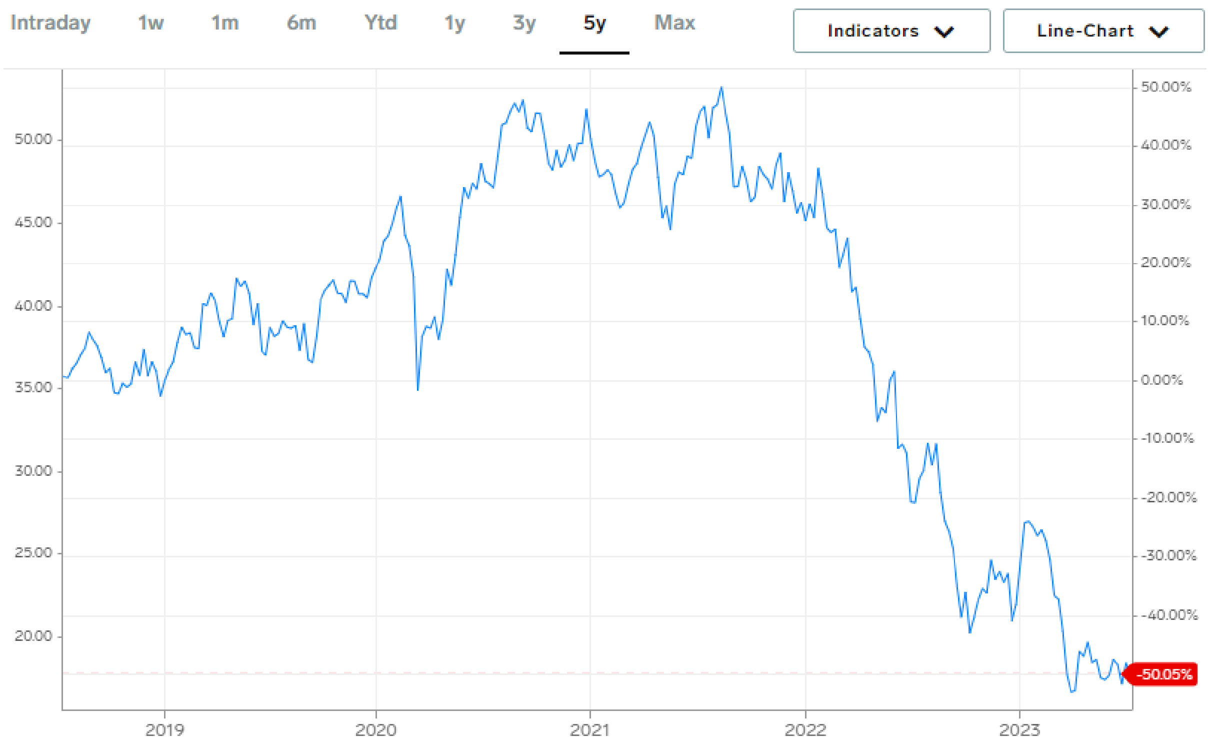
Over 90% of investors make this mistake with real estate stocks...

Dear reader,

European real estate stocks attract individual investors like moths to a flame. Price declines of 60 to 90 percent entice bargain hunters. As a representative example of the European real estate industry, I would like to discuss the stock of Vonovia below:



This stock has fallen by a staggering 68 percent since its peak in 2020! At times, it even breached the 70 percent mark. It is only thanks to the stabilizing movement observed in the past two months that even greater losses have been averted.

During such downturns, many individual investors start to calculate, as the company's website states:

"By March 31, 2022, Vonovia managed its own real estate portfolio with a market value of 96.0 billion euros. Our properties are primarily located in regions with positive economic and demographic development prospects."

Since the end of March 2022, Vonovia's stock has declined by approximately 60 percent. Of course, a portion of these losses can be attributed to setbacks in the real estate market. However, 60 percent? Many people think that the value of Vonovia's properties surely hasn't declined that significantly and therefore decide to invest.

Naturally, everyone would love to acquire condominiums in Berlin, where Vonovia owns 42,000 units, at a discount of 60 percent.

Here is where the fallacy comes into play

The balance sheet of a corporation consists of equity and debt capital. According to Vonovia's semi-annual report for 2022, the total capital is composed of approximately 35 percent equity and 65 percent debt capital. In the stock market, only the value of equity is traded, while debt is reflected in bonds.

Let's assume that Vonovia's total real estate portfolio is around 100 billion euros (as stated in the semi-annual report for 2022). This would mean that 35 billion euros belong to equity and 65 billion euros to debt capital. If there are losses in the real estate market, which Vonovia has not been immune to in recent months, these losses have to be borne by the equity providers, namely the shareholders.

If the financial market anticipates a potential 20 percent decline in Vonovia's portfolio value, then these 20 billion euros of losses would need to be absorbed by the 35 billion euros of equity. In percentage terms, this would result in a reduction of equity by approximately 60 percent. The fact that Vonovia has fallen even further indicates that investors are skeptical about the value of Vonovia's properties and are likely also concerned about its high debt. However, it's worth noting that in such situations, there can also be instances of overreaction.

In summary, it can be stated that in the case of Vonovia and other real estate stocks, it is not that properties can now be purchased at 60 to 90 percent lower prices, but rather that the traded value of equity has adjusted on the stock market.

My Conclusion

Personally, I find the discounts on some real estate companies to be extreme, but I wouldn't buy individual stocks in this sector. There will certainly be further write-downs, especially in the commercial real estate sector, in the coming months.

However, it is important to be aware that real estate belongs to an asset class that should be included in a portfolio, and most individuals do not have the capital to diversify extensively in the real estate market. Individual purchases always entail concentration and location risks, which can be mitigated through real estate ETFs.

Therefore, I would rely on a broad European real estate ETF. The largest position, comprising 13 percent, is Vonovia, but other real estate stocks and REITs (Real Estate Investment Trusts) also play a significant role. The fund includes a total of 61 positions, and has a low cost of 0.40 percent per year.

Furthermore, the ETF does not utilize derivatives such as swaps but rather physically buys the stocks. It offers an impressive dividend yield of 4.5 percent, which is regularly distributed. The name of the ETF is iShares European Property Yield UCITS ETF (ISIN: IE00B0M63284).

From a technical analysis perspective, it appears that the ETF has been forming a bottom after a period of losses since early 2022. For those looking for a diversification in the European real estate sector, this ETF can be used as a starting point for further research. Currently, Germany holds a weight of 22 percent, followed by France (20%), Switzerland (16%), Belgium (15%), Sweden (15%), Spain (5%), and Finland, the Netherlands, and Austria (between 1% and 3%).

The product becomes particularly interesting when considering the potential interest rate cuts by the ECB starting in 2024. This would likely lead to cheaper capital and overall revitalization of the real estate market. Therefore, given the current circumstances, the ETF can be seen as a contrarian investment strategy.