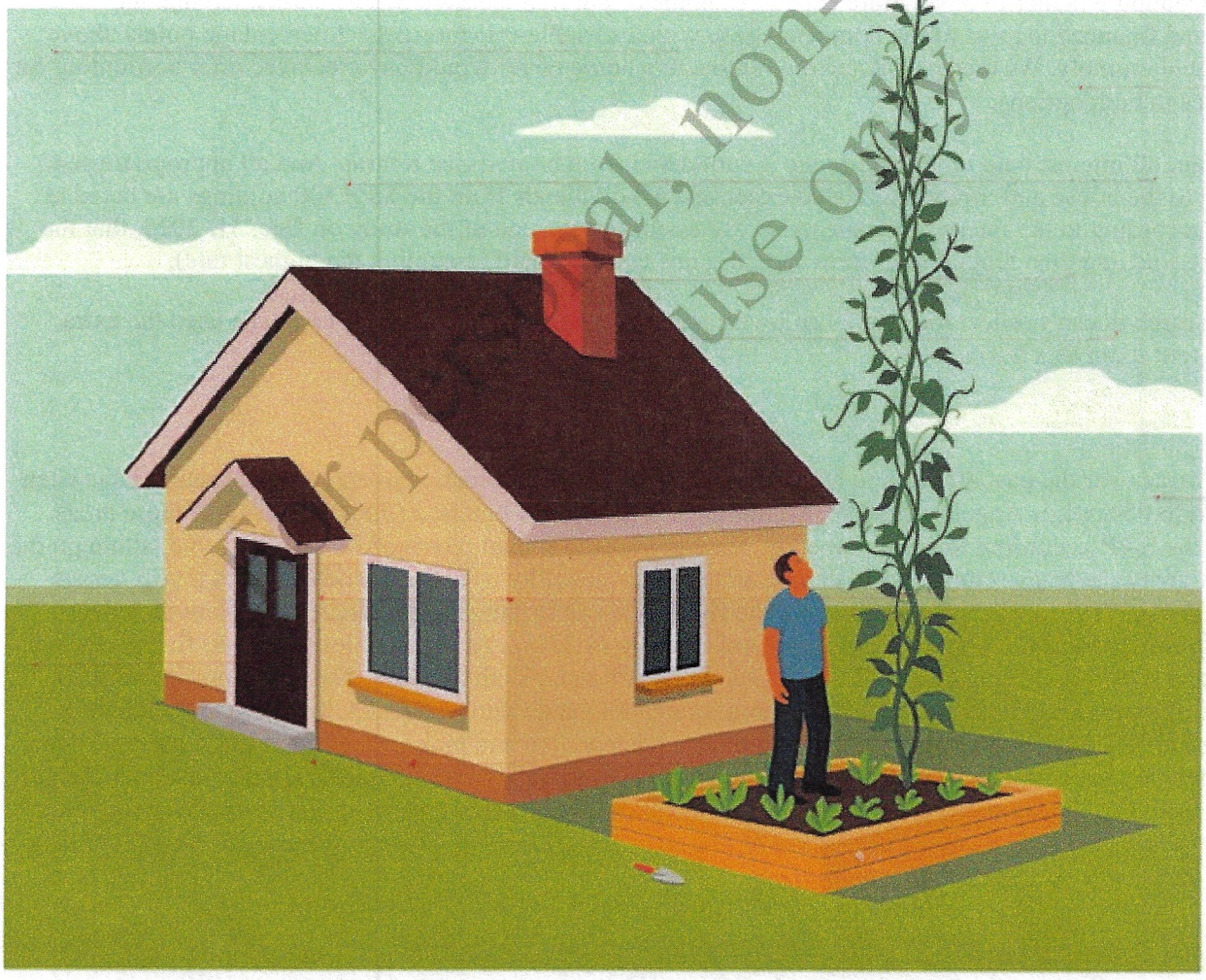
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Your House vs. Stocks: Which Investment Has Performed Best?

The S&P 500's returns over the past 40 years come out ahead, research finds

BY DEREK HORSTMEYER

IS IT BETTER to put more money down to buy a bigger house or invest in the stock market? That is the question my research assistants (Nandishwar Babu, Ana Manuel and Colby Rood) and I asked ourselves after a multidecade run-up in both stock and home prices. And we found that even in the best-performing state and local markets over the past 40 years, it would have been better on a posttax basis to allocate any extra dollars into the stock market and just sit on it in--stead of buying a larger home.

Our methodology

To study this issue, we pulled average housing-price data at the state and metropolitan-area levels going back to 1985 from the Federal Housing Finance Agency. From this database we looked at most states and the top 30 metropolitan areas. (We excluded Connecticut, Delaware, Hawaii, Massachusetts, New Jersey and Rhode Island from the state-level research as they lacked consistent or sufficient data over the period.)

Next, we considered a hypothetical home buyer in 1985 who was planning to purchase a $100,000 house but had some extra money to spend and was debating whether to buy a more expensive home or put it in the S&P 500. We assumed that the individual put 20% down and financed the rest of the home purchase with a variable-rate mortgage 2 percentage points above the Treasury bill rate, updated monthly. We then calculated the returns this home buyer would have received after accounting for federal, state and local taxes in both options.

To make the comparison fair, all interest paid on the mortgage is subtracted from home-price returns. And all appropriate state and local taxes are applied to the house and mortgage-related expenses. All dividends from the S&P 500 holdings are taxed at the state and federal level according to tax rates at the time. Also, we assume at the end of the study on Dec. 31, 2025, that the home and the S&P fund are sold and then federal long-term capital-gains tax is applied (assuming the highest rate).

One point of note: This research doesn't reflect the returns an investor-buyer would have received if he or she used the extra money to buy a home and rent it out as a business.

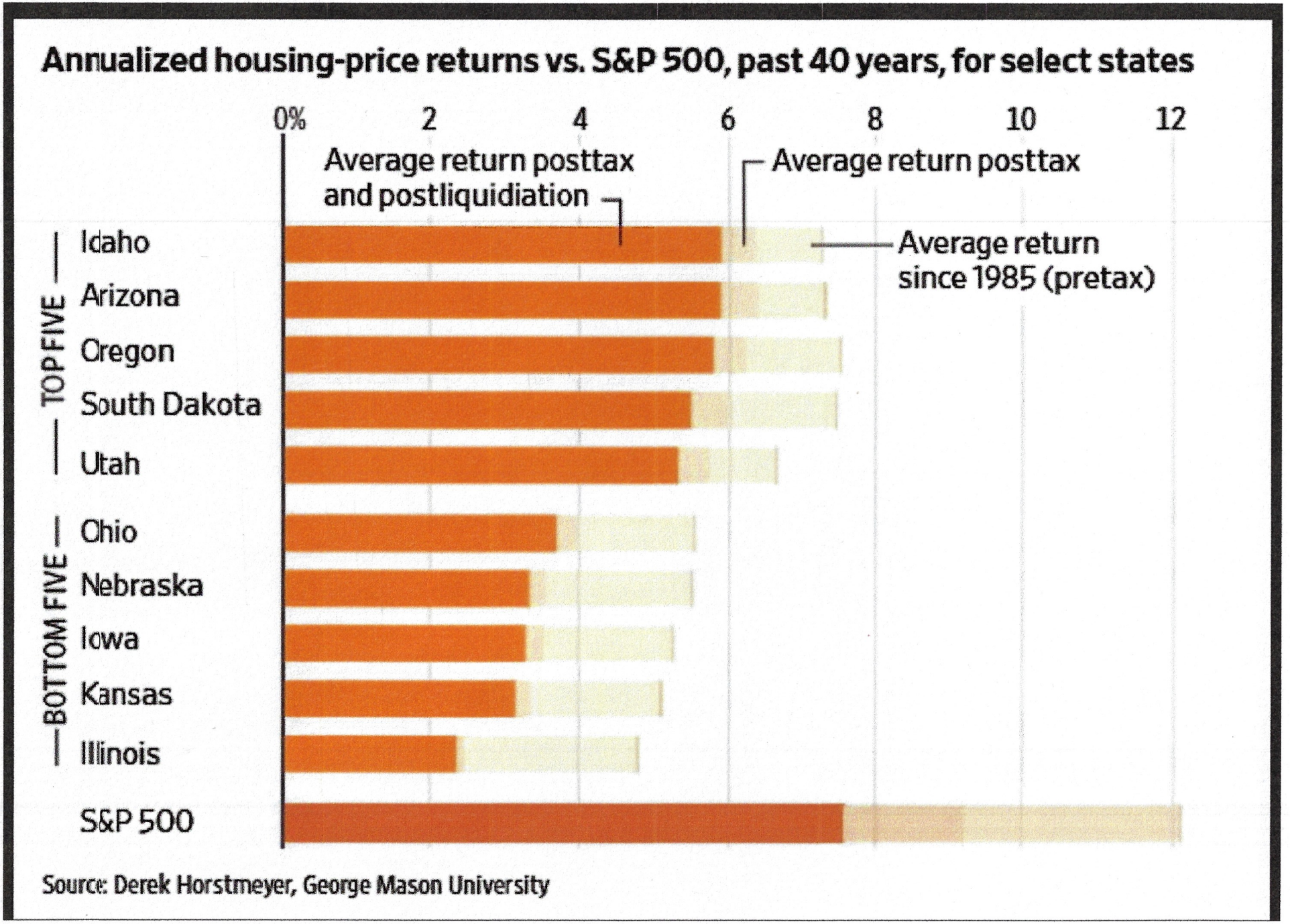
Our findings

The top five metropolitan areas over the past 40 years in terms of a posttax and postliquidation average annual return have been Seattle (6.22%), San Diego (6.05%), Los Angeles (5.98%), Miami (5.91%) and San Francisco (5.80%). Yet all of these areas have still underperformed the S&P, according to our parameters, with an average annual return of 7.57%. That said, although the S&P 500 did come in with greater average returns, it did demonstrate higher volatility over the period— 16.5% a year versus 9% a year for the average housing return. On the opposite end, the five worst-performing metropolitan areas were St. Louis (3.88%), Houston (4.04%), Dallas (4.22%), Cincinnati (4.22%) and Chicago (4.22%).. At the state level, the top five performers were Idaho (5.90%), Arizona (5.89%), Oregon (5.79%), South Dakota (5.50%) and Utah (5.33%). The five worst-performing states were Illinois (2.36%), Kansas (3.13%), Iowa (3.27%), Nebraska (3.31%) and Ohio (3.69%). Ultimately, the value of a home goes beyond the bottom-line price appreciation in that you have a place to live and make memories. And sometimes there isn't much choice, say, when you have to relocate for work or buy a bigger home for a growing family. But the results highlight that home-price returns in even the hottest metro areas across the U.S. couldn't match the stock market over the long run. *Derek Horstmeyer is a professor of finance and director of the Future of Finance Lab at Costello College of Business, George Mason University, in Fairfax, Va. He can be reached at reports@wsj.com.*

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Annualized housing-price returns vs. S&P 500, past 40 years, for select states
0%
2
4
6
8
10
12
Average return posttax and postliquidiation
Average return posttax
Average return since 1985 (pretax)
TOP FIVE
Idaho
Arizona
Oregon
South Dakota
Utah
BOTTOM FIVE
Ohio
Nebraska
Iowa
Kansas
Illinois
S&P 500
Source: Derek Horstmeyer, George Mason University