

Home prices, when adjusted for inflation, sometimes go nowhere for years. In a downturn, what's the best hedge—housing, stocks or commodities?

A 16-Year Housing Slump? It Could Happen

by Gene Epstein

BRACE YOURSELVES, HOMEOWNERS. THE CURRENT weakness in U.S. home prices could persist for years, especially if you count the toll exacted by inflation.

For all the wishful thinking in the housing industry, home prices can be remarkably stubborn. Just look at what happened in the '80s and '90s. The inflation-adjusted average price of an existing home peaked in 1979, didn't bottom out until 1984 and didn't return to the 1979 level until 1995. In other words, real home prices went nowhere for 16 years.

Granted, inflation during that period was running at an average of 4.7%, versus 2.6% since 1995. But that doesn't mean real home prices will now fare better. Chief economist Lawrence Yun of the National Association of Realtors predicts that nominal house prices will bottom out by the middle of this year, and then resume a 3%-plus yearly increase. Not bad, on the surface—but possibly in a dead heat with inflation.

Housing does remain a good hedge against inflation over very long periods. Examine any 20-year stretch since 1970 and you'll find that home prices, adjusted for inflation, rose. Inflation-adjusted stock prices generally did even better over long periods, albeit with greater volatility, a *Barron's* analysis found. Surprisingly, commodities way underperformed both housing and equities as inflation hedges, notwithstanding the current run-ups in food, fuel and metals.

The charts on this page tell a

tale of three markets—homes, stocks and commodities—from 1970 to the present, in both nominal and real terms, with nominal prices inflation-adjusted by the consumer-price index. Studying them can yield some valuable lessons amid today's inflation fears. Over the past 12 months, the CPI has risen by a disturbing 4%.

The housing chart tracks the median price of existing homes, which generally account for more than four-fifths of all home sales. One bright spot: Most sales this year have been profitable for the sellers, even though the median price is down nearly 10% in the past two years. That's because the holding period on a home is typically six years, not one or two, as the scare stories in the media often imply. Those who sold in early 2008 didn't buy at the higher prices of last year or two years ago, but at the lower prices of six years ago. So in both nominal and real dollars, these typical sellers made a profit.

Still, finding long-term protection against inflation is anything but easy. Even stocks can have prolonged famines. The stock chart on this page tracks calendar-year averages on the Standard & Poor's 500, to make those data comparable with similar averages on the median home price. For both, this averaging has the effect of blunting the drama of peaks and valleys. But the inflation-adjusted S&P 500 has more than enough drama remaining.

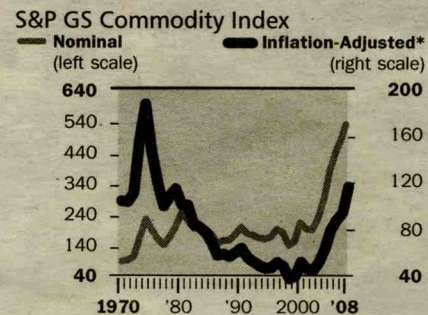
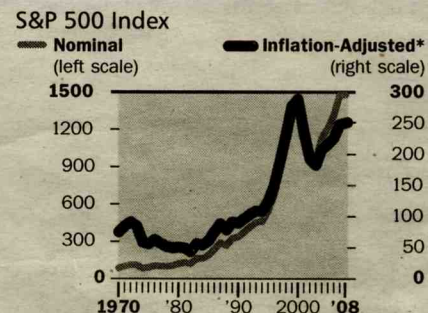
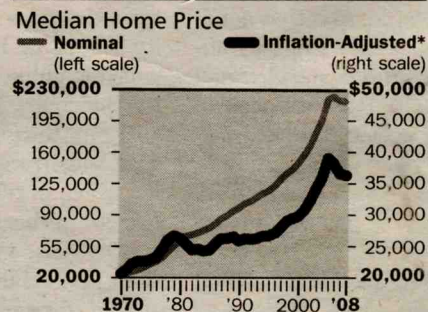
The real S&P 500 fell more than 50% from 1972 to 1982. Not until 1989 did it come close to its 1972 peak. And so far in 2008, the real S&P has been averaging more than 15% lower than its last calendar-year high, in 2000. Equity bulls might object that the stock data should include dividends, especially of the reinvested kind. But we have excluded dividends to make the stock data more comparable with the housing data. As economists point out, homeownership includes an implicit income in the form of money saved by being one's own landlord. Since this implied income is omitted from our calculations, dividends are omitted as well.

The Standard & Poor's Goldman Sachs Commodity Index also includes a "total returns" calculation that

Sturdy as a home may be, it's not always safe from inflation.

A TALE OF THREE MARKETS

Over the past 40 years, home prices have been a decent hedge against inflation—not as good as the stock market, but far better than the commodities market.



2008 median home prices based on first-quarter forecast by National Association of Realtors. 2008 S&P 500 and SPGSCI based on actual prices through early March. *Deflated by consumer-price index. Sources: Standard and Poor's; National Association of Realtors; Bureau of Labor Statistics

