

# Digging in against inflation

## Real estate is called the best hedge over 27-year period

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If you consider the effects of inflation, real estate has been about the best investment, G. William Schwert, assistant professor of finance in the University of Rochester's Graduate School of Management, told a special University course audience yesterday.

Schwert has analyzed various investments in terms of real returns — after inflation and taxes — from 1953 to 1978, using the Consumer Price Index as a measure of the inflation rate, the home purchase index of the CPI as a measure of real estate appreciation and government personal income figures to measure labor income.

The results indicate that in a time of gradual inflation, with a rate of about 1.3 percent per year from 1953 to 1957,

"That's not so bad, though," he said, as the audience groaned. "If you expect inflation now to be 15 percent and the real return on Treasury bills remains about 1 percent, then the yield is about 16 percent. Taxes then would take 8 percent of that, leaving 8 percent, and when you subtract 15 percent for inflation, the return is minus 7 percent."

Even if you try a tax-free municipal bond to avoid the subtraction for tax, the result remains the same, he said. That's because the initial yield is lower, leaving a minus number when inflation is subtracted.

"Taxes make residential real estate the attractive deal," Schwert said. "Also other 'things' — antiques, stamps, coins . . ."

"But not silver!" said a man in the audience.

"It's much easier to avoid paying any

common stocks rose by 11.1 percent per year, while residential real estate actually lost value slightly.

But after 1967, real returns on stocks began to fall as rapid inflation took over, Schwert said. When price controls were imposed, from August 1971 to 1974, stocks suffered especially, falling to a minus 14.6 real return, he said.

"If you had started in 1953, you would have been better off buying stocks," Schwert said. "If you started in 1967, though, you would have been better off with a fixed annuity, a bond contract of some kind."

Schwert was one of eight speakers in a special course for alumni and others that began with four lectures on philosophy, then went into finance and investments.

If his listeners felt disgruntled about their investments, Schwert reminded

kind of tax on the returns of something like that," Schwert said. "And you certainly don't have to pay tax on the enjoyment of having them around the house until they're sold. When you buy a durable good, the dividend of having it around and using it is tax-free."

Both before his talk and during the question period, Schwert emphasized that he can't "see the future," that the current inflation period isn't quite like any other he's studied, and that his research has used only two variables — the inflation rate and common stock prices.

"During these times there were factors such as the Vietnam War that would have to be considered," he said. "There is no perfect prediction rule to use" for deciding where common stock prices will go in the future, he said.

them that they hadn't been alone. "There's a school in New Haven, Conn., called Yale," he said. "To 1967 it ran its investment portfolio with conservative principles, concentrating in fixed-income securities and such.

"From 1963 to 1967 there was a run on stock values, and some schools in upstate New York were bragging about how well they'd done with growth stocks such as Kodak and Xerox," he said. "So Yale changed and went into growth stocks — and you can see what's happened to them.

"Fortunately," he added, "Yale has a large stock of alumni to make contributions. And it wasn't alone — a lot of universities did that," he said.

Schwert used the effect of inflation on Treasury bills to illustrate his research, part of which dealt with the difference

between expected inflation; unexpected inflation and actual inflation in the periods studied.

Basically, he said, Treasury bills have a small real rate of return, and the rest of the nominal rate reflects inflation. A chart of real value of Treasury bills from 1953 to 1978, measured in 1953 dollars, shows the rate varying only a fraction above or at one percent.

"Now if you expect a 2 percent inflation rate, then you'd anticipate that the bills would yield 3 percent," he said. "You would have to pay tax on 3 percent, not the real return. For ease of arithmetic, if you're in the 50 percent tax bracket, you'd lost 1 1/2 percent to taxes. Then if you subtract 2 percent for inflation, the Treasury bill has lost .5 percent in value."

That was the situation in 1953 according to his calculations, Schwert said.

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