Real Estate vs Stocks: What Makes More Money? [Ep. 10]

Transcript

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When we build a financial plan, we look at what is the least amount of risk we need to take to achieve your goals. So if you can meet all your financial goals, whether the simplest way in your case is to have a portfolio of a certain percentage in stocks and bonds, or whether that's through real estate, don't add a complexity to your life, especially as you get close to retirement. Keep it simple.

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Robert, you ready for another episode? Let's get it. Okay, so today we're going to talk about real estate and stock market, which as you know, people ask us all the time, is the stock market better?(...) Is real estate better? And we're going to dive a little bit in the weeds. Yes. So I guess if you wouldn't mind start us off with the difference between real estate investments and stock market investments. Which one's better in your opinion? I know it's a I know it's a strong topic for many for many people as far as they always everybody has an opinion. But what are your thoughts on it? Sure. Well, there's not a simple answer. I mean, if you look just from a performance standpoint, historically, stock markets, have done double digits, right? If you're diversified residential real estate's done about four to 8% commercial has done about 5 to 10. So it's not very much behind the stock market. But that being said, there's many outliers. I know people that have invested in real estate and have made twice the amount that the stock market's done.(...) That's rare. That doesn't happen all the time. In fact, most of the time, I'd argue a stock market outperforms vast majority of people that do invest in real estate because there's a lot of nuance to it.

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Which we can dive into. What has the greater risk? The greater risk I think is going to be real estate, right? Because if you invest in a stock market, you could have 50 stocks, 100 stocks, and you're completely diversified. If you own real estate, you're probably going to own what? Some people own one piece of property, whether it's residential, commercial, some might own two, three, four, five. That's still not super diversified.(...) Especially if you own one. Imagine if you own one in a particular area of the city you live in. Or even if you own two, three, or four, typically people tend to own them in a tight radius. So if that part of the state goes down, you could be hit dramatically in all your real estate. So I would argue real estate in general is going to be more volatile. It could have some more upside if this is your area of expertise. But in general, I think it's a whole heck of a lot easier to be diversified investing in the stock market. So both of them are going to take time. I mean, you know, we talk about DIYers and the time commitment that it takes. Real estate takes time. When it comes to a time commitment for a person, what do you think takes the most time?

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Real estate is going to take a chunk of time more out of your life. Why is that? Well, of course, you could pay somebody to be a property manager, right? But if you want a piece of real estate, whether it's residential or commercial, there's always things going on. You're going to have to buy the insurance. You might need a new roof every 10 years.(...) You're going to have to deal with tenants who might damage the property. That's a time commitment. Whereas the stock market, yeah, you have to do research on what you own.

But beyond that, you don't have to worry about, you know, if you own Apple, the Apple is going to knock on your door one day asking you to fix something, right? Fix the toilet or the roof. That's not going to happen. Okay, so let's say I'm not investing in actual properties. Let's say I want to invest in real estate in the market. There are things like REITs. Now, I know there are different types of REITs. But how do REITs play a part in real estate investment? There's three main types of REITs. There's public REITs that are traded, public REITs that are non-traded, and they're private REITs, right? So public REITs, if you're going to do REITs, by the way, we've done them as a firm from time to time, it can make sense. Historically, when the economy is strong, when you think rates might come down, why? Because then the REITs can perhaps refinance. By the way, what are REITs? Real Estate Investment Trusts. So this is a way to invest in real estate along with other investors. Instead of you being the owner of that property, the direct property, and having all the time commitment involved, you can invest in a REIT. Again, I'm not necessarily pushing it. I'm not in general a huge fan of it, but it is another thing to keep in mind if you want to invest in a REIT. So again, private traded is just what it sounds like. They trade on the New York Stock Exchange. They're extremely liquid. You know what they're worth.

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There are some good REITs out there that have done well. Public non-traded are exactly what it sounds like. It's public. It's pretty easy to get into, but they're not traded, so it's not fully liquid. When you hear about people getting in a REIT, whether it's a public non-traded or a private REIT,

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typically this is where you hear people have bad stories where they get in a REIT and it's illiquid, or they can't get out, or they have to wait six months to get out. They can be intentionally opaque in terms of what you're invested in. Many times it's hard to know, are you invested in this property or that property?

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The reason why they can get away with that is it's not, private ones specifically, they are not regulated by the SEC.

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So sometimes you see in Texas, we see these commercials about this type of REIT that's paying whatever, 10%, 12% cash flow. They make it seem almost like it's guaranteed that you can never lose money. Sometimes they can get away with saying things that are half-truths because it's not regulated by the SEC. They're not being monitored and held accountable to the same standards in general that perhaps a public REIT that's traded is held to. Are there different types of fees as far as expenses on them? Can some be more expensive than the others? And what about liquidity needs? Absolutely. So fees can be totally different. Again, the public traded one, typically the fees are the lowest and are the most liquid. You can trade it like a stock. Go on the stock market, buy or sell. The public non-traded and the private ones, the fees typically are super high.

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My experience, again, I've been doing this 20 years. I'm sure I have not seen every private REIT on the planet. But my experience is when we meet clients from time to time that have those, the performances is not impressive. Typically, they show us, hey, this is the prospectus. This is what the adviser told me I was going to make. And the returns in general are half that, 60% of what they expected. And then when we try to come up with a game plan to get out, a lot of times they're locked up for another couple of years to get a portion out or there's a penalty involved. So I'd read the fine print on any public non-traded REIT or any private REIT, read the fine print. OK, if things turn sour, how can I get my money back out? Because people are going to assume it's fully liquid. And in 99% of them, they are not liquid. It's funny, while you're talking right now, I can think of probably four or five clients that we've been helping get out of those unwind, those REITs that we did not put them in. They came to us with it. And it's just such a nightmare, especially when it's the private ones that they handcuff you in it. They got these huge fees in it. It's tough. I mean, I think that a lot of times the reason they're peddled is the commissions on those are massive, right? So, but who's the advisor if they don't have a moral compass, if they're just trying to make a buck, it entices them to sell these products that have a bigger commission. Typically, if you invest in something that it's not liquid and you're tied up for a period of time, in general, as a rule of thumb, you can assume the adviser's fees are way higher, right? The more liquid it is, the lesser the fees because they know if they're, if they lock you in for a period of time, you're going to be in for X amount of time that they're going to be getting their fees so they can justify paying a higher commission out to the adviser.

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So switching gears just a little bit, when it comes to investing in actual real estate, are the stock market, which has the best tax advantages from a tax standpoint? Sure. So I think there's two ways to look at it from a taxes point. When it comes to real estate, one of the benefits is you get the depreciation of the property, right? When you buy a stock, you don't get depreciation. And if you're listening and you're a successful real estate investor, you know, that's probably one of the reasons you own real estate is because you get the, you get to take the depreciation. So I'm not trying to minimize that. That's a, that's a real big deal.(...) In terms of taxes going forward, there's a huge distinction too. In real estate, you're going to pay ordinary income.(...) And if you're successful, you're going to be in the highest income bracket. So it's going to erode part of it, part of your earnings. Let's compare that to the stock market.(...) A stock market, when you sell it long-term capital gain, again, yes, I know the same thing as in true and real estate. But if you own stocks on the dividends, if they're qualified dividends, which are, you know, American stocks are paying dividends, typically your, your tax on that's going to be anywhere from zero to 20%.

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Versus maybe doubled in that in real estate. So, um, you, to summarize in real estate, I would say you do get the depreciation, not trying to discount it. If you're going to own that property for a very long time, um, on an ongoing basis, typically stocks are going to pay less taxes, uh, on the, the, the qualified dividend versus the cashflow coming from a property. Right. So real estate can't, can't all be bad. So what are some of the biggest benefits of investing in real estate?(...) I think the people that we come across that, that, that do well in real estate, they're in it both feet. I can think of a lot of clients that they own franchise. It's kind of, kind of think of it like franchisees, right? They own a bunch of McDonald's or a bunch of franchises.(...) It's easier to make money if you own 20 of them than if you own one. I think it's the same, same thing holds true in real estate. The clients that I know that have done very, very well. They don't own one piece of property. They own 4, 5, 10, 20.(...) Um, you can scale. You'll probably get discounts from your property manager. You, you, there's systems you can put in place. It's easy to be diversified. Right. If you, if you do 1 piece of property, well, what happens if the tenant leaves, right? That, that could kill you if it's for six months. Uh, and yeah, you still have to make your payment. Right. By the way, what did you ask me? What's the benefit of real estate? Yeah. So that might be the next question. What are the cons? Well, let me, let me see what the benefit of real estate would be. Um, appreciation,(...) tax deduction, tangible cash flow. You nailed it. Tangible assets. Some people that's important. They want to kick the tires. They want to actually see the building.

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I think those would be that from a high level, the benefits of real estate. So I know you just touched on one, but when we look at the cons, because that sounds like a lot of benefits, if you wanted to diversify, what are the cons of the real estate?

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The potential lack of diversification. You know, it's harder to own a ton of properties. Let's say a property is worth a million dollars and you have to fork out 20% down. How many of those properties do you want to buy of your net worth?(...) Um, illiquidity. If you get into a crunch to sell that property, that could take months, could take years, depending on what's going on in the world.(...) You can, unless you paid cash, you're going to have to continue to make those payments regardless if your tenants there or not.

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So I think it's a little bit more, uh, less liquid,(...) um, a little bit higher taxes on a cash flow, harder to be diversified. What about on the stock market side? What are the benefits when it comes to the difference? I guess it's going to be opposite of the pros of real estate, but what are the benefits of the stock market? I think the stock market in general, again, I know, I know there's going to, I'm not trying to beat up real estate because I personally know people that have crushed it in terms of performance. But in general, I think most people are going to be better off in terms of performance in a stock market.(...) There's no, there's no time commitment. I think that could be a bad thing of the real estate we talked about. But in a stock market, you, maybe you have an adviser, maybe you're doing it yourself. Maybe you're, you enjoy investing in stocks and you're good at it. I would, I think that's going to take less of your time than, than being a landlord. What about the downsides? I mean, the market's going to go up and down every day. So what are the downsides when people are looking at the stock market? And I know just through the years of doing this with you that, you know, people have their biases, right? And they either love real estate, they love investments. Some love both, but there's always a downside to one or the other. And if you, if you talk to a real estate investor, they're like, I got a tangible asset. I've got something that's secure. I can go put my hands on it. Right. Right. Right. But when they look at the stock market, if they're like almost a fear of the unknown, they're worried like, well, the market's going to go down. I'm not guaranteed anything. So what would you say to that? What are the downsides? You're not guaranteed anything, but I would argue pretty much in every investment out there, unless you're doing a CD or a treasure, you're not guaranteed it. Just because somebody peddling a real estate says it's guaranteed. It doesn't mean it's guaranteed. Just like we can't guarantee a stock market returns. I think the downside of the stock market is going to be a few things. You get full access to what it's worth. You could argue that's a good thing because daily, you know, it going up and down, but that could also be a negative because if you know your net worth in a bad day drop 5%, you might panic. You might sell at an opportune time. You don't have a tangible asset. Right.

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I remind people, hey, if you want a little bit of Walmart of Apple, you literally, if you own that stock, you own some. Of course, you can't walk in Walmart and start barking out orders, but you own it. That's why they didn't listen to me last time I was in there.(...) Yeah.(...) But you know, if you own real estate, you can do that. You can't see, oh, that's my building. That's my tenant. You can't do that. So I would try to encourage investors to think at the end of the day, how is it going to affect their pocketbook and not be so emotional when it comes in to that?

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I don't think that's really relevant. I care in terms of what's my expected rate of return. What's my minimum taxes? What's going to give me the biggest chance of success financially in my life? So if somebody today walked up, came into the office today after this and said, I've got $5 million and I'm thinking of either real estate or the stock market. What would your response be to them?

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That's a loaded question. I mean, first of all, I'd say it depends, right? I would ask certain questions like if they have $5 million, is that in cash or have they been into in real estate? How close are they to retirement? If they've accumulated to $5 million in real estate for the past 20 years and they've had success, who am I to tell them to get out of real estate? Maybe they want to diversify a little bit, but if it's not broken, why fix it? If that's how they do it, then they're going to have to do it. So if they've accumulated to $5 million, then they might want to continue their whole life. So if they've accumulated to $5 million, then they might want to continue their whole life. Now, if they've accumulated this through a 401k and they're three years from retirement and now all of a sudden they want to invest heavily in real estate, 90% in their net worth. I think that's a potential mistake for the reasons we've already addressed. Are you diversified? You're going to have to own, I would argue, many pieces of property. If you own one or two, what happens if one just blows up? That can demolish your retirement.

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Most people we work with, they don't want to work harder in retirement than they did while they worked. So in retirement, do you want to be that landlord? Are you okay paying 10%? Whatever a management property may charge you, which is fine. You can still make money that way, but these are all things you need to spreadsheet out. So your question is, of somebody had $5 million, which would I tell them to do? I can't give you a flat answer of one direction. I would say, do a financial plan,(…) financial adviser and create it, or do one yourself. Get a spreadsheet out. It might not be as sophisticated as we can do, but at least it'll give you some guidance of what the pros and cons of them. I would look at the depreciation if you're doing real estate, what's the value? Sometimes people put too much weight on that depreciation. Yeah, it's a big deal, but it's not going to make up if the property loses a ton of value. It's not going to make that up. So I would look at all those things, what you think it's going to appreciate, what the depreciation would be, what your taxes would be. Are you okay with the liquidity? What happens if you lose a tenant? Do you have enough money if you didn't pay cash for those properties and continue to make payments? Because a bank can repossess the homes or the real estate. Real estate. So not giving you a really straight answer, but it just depends, right? But it's a ton of information. So as we wrap it up, you gave a lot of good things, pros and cons on each side. If there was one takeaway that you would want listeners to, for sure to remember from this podcast or from this episode, what would it be today?

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I would say keep it simple. Don't add complexity to your life. When we build a financial plan, we look at what is the least amount of risk we need to take to achieve your goals. So if you can meet all your financial goals, whether the simplest way in your case is to have a portfolio of a certain percentage in stocks and bonds, or whether that's the real estate, don't add a complexity to your life, especially as you get closer to retirement. Keep it simple. Well, thank you. And before we finish off, we got a question from the mailbag. It's a two part, one question ordeal. So first part of this is Glen, and this is from Stephanie.(...) Do I need to have my house paid off before retirement? I think it depends, right? We're affiliated.(...) You're the representative of our team with Dave Ramsey, been with him for over a decade. It depends.(...) I know he's anti mortgages in general, if you can pay it off, that's wonderful. What's it going to depend on? It's going to depend on if you have a mortgage, what's your rate? We have clients who have a 2% mortgage. I don't think you should be in a hurry necessary to pay that off. That actually goes into the second part. How does my mortgage debt affect my retirement planning? You were talking about the rate. Yeah, well, you're going to have to assume if you have a mortgage in retirement, how are you going to get cashflow to pay that? Right? So let's say you have, if you have $2 million invested and you have a half a million dollar mortgage and you pay it off, so now you have 1.5, is that better off? What cashflow is that going to generate? Or are you better off having a full 2 million, having a half a million dollar mortgage? How much greater would your income be? And can you get a $1.5 million? How much greater would your income be? And can you make the payments? As a rule of thumb, I would say if you're under 3.5% I think that's pretty easy over time. Maybe not every year, but 8 out of 10 years you're going to beat that even in a conservative retirement portfolio. Right? So I would say it depends. Now the only caveat I would throw is a lot of what we do, it's numbers related. Right? I can crunch the numbers. Let's say you had this person, Stephanie, I think you said. Yeah. I would say Stephanie had a mortgage at 2.5%. And mathematically I can spreadsheet it out and say, "That makes zero sense to pay it off." But what I can't put a calculation on is what's that peace of mind worth to her? If she's going to sleep better at night, even if she's going to make a little bit less, then I would argue she should go ahead and pay off the mortgage. You know, you can't take that with you. If you're going to sleep better at night, have less anxiety to not have a mortgage in retirement, you can do that. Now before you do it, I would do the math behind it because that might affect how much anxiety is. That little bit of anxiety worth, I don't know, an extra thousand dollars of cashflow a month in my pocket. Some people the answer is yes.(...) Some people the answer is no. I know I'm going to have a less net worth when I die, but I don't want to have a mortgage. I've had a mortgage my whole life. And that's where it can be tricky. And you have to have that relationship with a client and hopefully get them to open up and see,(...) put some weight on that. How important is that to them? How the human emotion plays into that. It's huge, right? Because it's not if this was just, if this were just numbers, I think it's a, you can just, you don't, you don't even need an adviser. Part of our job, I think is not just crunching in numbers, but it's so emotional.(...) People can be so emotional. And people change what somebody says five years ago in terms of what they're comfortable with risk and things in their life.

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I've seen it two, three, four years later, completely changed. They were comfortable with a 50% drop. Now they're not comfortable with the 10% drop because the death of a loved one or something happened at work that hurt their income and just changed their perspective on money and cashflow. So as people adapt, you have to update the plan to adapt with them, right? Well, great. I appreciate it. Thanks for the insight. I love these mailbag questions. Continue to please send them in. Also, if you like what you hear on the podcast, feel free to comment on it on any episodes that you would, you would like us to talk about in the future. Like and share us. And if you have any questions, please feel free to email us at GDS at GDSwealth.com. Thank you, Glen. I appreciate the time today. Thank you.

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