

How the real estate market mirrors the stock market



The Sensex has always been a barometer of the country's general economic 'mood'. The BSE realty index was launched in 2007 in recognition of the growing significance of the real estate sector in the Indian economy. When launched, it consisted of 11 real estate scrips which represented approximately 95% of the capitalisation of real estate companies in the Sensex. Today it consists of 15 scrips.

The BSE Sensex is currently at 19400 levels, while the realty index is at 2400 levels. This is in stark contrast to January 2008, when the Sensex was at 21000 and the BSE Realty Index was at 13400.

Both markets reflect the economy of a country



While the Sensex is currently down 7% from its peak, the realty index is down 82%. However, at the same time, if one had bought an apartment on the periphery of any of the key Indian cities, its value would have risen by anything from 5-10 %.

The real estate market is similar to the stock market, with its peaks and troughs always seeming to make perfect sense in retrospect. Also, both markets reflect the economy of a country and offer good investment opportunities. However, the risks must be understood along with the opportunities.

The profit margin inherent in stock investments has always been higher when compared to other asset classes. Stock market investments offer advantages such as liquidity and flexibility, which real estate does not. Stocks also offer growth rates that the real estate market can rarely match.

Stocks are relatively easier to acquire



Stocks are also relatively easier to acquire and require lower investment to buy, sell and hold as compared to real estate, which has high transaction and other related costs such as broker commissions, legal fees, property taxes, insurance and maintenance costs.

It is also far easier to track stock prices, which are centrally traded, than real estate prices, which change hands in individualized and often opaque transactions. Real estate also requires active management and monitoring. For most of us, owning an apartment or house is not a matter of owning a financial asset but of settling down and homemaking.

Nevertheless, home ownership is also the most primary form of real estate investment. And unlike stocks, real estate is a tangible asset that provides for greater psychological comfort, security and satisfaction. Also, the return on investment for real estate is reasonably consistent because of the phenomenon of property appreciation.

Stock markets are far less predictable



Stock markets are far less predictable, as evidenced by various 'Black Mondays' or 'Black Fridays' on which the Sensex tanked by between 8% and 12% of its value in a single day.

Though real estate values have certainly slumped in some cities in the past few decades, no real estate market ever dropped by 10% in one day, week or even month. In fact, the Indian real estate slump of 2008 has taken considerable amount of time to bottom out in most markets. Even if the value of a home drops, the chances of the homeowner abandoning for another option are negligible.

Factors like the cost of moving, emotional attachment to the location and other ties to the locality such as children's school, relatives, neighbours, friends in the vicinity and proximity to the workplace invariably discourage the average home-owner from moving away.

Real estate values generally go up in the long run



This is in sharp contrast to the stock market, where an investor may decide to trade in his entire stock portfolio in a matter of minutes with just a click. If one buys property and holds it for the long term, one isn't likely to lose. Real estate values generally go up in the long run.

Fundamentally, the real estate market is a lot less volatile than the stock market. Real estate investment also offers benefits such as tax deductions on home loan interest, continuous capital appreciation and greater stability.

Property historically appreciates in value without many violent downswings. It can be purchased on a down payment of 1/5th of its total value, and the remainder can be financed by a bank. Financial institutions will lend money to a real estate buyer more easily than to stock market investors. Realty prices tend to sink far slower than they rise since property owners are more hesitant to sell in a downturn.

Property investment also helps in diversification



Property investment also helps in diversification, hedging inflation and yield enrichment. Realty stocks allow investors to participate in large-scale real estate projects without having to inject massive amounts into non-liquid investments. Moreover, the investor does not have to actively manage any property.

For someone looking for a passive real estate investment with the added benefits of portfolio diversification and liquidity, an investment into a realty stock is certainly a good option. However, investors need to ensure that the company is professionally managed and that investment decisions taken with circumspection.

Obviously, there is a direct link between the stock and real estate markets. In an escalating stock market, the profits find real estate the best place for reinvesting funds, leading to escalation in property prices.

Both allow investors to participate in long-term appreciation of values



By the same coin, the gradual collapse of the stock market reflects visibly on the real estate market. Both markets represent the two major asset classes for growth investing. Both allow investors to participate in long-term appreciation of values.

Both asset classes should be included in a balanced investment portfolio depending on the risk-return profile and in-depth understanding of the particular asset class.