HOW DOES PROPERTY COMPARE TO THE STOCK MARKET?

AES WEALTH

CONTENTS

INTRODUCTION

A house is the largest asset that most families will ever own. It is also the most emotionally meaningful. Over the past two decades, housing values have increased significantly, even doubling or tripling in some global cities.

These dynamics result in the conventional wisdom that renting is "throwing money away" while buying "builds equity." But is that true?

I know that the debate is further catalysed by recent stock market volatility which leads investors to feel more confident in a bricks and mortar purchase. Is it a false sense of confidence though?

As a senior international professional or business owner, you probably have a family home in your home country. It's likely you also have a holiday home along the coast or in the countryside that your family can escape to, to unwind and spend quality time together.

The memories in these properties make the purchases worthwhile – they add value to your life. They help you forge stronger relationships with those you hold dear.

This guide is not about the properties you call home. It’s about the properties you buy to let or hold on to in the hope they will be good investments or possibly subsidise a pension – in which case, your money is better kept elsewhere.

In this short guide, I will explain why.

Sam Instone
CEO & Founder
AES

THERE ARE GOOD REASONS TO BUY A HOUSE...

But those reasons are not financial.

The arguments for homeownership are usually some combination of the following:

- Because it provides stability. You want your children to have a "home base" that they will always remember, think of fondly, and be able to return to.

- Because it allows you to customise. You want a space that you can use, remodel, and decorate precisely as you choose.

- Because of the social benefits. There are proven intangible benefits to owning such an emotionally-meaningful asset. People who own their homes are more likely to be satisfied with their neighbourhoods, more likely to get involved in the community, and more likely to participate in political or voluntary activities.

- Because your significant other wants to. In some couples, one member feels strongly about one or more of the above reasons. Even if the other does not, this alone can be a powerful motivator.

- Because renting isn't an option. The type of home you want, in the area you want to live, simply is not available as a long-term rental. These reasons are valid. But, importantly, they are entirely non-financial. There are proven intangible benefits to owning such an emotionally meaningful asset.

IF THE DECISION WERE PURELY FINANCIAL, YOU'D BE BETTER OFF RENTING

A properly constructed 'Rent versus Buy' model will typically reveal that renting is the better decision financially. The logic is driven by two factors:

FIRST, THE COSTS OF HOME-OWNERSHIP ARE SIGNIFICANT

These costs, which renters largely avoid, are almost always underestimated. They include:

- Transaction costs. The sale of a house generally involves a commission to real estate agents that ranges between 2% and 6% of the purchase price. In most regions, the buyer and seller also pay various transfer fees and taxes. These transaction costs create an immediate financial loss that takes time to recoup, making it unwise to purchase a home unless you intend to own it for at least six or seven years.

- Improvement. We mentioned the ability to customise your home as a non-financial argument for buying. The financial downside is that you will likely take advantage of this option, and it is often costly to do so. Homeowners often rationalise these costs by assuming they will be recouped when the house is sold, but because buyers and sellers have different tastes, rarely does a seller fully recover all improvement costs.

- Property taxes and maintenance. While these significant expenses are often the first ones mentioned when discussing the costs of homeownership, we don't believe that they are a major factor in the Rent versus Buy decision, as they are largely implicit (or "baked in") to rental prices. That said, because people tend to purchase larger homes than the ones they would have rented, they typically pay more in taxes and maintenance than they would have paid implicitly through rent.

SECOND, THE OPPORTUNITY COSTS OF HOMEOWNERSHIP ARE ENORMOUS.

The more important, but less obvious, downside of buying a home is the opportunity cost. Money used for a down payment and mortgage (above what would have been spent on rent) could have been invested elsewhere.

Any analysis of the financial implications of homeownership therefore must compare the expected return of a house to the expected return of other investments, most notably stocks.

STOCKS HAVE OUTPERFORMED HOUSING OVER ANY MEANINGFUL TIME PERIOD

The chart below shows the UK Property House Price Index which tracks the average price paid for UK property, versus the MSCI World Index which tracks global equities.

While the UK House Price Index has returned 79.36% since January 2005, the MSCI World has returned 636.10%

31/12/1987 - 18/11/2024 Data from FE fundinfo2024

How can this be? The compound annual growth rate of housing during this time frame was 4.6%, while the growth rate of stocks was 10.6%. Compound that difference over 70 years, and the result is pretty staggering.

Academia's most prominent housing expert reaches the same conclusion: Yale economist (and Nobel Laureate) Robert Shiller measures nationwide home prices in the USA going back to the 1890s.

His data reveals that from 1890 — just three decades after the Civil War — through 2016, the annual real (meaning, adjusted for inflation) return of home prices was just 0.4%.

Put another way, home prices have kept pace with inflation, but have provided no meaningful return above that. As Shiller said in an interview:

> " If you look at the history of the housing market, it hasn't been a good provider of capital gains. It is a provider of housing services… To me, the idea that buying a home is such a great idea is just wrong.

SO WHY DO PEOPLE THINK HOUSING IS A GOOD INVESTMENT?

Conventional wisdom is that buying a house is the wise financial decision while renting is "throwing money away." Why does this idea persist, despite overwhelming evidence to the contrary? Here are a few theories:

- The increase in home price is easy to calculate and remember. We all have loved ones who can recite both the purchase and sale price of a particular house, leaving the impression of substantial gains: "My parents bought their house for $50,000 in 1970 and sold it for $500,000 in 2010!" Of course, you will never hear the comparative return of that capital is invested in stocks over that same time frame, or the housing-related costs (commissions, taxes, maintenance costs, etc.) that were incurred over the years.

- People underestimate the long-term impact of inflation. In the above example the $50,000 paid in 1970 is the equivalent (after inflation) of $281,000 in 2010. In other words, the majority of the $450,000 increase in value is simply the result of inflation. Because the magnitude of the impact of inflation is not intuitive, it is often underestimated.

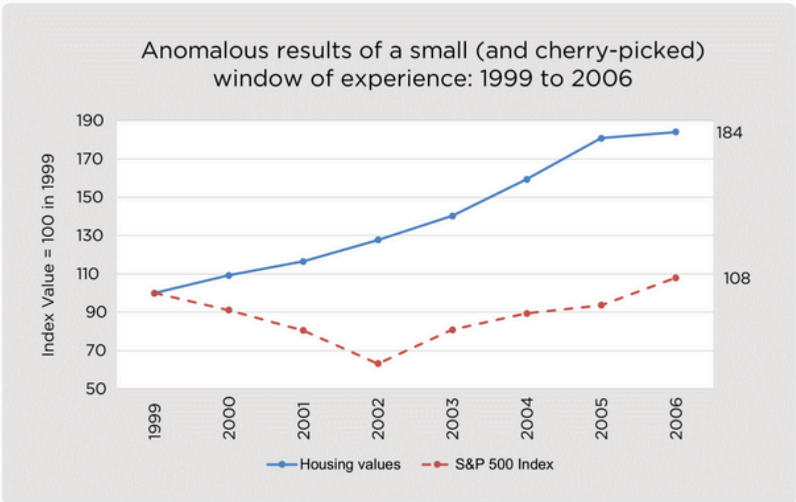
- Houses are tangible, stocks are not. A home has real worth and value, which is readily apparent to everyone. Stocks, on the other hand, are merely paper representing a claim of ownership in a business. This feels too abstract for some, and downright scary for others.

- Housing prices are less volatile than stocks. Speaking of scary, stock prices are more volatile than housing prices. Stock market declines are more frequent, more severe, and more publicised than those of housing.

It is not a coincidence that stocks offer higher returns, as investors must accept more heartache in order to capture those returns. The short-term (relative) stability of housing often convinces people that it is a better investment, without consideration of the long-term trade-off of lost returns.

- Your own personal experience is limited (and anomalous). Many of us have direct personal experience with housing values only over the last 15 to 20 years. Housing values have increased significantly over this time frame, but the results are anomalous when compared to any longer period.

Below is an intentionally cherry-picked time frame (1999 to 2006) in which housing values increased more than stocks:



WHY DO STOCKS HAVE HIGHER RETURNS THAN HOUSING?

Books could be written on this topic, but the critical distinction is that houses don't produce anything, while companies do.

Businesses exist to maximise earnings and the growth of those earnings, and stocks capture these efforts.

In contrast, the value of a house is based more on supply and demand dynamics than its inherent productivity.

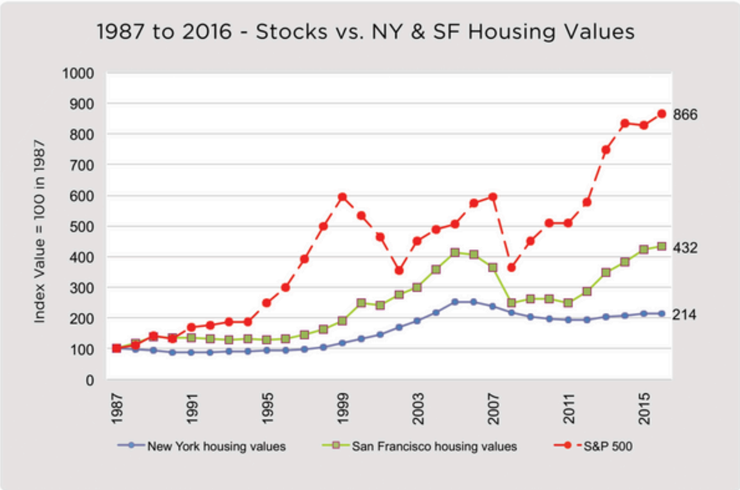
COMMON OBJECTIONS, AND OUR RESPONSES

- But I use leverage on my house, so the returns are magnified! Thus far in this analysis, we have ignored the fact that most houses are leveraged via a mortgage, which magnifies returns. Of course, stocks could also be leveraged, but most people (wisely) choose not to. An "apples to apples" comparison would have the same result – the levered returns on stocks are much higher. And remember: leverage works both ways, as many people learned in the housing crash of the late 2000s.

- But I get a tax deduction on my interest expense! We often hear people talk about the benefit of the tax deduction for mortgage interest expense and property taxes. These are indeed valuable. But the impact of these deductions is simply to reduce the cost of the interest and taxes paid, and does not come close to making up for the difference in returns.

- But interest rates are so low! Again, this simply serves to reduce the cost of interest and does not close the gap between housing and stocks. It is also important to understand that when interest rates are low, the prices for assets purchased with leverage (like houses) tend to inflate, which often outweighs any benefits of borrowing at a low rate.

- But stocks are overvalued right now, so future returns will be lower! We don't know if stocks are expensive. Or cheap. Empirical evidence suggests that nobody knows. Markets are generally efficient, so stocks are probably worth what they're trading for today. Housing markets also tend to be efficient (and similarly difficult to predict), so the same logic applies. Attempting to "time" either market is a dangerous game and not worth playing.



IN SUMMARY

There are a lot of good reasons to own your home, and we fully support you in doing so.

Just be mindful, if you decide to buy a house, you should do so with the idea of it becoming a home. It should enhance your and your loved ones' lives by giving you all a space to grow and do things you love.

If, on the other hand, buying property is to increase your net-worth; you'll be better off renting instead. Even though that comes with far less prestige, it will free up more of your capital to maximise the returns of the stock market.

Which, all points considered, should put you further ahead in achieving your life goals.

WELCOME TO BETTER

For a better you and better business, subscribe to AES Education.

IMAGINE IF YOUR PENSIONS & INVESTMENTS WERE 100% UNDER CONTROL...

We ask just 3 questions of you to see if we are the right fit for each other:

1. Do you have over £500,000 in pensions or savings (£650,000 for pension transfers)?
2. Do you value personal service and an equal relationship between us both?
3. Do you want a 12-month, risk-free, money-back service guarantee, so you have peace of mind with your investments?

When you've answered YES to all 3, we'd love to help you along your financial journey. It's now just one small step away. Simply get in touch today.

Sam Instone
CEO & Founder, AES

CLICK HERE TO TALK TO US TODAY

AES WEALTH

hello@aesinternational.com
www.aesinternational.com

RISKS

Investment involves risks. The investment return and principal value of an investment may fluctuate so that an investment, when redeemed, may be worth more or less than the capital invested. Past performance is not a guarantee of future results. There is no guarantee strategies will be successful.