Re: Investment Group meeting, Sep 12, Collingwood Library, 9:30 to 11:30

Please look over the following article and make notes for our discussion on the 12th - and if you've had experience with either or both of RE and ETF's investing, be prepared to share what you learned.

Looking forward to a lively and informative meeting!

Cheers – Rod

Naomi Dobey, a third-year finance student at McGill University and a summer intern with The Mary Hagerman Group, also contributed to this column.

The Canadian real estate market has dodged predictions of a crash for more than a decade, with home prices seemingly rising every year. As a result, many people may believe that real estate is a better long-term investment that the stock market or a broad-based ETF.

However, data shows that investing in a broad stock market index or ETF can potentially outperform real estate over time due to several factors such as diversification, liquidity, historical performance, cost efficiency and market access. (This article analyzes real estate as an investment property and excludes the tax and other benefits of purchasing a principal residence.)

According to an analysis from RBC Global Asset Management, the S&P/TSX composite total return index outperformed several major Canadian real estate markets, as well as the national average, over the 25 years from Jan. 1, 1997 to Dec. 31, 2021. The same index also outperformed the national average home price on a 1-year, 3-year, 5-year and 10-year basis as of Dec. 31, 2021.

Of course, past performance does not guarantee future returns, and it is important to consider individual circumstances and market conditions. But why does the perception persist that real estate is a better investment?

This can come down to recency bias and familiarity – real estate is often in the news and clients are better able to understand a tangible asset. However, with education from their advisors, clients can make a more informed investment decision.

For example, while real estate can be less volatile than stock markets in general, investing in a broad market index diversifies across the entire market. Real estate typically ties up a significant portion of capital in a single property, which can expose investors to localized risks such as changes in the housing market or neighbourhood conditions.

Furthermore, investing in a broad-market ETF means much more liquidity than real estate, since you can buy or sell your units at any time during market hours. This allows you to quickly adjust your investment portfolio based on changing market conditions, economic outlook or personal financial needs. In contrast, selling a property typically takes time and effort, and the proceeds may not be immediately available for reinvestment. Also, mortgaging or re-mortgaging real estate to access capital is a lengthy process.

Depending on the type of ETF, internal management fees can be quite low. For example, State Street's SPY ETF provides exposure to the S&P 500 for 0.0945%, and BMO's ZSP has a management expense ratio (MER) of 0.09%. Expenses related to investing in real estate typically include such things as property taxes, insurance, maintenance and landscaping.

Furthermore, real estate is often referred to as "sweat equity", since owners need to be prepared to maintain the building they own or outsource the work to a contractor. Also, investing in real estate usually requires a significant upfront capital outlay through a down payment or mortgage, while index investing allows for more flexible purchase options.

Investing in a single property limits your exposure to a specific location and the performance of the local real estate market. ETFs offer diversification across industries and geographic areas that can enhance potential returns and reduce risk. Indeed, investing in a broad market index provides exposure to a wide range of companies, including both established and emerging businesses. The barrier of entry for this investing is lower than for most real estate investments.

This is not to say that real estate doesn't have a place in a well-diversified investment portfolio. It is recommended to allocate between 5% and 10% of total investments in real estate, not including a primary residence.

For clients that are concerned with the expense and effort in owning a physical property, they can consider REIT ETFs such as BMO's ZRE and iShare's XRE, both of which have an MER of 0.61%. These ETFs can be a good way to gain diversified real estate exposure at a relatively low cost.