Weekly Economic Newsletter

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ECONOMIC COMMENTARY

- By Francois Stofberg

New research: which asset class is best?

An amazing bit of economic research was published in December 2017; the new historic time series considers the real return on investment (ROI) of various assets (equities, bonds, housing, etc.) for 16 developed economies. Using this dataset, that starts in 1870, many of today's tough economic questions can be answered with more certainty. Questions like: Which asset class yields the greatest returns? Are global interest rates really low? Are investment returns significantly contributing to inequality?

It was interesting to note that, although both assets came in at an annual rate just shy of 7%, housing returns outperformed equity returns. At first, this runs counter to much of the current debate that equity returns are superior in the long term. However, these high returns were achieved by rent-yielding property, not from buying a family home and simply enjoying the long-term capital gains thereof. In fact, more than half of the return earned by "housing" came from rent. What this therefore suggests is that a well-diversified portfolio of rent-yielding property should deliver substantial returns in the long term. Before we are too quick to copy-paste these findings in the South African (SA) context, just remember that SA's equity market outperformed all 16 of the developed markets over the very long term. It was also evident from the research that the returns from equity, as we have come to believe, are much more volatile than other asset classes.

Then, are interest rates actually low? The data seems to suggest that the decrease in global interest rates over the last couple of decades, is not too much to be worried about. In fact, the high-interest rates of the 1980's were actually an anomaly – for those old enough to remember when the prime interest rate in SA was around 25%. Current interest rate levels are much more "normal" than the rates global central banks seem to be targeting. It turns out, it's actually quite common to see negative real interest rates (shocking, I know). What this further implies, is that today's low-interest rates do not point towards a global downturn or stagnation. Furthermore, if low rates are common it will likely be easier to manage high government debt levels. By implication, this suggests that debt can be used more aggressively by governments in economic downturns to boost the economy back to healthier levels.

A final observation that was made by The Economist (a publisher) on this dataset, is that GDP growth does lack investment growth quite substantially. This supports Thomas Piketty's grand theory on inequality, that the stock of a country's wealth (which is held by a relative minority) grows as a percentage of GDP over time. By implication, the rich will be getting richer. Real wealth in these developed economies has grown annually at about 6%, compared to GDP's 3% annual performance. At face value, it doesn't seem like much, but a 3% difference over 145 years makes for a huge gap.