MULBERRY BOW

THE BOW BLOG

Safe As Houses; Shares Make Rational Sense, But Property Offers Emotional Comfort

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The study of long-term investment performance usually focusses on shares, bonds and cash. This isn't particularly surprising as publications such as the Barclays Equity-Gilt Study and Credit Suisse's Global Investment Returns Yearbook ensure the information readily available.

It's different for 'institutional' investors like pension funds, but for most private clients around the world, such investments represent a small part of our total net wealth, especially earlier in their lives. Even among the 'super-rich', the aforementioned asset classes only account for c.25% of their total assets. Property, including an individual's main residence, represents almost 40%[1]. Business enterprises represent another 25% whilst some diversify further and hold significant investments in art, classic cars or wine.

There are regional difference of course. In the US, house prices have tended to lag shares and investing in the stock market is the norm; Credit Suisse estimates that 77% of all wealth is held in listed securities. In the biggest 'emerging market', China, investors have 45% of wealth in such securities. Back home in Blighty, we split the two pretty much equally with 56% in investments and 44% in property, mainly our homes.[1]

It is well known that diversification is a key principle of successful investing and the argument to do so is well justified. However, how strong is the argument for owning property beyond what fits your personal use?

Over the long-term (10+ years) overwhelming evidence supports that we are right to invest and allocate a larger proportion of our wealth to financial assets. Simply put, an investment of £100,000 in the UK stock market in 1900 would have grown to £566,000 by the end of 2017; an impressive return of 466%. And that's even after accounting for inflation.[1]

Property, however, has also done well, but not as well, particularly if we aren't 'wise in hindsight'. In America, for example, house prices have only just about held their real value and not done much more than that. Interestingly, wine and classic cars, the so-called passion investments, have also done better than bricks and mortar (art, in aggregate, has done less well) over the period.

Yet, despite such figures, property is still the most significant asset class for most people, not least because you can't live in a share certificate; global residential housing is worth a staggering $170trn, which is exactly the same value as all the outstanding bonds ($100trn) and equities ($70trn) combined.[1]

The Baby Boomer generation in the UK and Australia has come to view property as a money-making machine and this drives much of the hunger their children have in attempting to get on the ladder. It is justified to say that both (the latter through inheritance) will do well out of property prices rising, but this appreciation in property is a relatively new phenomenon. Up until the 1950s, homes just about kept pace with inflation and nothing more.

With the advent of stricter planning regulations subsequently pushing up the price of land in the latter part of the 20th century coupled with loose monetary policy and the availability of cheap credit has resulted in a boost in the price of all assets, and of course houses tend to be purchased with significant amounts of borrowed money, making them a 'leveraged play' on this story.

Comparing the returns from both house and equities is not easy. The indices used to measure house price changes have a limited impact on the actual experience of being a homeowner. To be more accurate such indices would also need to include a historical bias towards big cities as well account for the expensive maintenance costs associated with running a home, such as utilities or renovation work. A further adjustment would need to be included to account for rent, either for buy to let properties or imputed for home ownership. The final adjustment would be to include risk, not least liquidity risk.

People often say 'safe as houses', but is this true? Let's remind ourselves that in the US, real house prices fell by 36% between 2005 and 2012[1] and are still well below where they could be and many of our clients remember UK interest rates hitting 15% as recently as the early 90s.

Charts and statistics can tell you all sorts of information but what they can't do is account for are the psychological returns being a homeowner provides. That said, shares have long proved their outsized returns for the risk of short-term volatility and as such should dominate any long-term strategy.

Our view? It depends on client circumstances of course, but for many of our clients it's about striking a balance and also understanding why you own additional properties to your home, is it for enjoyment or as an investment, or perhaps it's a case of 'liability matching' for when your children hit their early 20s and need somewhere to live? These might seem obvious questions, but so many clients we meet own properties simply because they don't understand/aren't emotionally comfortable with other assets, which is a great shame as it is likely to lead to reduced diversification and greater risk, for the same or lower return over the long-term.

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[1]*Tom Stevenson, Investment Director at Fidelity International, writing in The Telegraph June 2018*