The Average Home Hits $816,720: Should You Invest Your Down Payment in Stocks to Keep Up?

Description

In the winter months, it's hockey season, there's lots of snow, and, traditionally, it's the best time to buy a house. Homebuyers are usually cloistered inside, uninterested in touring cold houses and driving in bad weather, and home sellers, knowing demand is low, will typically offload a house for a low price.

But not this year. This winter, the Canadian housing market was red hot. And by some estimates, it's not going to cool down any time soon. In February, the average price of a home rose to $816,720, which is over 20% since last year.

At that price, you'd need to save a $56,672 down payment, or around 6.94% of the total cost. For many Canadians that's a hefty sum. And what's worse, the more expensive homes become, the more down payment you'll need to save to keep up, which can make you feel a bit like Sisyphus rolling and re-rolling a boulder up a hill.

For instance, in January, the average price of a home was $748,450, which would have required a $49,845 down payment. That's a $6,827 difference between February and March. In other words, if you had put $7,000 aside for a home last month, you'd be in the same position: you'd have more money, but you couldn't buy more home.

That might lead some Canadians to ask, "Should I invest my down payment in stocks to keep up?" It might seem like a good idea, but if your time horizon is short, it can be disastrous. Let's take a look at when you should and shouldn't invest your down payment.

When you shouldn't invest your down payment

I would strongly advise against investing your down payment if you're looking to buy a home in the next five years or less. The reason: market volatility. No stock or fund is completely immune from market downturns, and while the upside potential on stocks is unlimited, the downside potential could crush your portfolio, leaving you with less money than you expected.

Often, when you have a long time horizon, you'll make up your losses in investment gains. Traditionally, that's how the stock market has worked: you might lose money in the next six months, but as long as you stayed invested for the next, say, 10 years, you should see a steady upward growth. When you have a short time horizon, however, you might not have enough time to make up for your losses. Depending on when you buy a home, you could find yourself selling investment for a loss.

If you're certain you want to invest your down payment (no matter your time horizon), then consider buying shares of an ETF or index fund. Since funds are baskets of stocks, they come pre-diversified. That means they're technically less risky than buying individual stocks. Of course, with greater security comes less chances at hitting extraordinary gains. But if you're investing your down payment, you shouldn't aim to get rich. At the very least, you should aim to outpace inflation.

You might also want to consider low-risk stocks, such as water stocks or other utility stocks. These are considered "safe" investments, since water and utilities are commodities people will *always* need. Of course, utility stocks have moments of volatility, too, and they don't grow as quickly as growth stocks. But if you're looking to outpace inflation, they could come in handy.

When you should invest your down payment

For Canadians who don't plan to buy a home in the next five years, investing a portion of your down payment might not be a bad idea. Because your time horizon is longer, you have more time to recover from a market downturn. And because you are planning to buy a home this far in advance, you'll want to outpace inflation, which stocks have the potential to do.

But I would advise against investing *all* of your down payment. Keep a portion in something safe, such as a GIC or savings account. The other portion you can invest in stocks or funds. Keep in mind, if you're a first-time homebuyer, you could use money in your RRSP as your down payment. Under the Home Buyer's Plan, you're allowed to withdraw $35,000 to use as your down payment (if you have a spouse, then you can both withdraw $35,000). This is money you could have invested in stocks, along with a much larger sum.

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