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Should You Invest in the Stock Market or Real Estate?

In weighing investment properties vs. stocks, it's important to consider the pros and cons.

You're standing at the crossroad of an important investment decision, torn between the allure of the stock market and the tangible promise of a real-estate investment property. But which investment is better for you?

Owning property is often viewed as a major tenet of the American dream: a sign of financial success. But real estate is sometimes viewed as more of a younger person's game. Gen Z and Millennials (ages 21-43) tend to view real estate as the ultimate investment, while their older counterparts (ages 44+) gravitate toward stocks as the smartest path to wealth.[1]

Both stocks and real estate have advantages and drawbacks. Let's take a look.

Key Points

- Real estate, which can be financed with borrowed funds, has historically increased in value over time. But property maintenance, taxes, and insurance can be expensive.
- Stocks have traditionally offered higher long-term returns than real estate. Mutual funds, ETFs, and retirement accounts offer professional management. But markets can be volatile, especially in the short run.
- Real-estate investment trusts (REITS) offer a way to invest in both stocks and properties. But REITS are sensitive to changes in interest rates and are sometimes vulnerable to property-specific risks.

Potential Advantages of Real Estate

Real-estate properties have historically increased in value over time. For example, consider the growth from 1970 to now; then, the average price of a home was $27,000.[2] That same investment property today would fetch at least $500,000[2] based on the average housing-inflation rate since 1970—and possibly much more in some hotter-than-average real-estate markets. To put this into perspective, if a 25-year-old had made this investment in 1970, this now 54-year-old investment could potentially contribute to a relatively generous retirement nest egg if the property were sold.

Owning real estate also allows investors to make use of debt since a small downpayment can fund the rest of the property's costs. Qualified homeowners can deduct mortgage interest on up to $750,000 in mortgage debt. Additionally, real estate is a physical asset with intrinsic value, ensuring it will retain some value even during severe financial downturns.

Potential Disadvantages of Real Estate

The average price of a home in 2024 is $363,438.[2] While it's possible to buy a property with as little as 3.5% down, it can be much more difficult for potential buyers to come up with the 20% downpayment necessary to avoid private mortgage insurance, which significantly increases the monthly payment amount.

Additionally, it may be difficult for many 25-year-olds to spare the time and attention needed to maintain an investment property while they're just beginning their careers—not to mention the significant expenses associated with hiring property managers and paying for property taxes, insurance, repairs, and renovations. These costs have also escalated since 2022 due to higher inflation.

Real-estate investors also must consider the time and resources needed for evaluating new properties, tenant screening, addressing tenants' questions and concerns, and maintaining a property. Finally, there's the issue of limited liquidity; It may take months to sell a house or other investment property, particularly in a slack housing market.

While equities and real estate are both considered successful long-term investments, stocks have historically held a clear edge.

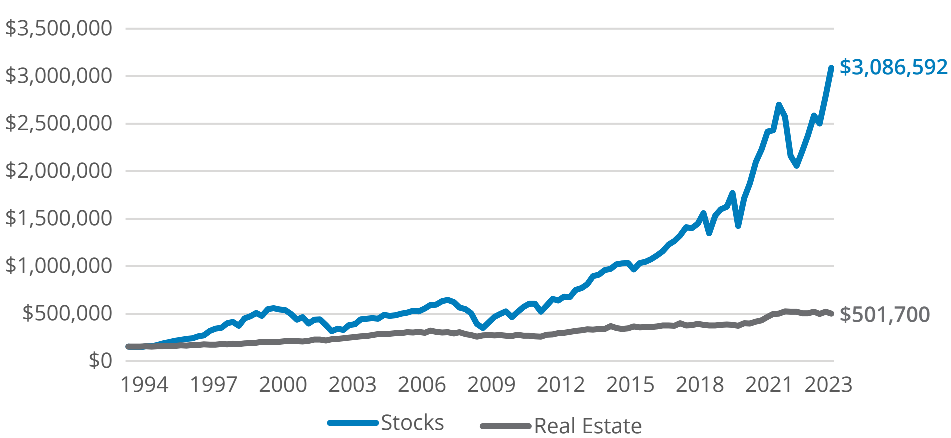
Potential Advantages of the Stock Market

Alternatively, the stock market offers another avenue for investment. A young adult can start with as little as a few thousand dollars and potentially turn it to hundreds, thousands, or even millions of dollars if they invest consistently over a long period of time regardless of market conditions.

The primary effort required is choosing which companies to invest in and monitoring them on an ongoing basis. To help mitigate some of those challenges, an investor may also consider purchasing shares in mutual funds or exchange-traded funds (ETFs), which require less responsibility than direct ownership and can offer a diversified portfolio. Fees vary but are generally lower than real-estate fees.

While equities and real estate are both considered successful long-term investments, stocks have historically held a clear edge. As **FIGURE 1** shows, a real-estate investor who paid $153,600 for a property in 1994[2] (the average price at the time) would have seen its value grow to $501,700 in 2024. But if the same amount were invested in the S&P 500 Index in 1994, it would have grown to more than $3 million over the next 30 years.

FIGURE 1
Stocks Have Significantly Outpaced Real Estate the Past 30 Years
Growth of $153,600 in Stocks vs. Real Estate (1994-2024)



As of 3/31/24. **Past performance does not guarantee future results**. Indices are unmanaged and not available for direct investment. Stocks are represented by the S&P 500 Index, a market capitalization-weighted price index composed of 500 widely held common stocks. Home values are represented by the Federal Reserve Economic Data (FRED) housing database maintained by the St. Louis Federal Reserve. Source: Morningstar and Federal Reserve Bank of St. Louis.

Furthermore, investing shares through accounts such a 401(k) or individual retirement account (IRA) allows for tax-deferred or tax-free growth. This tax efficiency can enhance long-term returns and provides valuable advantages.

Potential Disadvantages of the Stock Market

However, stock returns can be volatile due to several factors. Economic events such as recessions, interest-rate changes, and geopolitical tensions can significantly impact stock prices.

Moreover, company-specific performance, including financial health and earnings reports, also contributes to unpredictability. Staying abreast of companies' financial results and trends impacting their industries is essential, but it's time-consuming.

What If You Could Have the Potential Benefits of Both?

Sometimes you don't have to choose. Real-estate investment trusts (REITs) offer a blend of benefits between real estate and stocks. They provide exposure to real estate without the hassle of property upkeep and offer liquidity similar to stocks, allowing investors to quickly exit their investments if necessary. Additionally, driven by dividends, REITS have outperformed stocks over the past 20, 25, and 50 years, although stocks have outperformed over the past decade.[3]

On the other hand, drawbacks of REITs include high sensitivity to changes in interest rates, their dividends are often taxed at higher rates compared to other investments, and REIT values are influenced by property-specific risks.[4]

While real estate offers stability and intrinsic value, the stock market has provided greater accessibility and returns. Ultimately, the choice depends on your individual preferences, risk tolerance, and financial goals. It's also important to note that a well-diversified portfolio may include a mix of asset classes, including real state, stocks, and REITs.

Talk to your financial professional about which type of investment is appropriate based on your financial goals.

[1] Bank of America Institute, "2024 Bank of America Private Bank Study of Wealthy Americans," 6/18/24.

[2] Federal Reserve Economic Data (FRED) housing statistics, Federal Reserve Bank of St. Louis, 4/1/24.

[3] The Motley Fool, "REITs vs. Stocks: Which Investment Is Right for You?" Matthew DiLallo, 3/4/24.

[4] SoFi, "Pros & Cons of Investing in REITs," Dunleavey, MP 2/27/24.