CANACCORD Genuity
Wealth Management

January 21, 2018

Weekly Note

To us there are no foreign markets.™

Investment Team

Robert Jukes
Global Strategist
T: 44.207.523.4594
robert.jukes@canaccord.com

Michael Quach
Senior Research Analyst
T: 44.207.523.4528
michael.quach@canaccord.com

Ian LeCroy
Research Analyst
T: 416.867.2643
ian.lecroy@canaccord.com

Back to Life

At the end of last year, the Federal Reserve Bank of San Francisco published a paper* on historical rates of return of major assets. The particularly interesting aspect of this paper was the exhaustive lengths that team went through to assemble a truly impressive database of returns across developed nations stretching back almost 150 years. After the extraordinary returns seen last year from US equities, we think it is worthwhile to take a moment and recalibrate expectations around what might be considered "more normal" in a long-run historical context.

It turns out that the long-run average equity return has been just over 10% since 1870 across developed nations (Figure 1), and it is something closer to that which we should be expecting this year, rather than a repeat of the 22% returns seen last year.

More than that, however, the report shows that the proportion of investible assets across developed countries is roughly 25% in equities (Figure 3). In the US, however, that proportion is much higher at roughly 40%. The equity gains seen last year will therefore likely fuel consumption going forward disproportionately in the US rather than other developed nations.

Perhaps the other notable deviation from the normal is the UK, where the proportion of investible assets held in real estate is 27% compared to the average which is just 20%. The UK real estate market has been held back significantly since BREXIT, and that will no doubt be yet another factor holding back the UK consumer as wealth effects remain muted.

Figure 1: Long run returns of major asset classes, 1870-2015

	Real returns		Nominal returns	
	Average (pa)	Stdev	Average (pa)	Stdev
Bills	0.98	6.01	4.60	3.33
Bonds	2.50	10.74	6.10	8.91
Equity	6.89	21.94	10.75	22.78
Housing	7.05	9.98	11.06	10.70

Source: SF Federal Reserve, Canaccord Genuity Wealth Management

*"The Rate of Return on Everything, 1870-2015", November 2017

The report also shows that average returns from real estate and equities have been roughly similar, but equity volatility has been twice that of real estate (Figure 1). Part of the difference can be explained by the way in which the data has been collected - a more comparable method (year average returns for equities rather than year-end returns) would lower equity volatility by roughly one fifth. We suspect that real estate markets by their very nature also hide true price discovery on a real-time basis because transactions are so infrequent, and that is one reason why REITS are so much more volatile than real estate price indices.

Nevertheless, real estate investing seems to make sense for many households over and above equity investing for other practical reasons too. It is much easier to lever investment into real estate than equities, and there are obvious non-price utility gains from owning real estate, often combined with favourable tax treatments to gains from real estate (particularly if a primary residence).

In addition, the study by the San Francisco Federal Reserve noted another interesting comparison between equities and real estate, which has been the low level of co-variance or correlation between real estate investments across different countries as opposed to equities. For investors looking to reduce the correlation of returns within their portfolios, international real estate compares well in this report, and is something to which we plan to examine more closely in the future.

For now, we can't help but recognize how this year has started in much the same way as the last one ended. US equities are up more than 5% in the first few weeks of the year. As bullish as we are on the coordinated global growth outlook, we suggest that this pace of return can't last forever, and that investors should be recalibrating expectations back down towards longer-term averages.

Figure 2: Long run returns of major asset classes, post 1950

	Real returns		Nominal returns	
	Average (pa)	Stdev	Average (pa)	Stdev
Bills	0.87	3.43	5.40	4.04
Bonds	2.77	9.94	7.31	9.80
Equity	8.28	24.20	12.99	25.09
Housing	7.44	8.88	12.31	10.15

Source: SF Federal Reserve, Canaccord Genuity Wealth Management

Figure 3: Composition of investable assets by country

	Housing	Equity	Bonds	Bills	Deposits	Other Financials	Other Non-financials
France	23.2	28.0	5.1	1.5	10.4	11.9	19.8
Germany	22.2	24.2	5.6	0.2	14.0	17.3	16.4
Japan	10.9	13.4	13.1	1.5	18.9	12.9	29.4
UK	27.5	24.8	6.1	0.2	10.7	12.6	18.1
US	13.3	39.1	8.6	0.8	7.3	11.2	19.8
Average	**19.4**	**25.9**	**7.7**	**0.8**	**12.3**	**13.2**	**20.7**

Notes: Other financials comprise mainly of corporate bonds and asset-backed securities whilst Other non-financials comprise mainly of other buildings, machinery and equipment.
Source: SF Federal Reserve, Canaccord Genuity Wealth Management