaux, particularly those whose fortunes are linked to Asia. 2016s should be held for reasons already stated, though judicious selling of those that have risen most rapidly – Lafleur for instance – would be a useful strategy to generate liquidity.

The Quarterly Wine Market Review is compiled by Cellar&Co's wine investment team. Please contact us for further information on any of the subjects covered. We are buyers of well-cellared stock.

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