Get Rich Faster: Buy TSX Stocks or Pay Off Your Mortgage Early?

Description

Mortgage interest rates are at record lows, while the stock market is just under its all-time high. Millions of ordinary Canadians have made a fortune by buying a house or investing in stocks over the past few decades. In fact, investors who bought condos in Toronto or tech stocks a few years ago are probably millionaires now.

However, investing isn't about looking in the rear-view mirror. Instead, savers need to look ahead to see where the best opportunities are. Most homeowners might want to consider whether it's better to pay off their mortgage and own their home outright or keep the loan and invest excess cash into stocks for retirement.

This isn't an easy choice to make. Property values tend to appreciate over time, and there's a chance that mortgage interest rates might move higher in the future, raising the carrying costs of homeownership. However, stocks have delivered better gains than property over the past decade, and some dividend stocks pay more than the average mortgage interest rate.

For investors seeking the quickest path to wealth, here's a closer look at these two options.

All about expectations

The choice between paying off a mortgage early or investing excess cash into the stock market hinges on one key factor: expected returns.

In other words, if you expect the stock market to deliver a 6% return on average every year for the next five years, while your mortgage interest rate is 3.5%, investing in stocks is clearly the better option. By keeping your mortgage balance outstanding and investing in stocks, you're effectively earning the difference between those two rates (6% – 3.5% = 2.5%).

So, what are interest rates and stock market returns likely to be in the future? Well, it seems likely that mortgage interest rates will remain stable or go lower over the next few years. Interest rates in Canada have been steadily declining since the 1980s, as central banks have been aggressively cutting rates across the world.

Considering the risk of a recession this year and the slowdown in global growth, experts expect the Bank of Canada to cut rates in 2020 and create monetary stimulus to bolster the economy. According to the British Columbia Real Estate Association's latest forecast, mortgage rates could drop to 2.77% by the end of this year.

Unfortunately, the expected return on Canadian stocks is likely to drop as well. The **S&P/TSX Composite Index** has delivered 9.3% per year between 1960 and 2018. Wealth manager Edward Jones forecasts lower returns, 6-7.5%, for the years ahead.

However, I prefer to use the cyclically adjusted price-to-earnings (CAPE) ratio to measure expected returns. According to the TSX CAPE ratio, expected annual returns are likely to be around 4.4% for the foreseeable future. That's less than half the rate of return over the past six decades but still considerably higher than the expected mortgage interest rate.

Bottom line

The expected return on the Canadian stock market and the interest rate on an average mortgage are both expected to decline in the near future. However, the potential returns on the stock market are still likely to be much higher than the mortgage payment costs, which is why it's generally better to invest excess cash rather than pay a mortgage off early.

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