Are Champagne Stocks In A Bubble?

Legend has it that Dom Perignon, the late 17th century cellarmaster of the Benedictine Abbey of Hautvillers announced the product of his new technique of double-fermentation, the *methode champenoise*, "come here my brothers! I have tasted the stars!" Whether this eureka moment exceeds whatever you have on the docket for this Friday night is entirely up to you, although I do have to confess that an Internet search of the phrase "I have tasted the stars" returns some references altogether inappropriate for a financial Web site.

Even if your New Year's Eve does not rise to the level of poetic exclamation, chances are it will involve champagne. The bubbling wine has insinuated itself into the very meaning of celebration. As is the case for all luxury goods, the sellers of champagne strive to make you feel better about the purchase by charging you more. How has this been as a business model? Has it been worth it for you to own the purveyors of champagne so that you could raise your flute and the stroke of midnight and snicker to yourself, "yeah, drink up my little bubble slaves!" or something similarly misanthropic?

Yes: Champagne is a still-profitable bubble market.

Geography Matters & Booze In The News

I am going to restrict the meaning of champagne to those produced in the Champagne region of France. This is not out of any affectation or (shudder) Francophilia, but rather recognition of the indelible link between brand and geography. This is a major global trade issue at the moment: The European Union, for whatever their baser commercial motives, happens to be on solid intellectual property footing when they note that Burgundy, Cognac, Parma, Gorgonzola, etc., refer to specific regional names. These names have considerable property values associated with them and use without quality control or licensing arrangements constitutes infringement. We would not like it if the French started selling Kentucky bourbon or the British started selling Wisconsin cheddar.

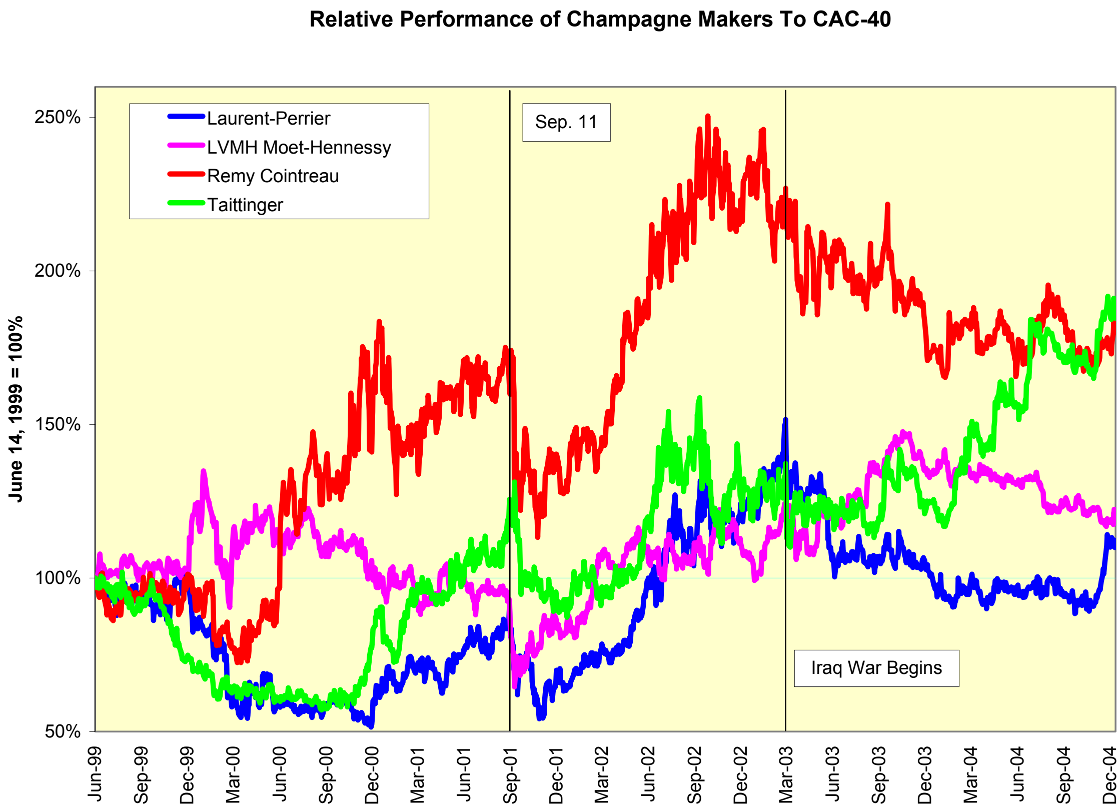
As a result, it is always correct to say both "that Korbel's not champagne," and "that champagne's not Korbel" for Brown-Forman makes Korbel in California.

If your party slows down, bring up the World Trade Organization's Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS; everything in an international organization must have an acronym). Point to that bottle of California sparkling wine (or German sekt, or Italian Asti) and say "Excuse me, but you do realize wines and spirits 'are given a higher level of protection for geographical indications (TRIPS Article 23) than other products (which are protected under Article 22),' don't you?"

Yes, that's right: All those nihilistic window-breaking hooligans who tore around Seattle a few years back were protesting an organization that treats wines and spirits differently than all other articles of commerce. As a proud American patriot, they sound like my kind of people: Two of the 27 Amendments to the U.S. Constitution, the 18th and the 21st, deal specifically with the sale of alcoholic beverages. Even now the Supreme Court is considering whether state restrictions on interstate sales of wine over the Internet violate the Constitution's Commerce Clause.

Social Barometers

Let's take four high-end champagne makers, who as we have established must be French firms. They are, with lead brands in parentheses, Laurent-Perrier (Larent-Perrier), LVMH Moet-Hennessy (Dom Perignon, Moet & Chandon, and Veuve Cliquot), Remy Cointreau (Piper-Heidsieck) and Taittinger (Taittinger). Each of these firms has outperformed the French CAC-40 index since LVMH Moet-Hennessy began trading in June 1999.



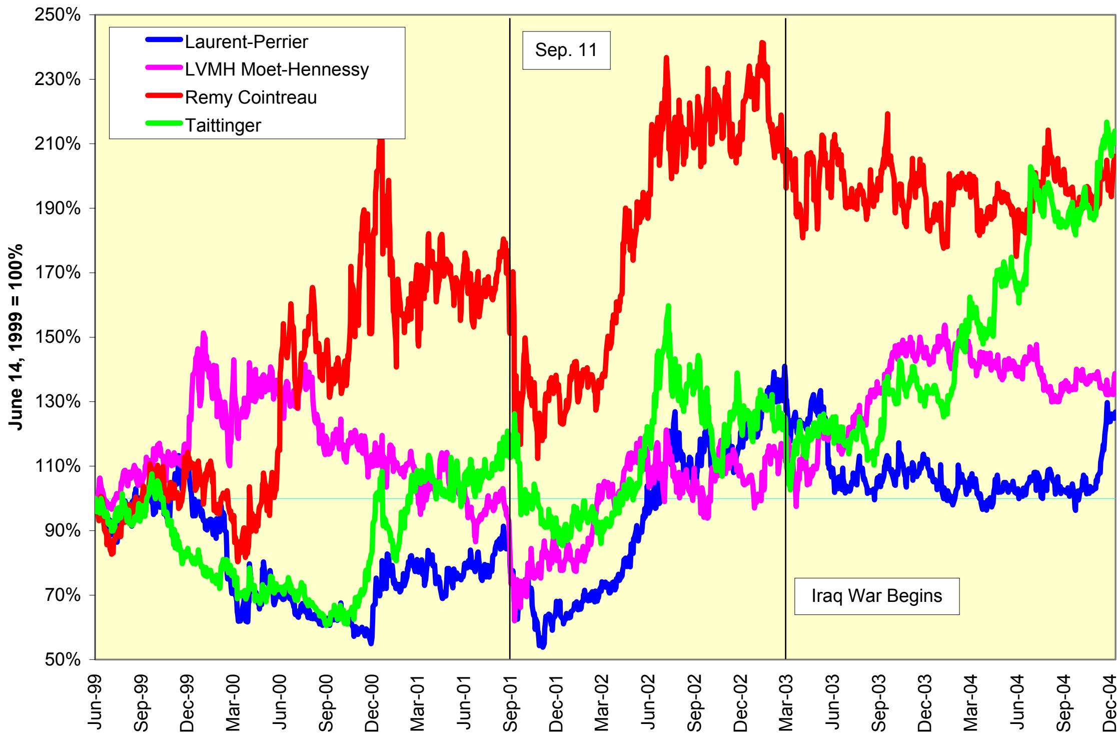
An interesting aspect of these firms' relative performance is how two international events affected them. The first was September 11; the stocks of luxury goods makers worldwide plunged amidst the expected dropoff in global travel and entertainment. Each bottomed shortly thereafter and greatly outperformed the French market during 2002's horrendous bear market. Luxury goods frequently outperform prosaic goods during difficult times as people treat themselves to small rewards. In some ways they are better defensive stocks than the usual suspects such as Procter & Gamble; who treats themselves to a box of detergent to feel better?

The start of the Iraq War in March 2003 affected the firms as well. Whether any of this had to do with changed attitudes toward France in the U.S. and the U.K., two large importers of French goods, is speculative. What is telling is how only Taittinger, which has financial and real estate operations as well as its beverage business, has managed to outperform the CAC-40 since that date.

The Currency Effect

A second variable emerged in force after the Iraq War, and that was the dollar's descent against the euro. If we convert the performance of the champagne makers to dollar terms and compare them not to the euro-based CAC-40 but rather to the dollar-based Russell 3000, a different picture emerges.

Relative Currency-Adjusted Performance of Champagne Makers To Russell 3000



A U.S. investor in French vintners has enjoyed a nice little currency conversion trade. All four champagne makers have outperformed the Russell 3000 quite handily, with Remy Cointreau and Taittinger leading the way. The French exporters, like all exporters in strong-currency countries, have had to absorb some of the euro's appreciation in their margins.

So while our trade arrangements with Asia wherein they finance our consumption by buying our bonds can be described as having our cake and eating it, too, owners of these stocks have had their wine and profited, too. Has this been a good trade? Yes, I'd say it sparkles.