Stock Market Returns vs Commercial Real Estate

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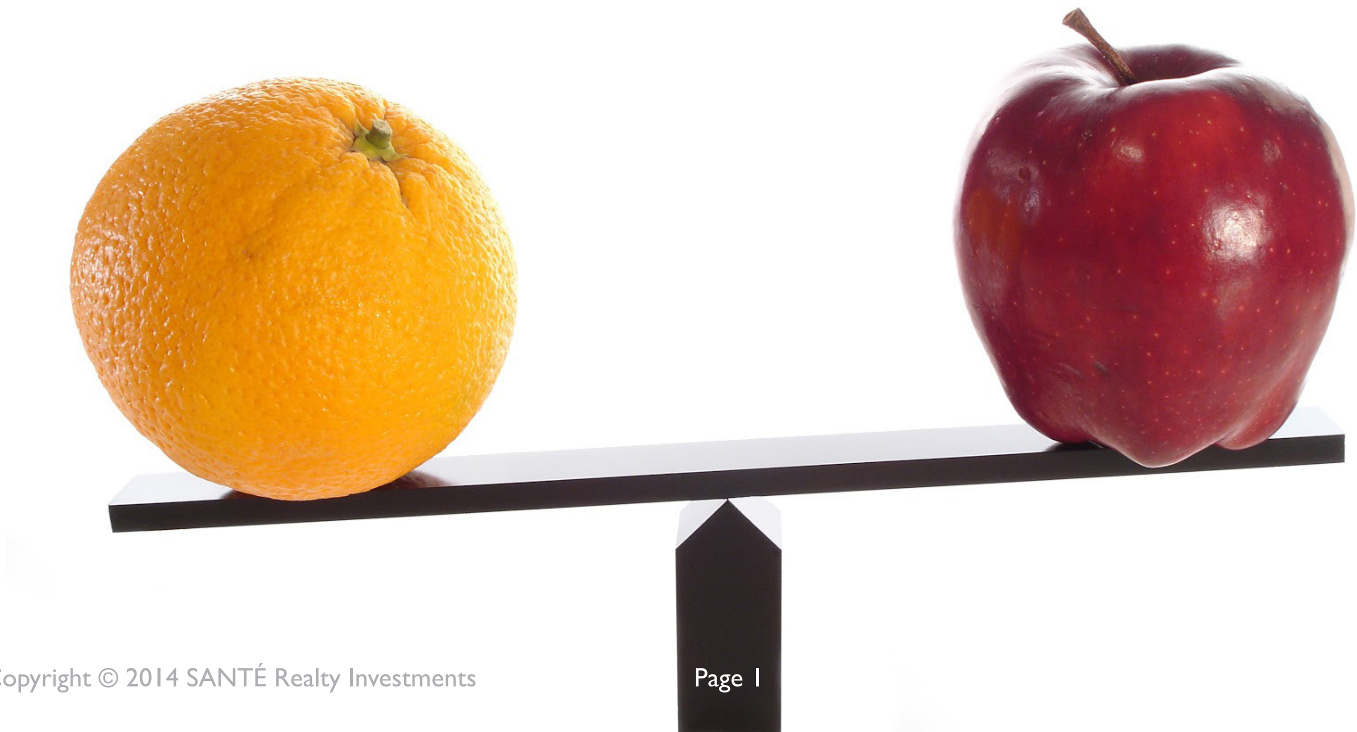
The Challenge: Comparing Investment Results



Taking an Objective Approach

Some stock market gurus suggest that your investment success is as simple as "Buying low and selling high." Even if it were that simple, what kind of stocks would you buy? Blue chips, REITs, corporate bonds, mutual funds, ETFs? On the other hand, if your choice is simply between buying stocks and buying commercial real estate, what would you do and how would you make your decision?

Comparing the investment merits of commercial real estate to common stocks is certainly a smart strategy for anyone facing a decision about where to invest capital. Despite the legal advice that "past performance should not be used as the basis for forecasting future results," many investors rely on past performance anyway.

But what do you think you would find if you analyzed how stocks have performed in comparison to commercial real estate over an extended period of time? An objective answer to this question is provided in the next section ("Supporting Evidence: Understanding the Real Rate of Return for Your Investments").

While real estate ownership represents tangible assets and common stock represents only partial equity ownership of a business enterprise, it is actually possible to make a fair comparison between the two.

One of the most practical approaches is to look at the overall total returns and historical performance on your investment over the full ownership period. This analysis should also include factors such as income, tax benefits and capital growth produced by your invested capital.

Two vital questions to ask yourself:

- Which is the best investment for you: Commercial Property or Common Stocks?
- If you decide to invest in commercial real estate, how will you proceed?

Supporting Evidence: Understanding the Real Rate of Return for Your Investments

Summarizing Stock Market Returns

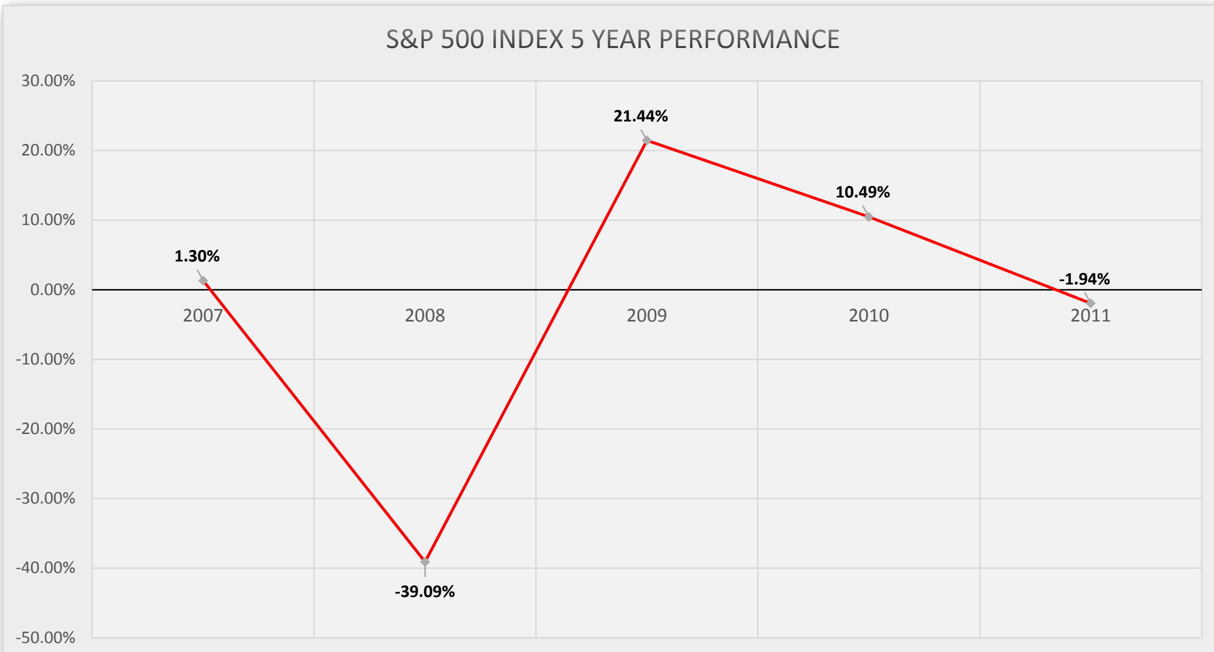
If you are looking for the promised answer to the question posed above about historical returns in the stock market: over the last 200 years, the annual inflation-adjusted return for stocks is 6.8%.

More recently, the performance of the S&P 500 over the last 85 years has produced an average of just less than 7% in real returns* when we account for average transactional fees (1%) and inflation (3%).

Year	*Real Annual Rate of Return	Year	*Real Annual Rate of Return	Year	*Real Annual Rate of Return	Year	*Real Annual Rate of Return
1928	38.10%	1950	25.61%	1972	14.04%	1994	-2.70%
1929	-11.94%	1951	18.77%	1973	-17.71%	1995	31.75%
1930	-28.10%	1952	13.46%	1974	-28.84%	1996	18.90%
1931	-46.07%	1953	-5.13%	1975	31.56%	1997	26.62%
1932	-12.27%	1954	46.51%	1976	18.91%	1998	23.24%
1933	44.03%	1955	27.33%	1977	-10.67%	1999	16.09%
1934	-5.11%	1956	3.17%	1978	2.28%	2000	-12.64%
1935	40.91%	1957	-14.01%	1979	13.81%	2001	-15.35%
1936	26.71%	1958	38.01%	1980	26.51%	2002	-25.07%
1937	-37.90%	1959	7.61%	1981	-8.49%	2003	23.31%
1938	24.15%	1960	-3.65%	1982	15.64%	2004	6.31%
1939	-5.02%	1961	21.61%	1983	17.48%	2005	0.69%
1940	-14.22%	1962	-12.43%	1984	1.93%	2006	11.04%
1941	-16.23%	1963	17.74%	1985	26.03%	2007	1.30%
1942	14.44%	1964	11.79%	1986	13.79%	2008	-39.09%
1943	20.10%	1965	7.94%	1987	1.61%	2009	21.44%
1944	14.31%	1966	-13.55%	1988	11.91%	2010	10.49%
1945	30.43%	1967	18.89%	1989	26.26%	2011	-1.94%
1946	-12.06%	1968	6.42%	1990	-6.91%	2012	7.25%
1947	1.02%	1969	-11.88%	1991	25.06%	2013	21.37%
1948	1.51%	1970	-0.55%	1992	3.23%	**Average**	**6.97%**
1949	13.61%	1971	9.69%	1993	5.60%		

A Closer Look at The S&P 500

Your stockbroker is likely to dismiss any factual data that produces an annualized return of under 7 percent for the stock market by talking about the need to focus on more recent stock market performance or more "representative" securities such as the S&P 500. Here is what the objective data would look like if a recent five-year period (2007 through 2011) is analyzed for the S&P 500 Index:



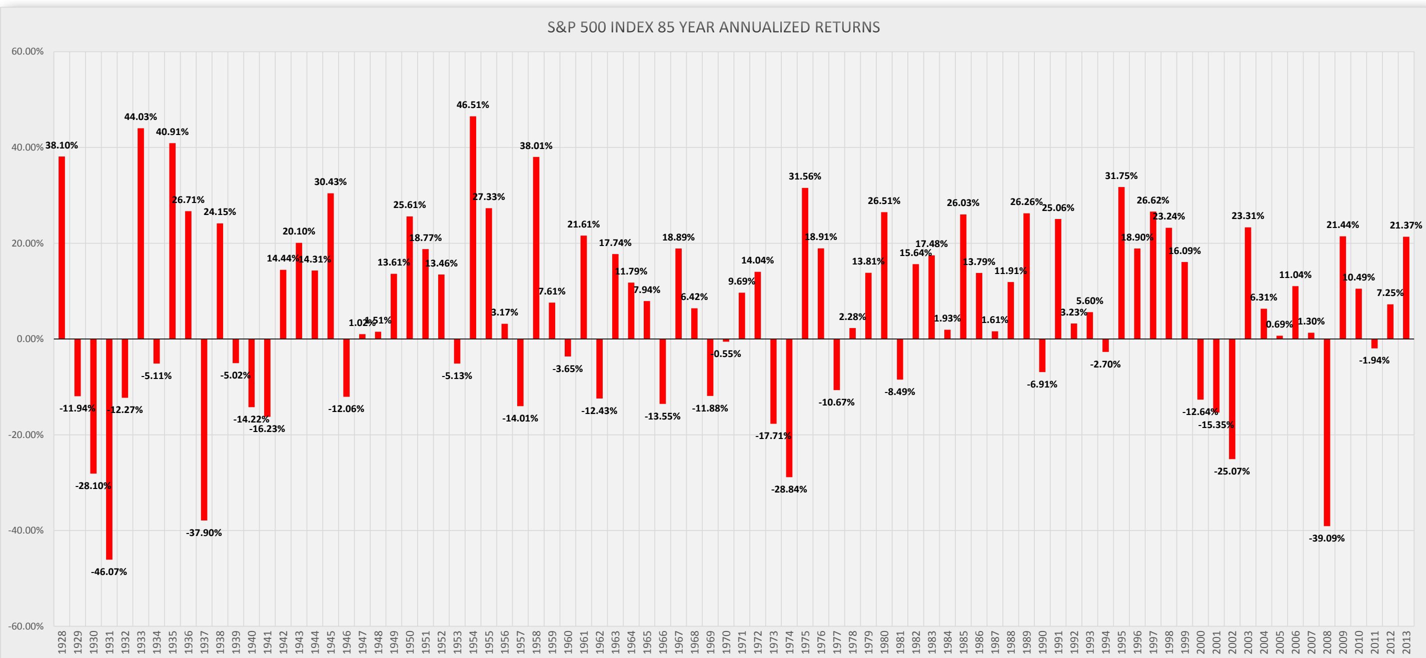
By using recent data that reflects the performance of the 500 major companies included in the S&P 500, your total return over this five-year period would have been 0.02% (annualized = minus 2.47%).

Does it get any better if you look at a longer period of recent results in the stock market? For an investor placing equal amounts in the stock market each year from 1992 to 2011, your compounded annualized return would have been just under 5.2%.

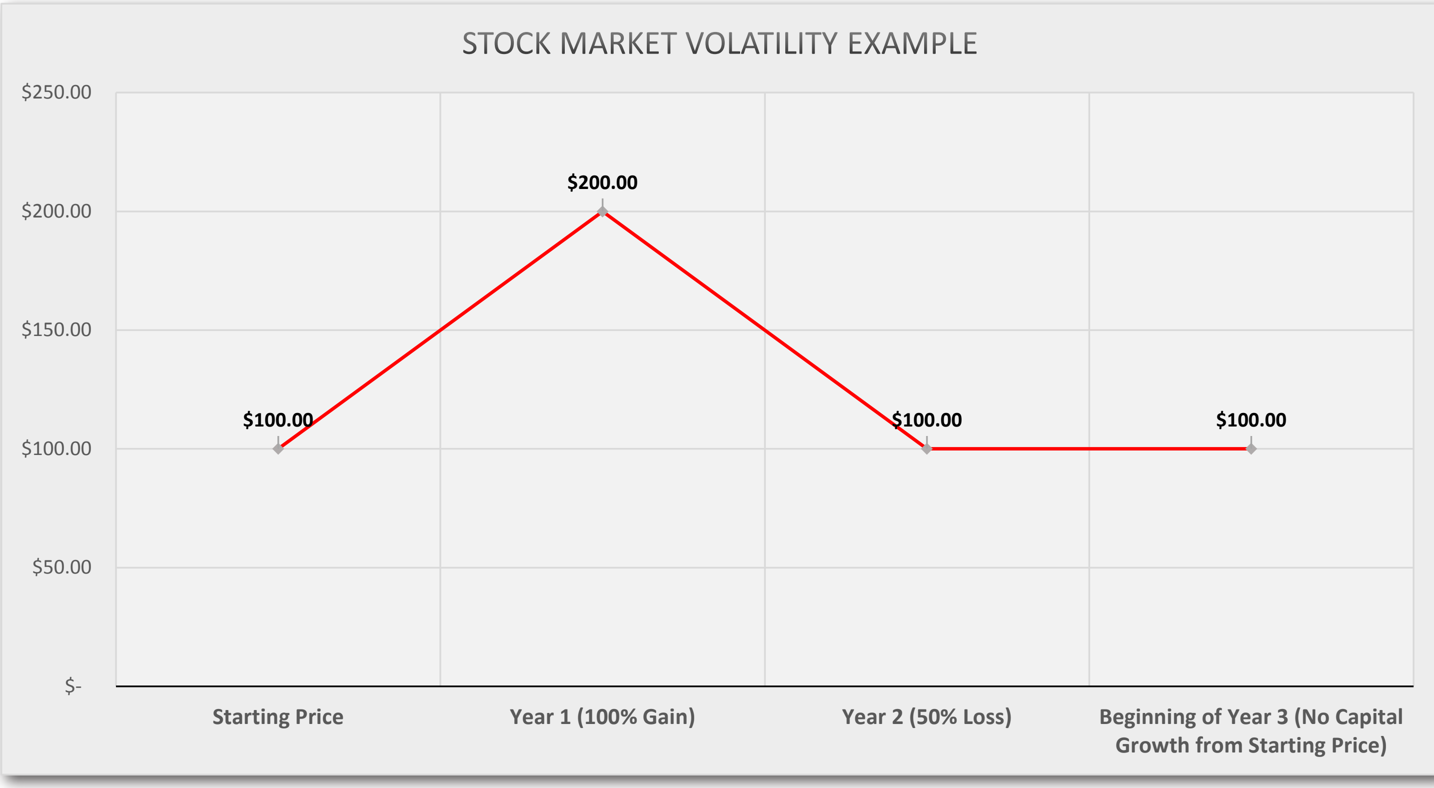
Stock Market Volatility

The stock market has a history of significant volatility. If you want a classic example of what this means in real terms, please refer to the five-year performance data shown above. Just read the numbers out loud (after rounding up or down to the nearest whole number) and you will have a textbook definition of volatility: 1%, -39%, 21%, 10% and 2%.

Once again, by looking at the last 85 years of the stock market we can clearly see a pattern of extremely volatile performance in the following graph:



Volatility is simply not your friend when your money is at risk. Liz Davidson ("Why Your Investment Returns Could Be Lower Than You Think") made a compelling case for the dangers of stock market volatility when she described two consecutive years with a 100% gain in one year followed by a 50% loss in the next year. The "average annual return" appears to be 25% by simply averaging the two, and you might assume that you will have $125 at the end of two years. In reality, you will have $100 and no capital growth at all.



Real Returns for Commercial Real Estate

As we've noted in the previous pages, the real rate of return for any investment must include more than capital appreciation. While determining your total returns with stocks is a simpler process that primarily includes adding dividend income and factoring in transactional fees and inflation, commercial real estate returns are ultimately the result of a wide range of variables.

With commercial real estate, your total return can include the following:

- Capital Growth
- Monthly Cash Flow
- Depreciation
- Tax Deductions
- Tax-Free Refinancing (a non-taxable event)
- Leveraged Income (producing additional positive cash flow with mortgage financing)

Your projected total return for commercial real estate will vary according to a number of combinations of the above factors. In one basic example, apartments typically produce higher occupancy rates than retail and industrial properties, but also generally consist of shorter tenant lease terms and require more administrative management.

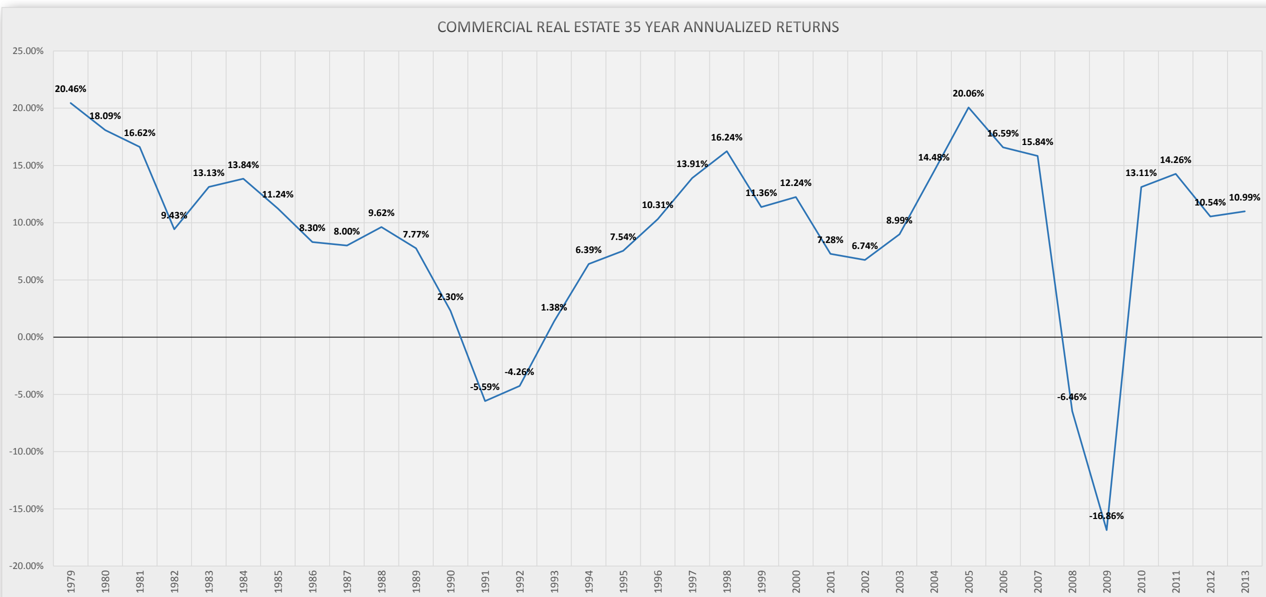
In addition to these types of relatively low level considerations, measuring overall returns for commercial real estate across the United States may seem to be an incredibly complex and abstract task. For example, the buying and selling of many thousands of unique properties across hundreds of diverse markets every month certainly presents an intriguing equation.

To properly simplify our analysis, we will refer to the most reliable and objective data for measuring U.S. commercial real estate activities: The National Council of Real Estate Investment Fiduciaries (NCREIF) Property Index (NPI). This index is the "composite total rate of return measure of investment performance of a very large pool of individual commercial real estate properties acquired in the private market for investment purposes only." While the NPI includes virtually everything classified as "commercial" property in the U.S., it is important to note that the most strategic commercial real estate investments will consistently generate much higher returns.

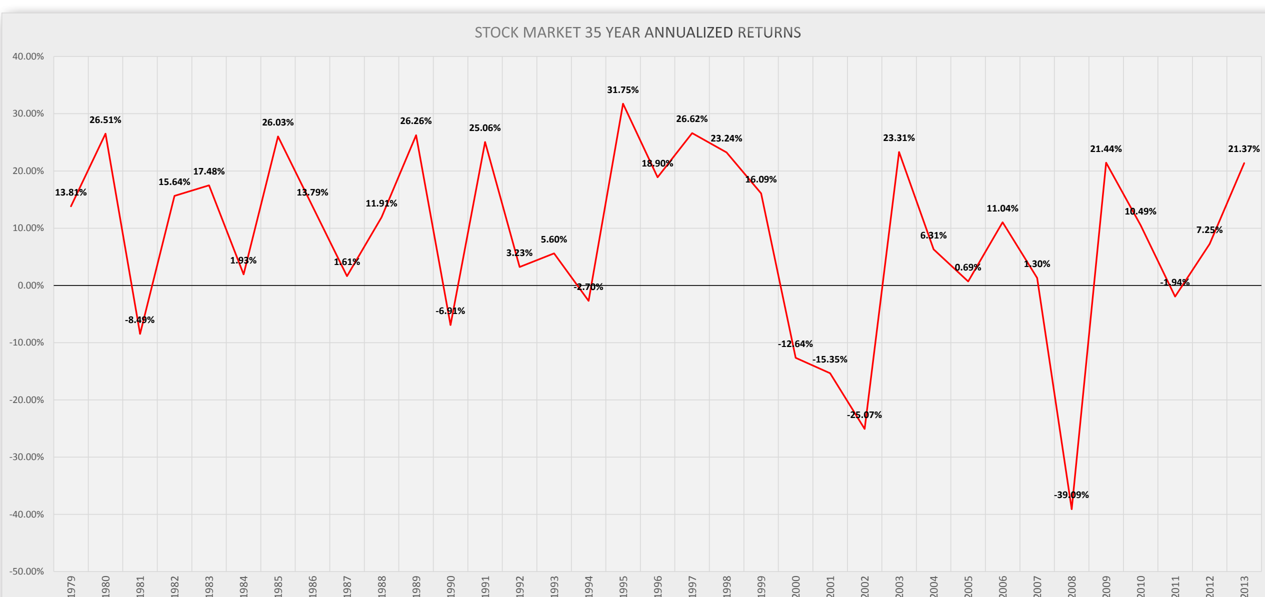
The Comparative Performance Numbers

Using similar ranges from our stock market return analysis, let's now take a look at the results we get from commercial real estate investments in comparison to stocks. As the NPI goes back only as far as 1978, we will directly compare the two sets of data only where they can can be aligned as such.

To begin with, the following chart represents annualized, inflation-adjusted rates of return for U.S. commercial real estate over the last 35 years:



Here, we see the same 35 year period for the S&P 500:



By evaluating the data from stock market and commercial real estate returns, we have the following numbers to compare the two:

<u>Compounded Annualized Inflation-Adjusted Returns</u>

35 Year (1979 - 2013)
Stocks: 8.12%
Commercial Real Estate: 9.25%

20 Year (1994 - 2013)
Stocks: 6.69%
Commercial Real Estate: 9.34%

10 Year (2004 - 2013)
Stocks: 4.88%
Commercial Real Estate: 8.63%

5 Year (2009 - 2013)
Stocks: 15.59%
Commercial Real Estate: 5.68%

In addition to these historic numbers, we can also take into account the performance of the compunded annualized stock market and commercial real estate returns so far in 2014 (as of the publication of this paper):

2014 YTD January 1 - July 31
Stocks: 0.44%
Commercial Real Estate: 12.17%

By recognizing the difference between the volatile nature of stocks and the stability of commercial real estate, investors are better equipped with the confidence needed to ensure their capital is going to produce ample returns. Besides simply outperforming stocks more often, our analysis also shows us how commercial real estate clearly provides a superior level of consistency and security in achieving real investment growth.

Additional Challenges: Risk vs Return and Your Investment Goals

Risk vs Return: Leveraging Debt in Your Investments

In the Stock Market

The use of debt to buy stocks "on margin" is viewed as a speculative and risky practice that is regularly shunned by conservative and mainstream investors alike. With stocks and other securities, the use of margin accounts is not recommended unless you are willing to lose your entire investment. As you can imagine, a total loss will have an extremely adverse impact on your total return for your common stock investment.

In Commercial Real Estate

In contrast to stocks, the availability of mortgage financing often means that commercial real estate investors can leverage the return on their investment by buying property for as little as ten to twenty percent for the down payment while financing the remainder. Commercial mortgages are used by even the most conservative investors to increase their total returns. With commercial properties, the prudent use of debt can increase your total return while allowing you to reduce your invested capital.

Your Risk and Return Goals

Your investments should be correlated with specific investment goals. What investment features would be acceptable to you? The simple step of defining and clarifying your investment goals can make your decision-making process easier.

For example, here is one possible list of seven primary investment goals:

- Steady Capital Growth
- Avoid Volatility
- Control Risks
- Full-Time Asset Management
- Tax Benefits
- Safety & Security
- Income

Over a period of time, it is normal for your investment goals to change. As your family grows or as you approach retirement, you are likely to have different goals than when you started your first job. But you should always keep your current investment goals front and center when making investment decisions.

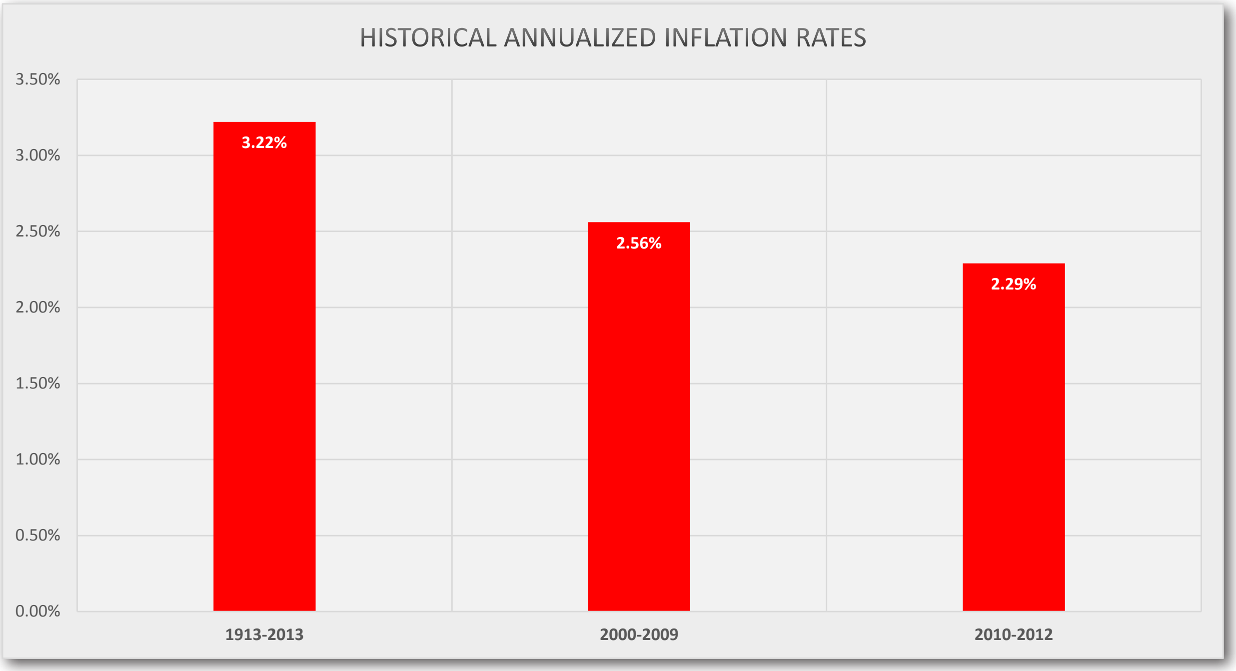
If you are using the above list of investment goals, would you be more likely to buy stocks or commercial real estate? How do you feel about risk?

Your attitude toward risk should play a major role in formulating investment goals. Any investment involves some risk, but you should always address how those risks will be controlled and managed so that you are comfortable rather than worrying about unpleasant surprises.

"Risk vs return" is a basic investment concept that needs to be dusted off and reviewed periodically. In general terms, a higher risk should provide a higher potential return. What often gets lost in the shuffle is that higher risk also creates an increased possibility of losses.

When investors open a stock market trading account, one of the standard choices for investment objectives is "speculation." This investment goal means that you are comfortable with making risky financial transactions. If that does not sound like you, then your immediate solution should be to seek investments that are not speculative and enable you to control your investment risks.

If your investment objectives include speculation, volatility and average annualized returns stuck in the 2% to 3% range, then common stocks should definitely be included in your investment strategy. However, this approach will barely enable you to keep up with historical inflation rates:



Do you want to do better than see your investments simply match the rate of inflation? If so, a prudent solution is to employ a conservative investment philosophy with a modest goal of beating inflation by at least 5% annually. Based on the above inflation rates, this means your annualized total return should consistently be 8% or higher.

Two more vital questions to keep in mind:

- What are your investment goals?
- Do you want more risk or less risk?

Taking Action: Low-Risk, High-Yield Commercial Real Estate for Your Investment Portfolio

How to Use This Information

If you have not already done so, the least you should do is to take a long look at adding commercial real estate to your portfolio. If your investment objectives include controlling risk, avoiding volatility, maximizing cash flow, achieving steady capital growth, taking advantage of tax benefits and realizing annualized returns approaching or exceeding 10%, commercial real estate such as apartments and retail properties should be a major part of your winning investment strategy.

Unless you want to do everything yourself, your first step should be to find a professional real estate manager. Professionally-managed commercial real estate investments offer a combination of the following:

- **Asset Management** (someone who can find undervalued commercial properties and buy them on your behalf)
- **Property Management** (someone managing the cash flow while you own properties)
- **A conservative and long-term investment philosophy** rather than a speculative and short-term investment strategy (someone thinking ahead about what is in the best interest of investors)

Who should you contact?

Be sure to contact a professional real estate asset management company with a proven track record of minimizing volatility and generating healthy returns. At SANTÉ, we have been doing this for many years and the clear advantages of using a professional firm to manage your capital investment in real estate assets are substantial.

SANTÉ Realty Investments is constantly looking for (and finding) undervalued commercial real estate throughout the United States. Portfolio diversification is always important, and geographical balance is one of SANTÉ Realty's secrets to success.

SANTÉ Realty's average annual returns are 10% (and we take care of all property management responsibilities). Depending on tax rates, tax-exempt investors are earning real rates of return averaging **13% to 14%.**

In addition to doing everything that an expert real estate manager should accomplish for their clients, SANTÉ Realty Investments has added the capability to help both U.S. investors as well as foreign investors. SANTÉ Realty can also handle self-directed IRA investments.

What should you do next?

Your next step should be to talk to SANTÉ Realty Investments about adding higher return, less volatile, commercial real estate investments to your personal investment plan. Be sure to describe what you want to do in detail. A recommended approach is to include your accountant in the conversation.

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