Luxury home prices expected to climb higher

Despite a run up in high-end home prices in 2012 and 2013, the year ahead seems likely to hold further upside.

With all signs pointing to an even stronger U.S. economy and global growth in 2014, J.P. Morgan anticipates that home prices, particularly in the luxury segment, will climb steadily higher during the course of the year. Here are the key trends to watch:

What’s driving luxury home prices higher?

1. Accelerating GDP growth marks the beginning of a new business cycle in the United States
2. Higher equity prices have disproportionately benefited high-income households
3. High-income households are more confident about the U.S. recovery
4. A limited supply of trophy properties for sale intensifies demand and pushes up prices
5. Overseas buyers view U.S. real estate as a safe haven asset
6. Home valuations are fair and benefit from the low interest rate environment

1 Defined as homes in U.S. zip codes where average per capita income is in the top 0.1% of all U.S. households.
2 Drivers of luxury home prices and strength of each driver are based on analysis by the J.P. Morgan Private Bank Economics team. Strength of signal is a comparison of impact of each driver on increasing luxury home prices to the other listed drivers.
Luxury home prices on an upswing since late 2012

The U.S. housing market gained momentum in 2012 and 2013 on the back of a healthier economy, improving fundamentals and increasing investor appetite.

The U.S. economy is picking up speed

After several years of private sector healing, we are now entering the expansion phase of a new business cycle. Leading indicators for the U.S. economy have strengthened in recent months, suggesting that economic growth may accelerate. Households and businesses have stronger balance sheets and large cash positions that will support consumption and investment through 2014.
With the economy improving, corporate profits and equity prices should continue to move higher.

After very strong equity market returns in 2013, the investment strategy team at J.P. Morgan Private Bank expects the S&P 500 may continue to appreciate in 2014 on a total return basis, creating a so-called wealth effect. That is, buyers in the luxury housing segment tend to have more exposure to the stock market, thus higher prices tend to make them feel wealthier and more confident. This trend was most apparent in the luxury market in the early 2000s, while median home prices were not highly correlated with moves in the equity market. The wealth effect resurfaced with strong equity market returns in 2013 and should continue to support the market into 2014.

Property valuations still fair—even after an impressive rally

With luxury home prices reaching new highs, buyers may fear they have missed out. But when adjusted for inflation—and given the fact low interest rates are making monthly mortgage payments more affordable—luxury home prices appear justified. In fact, affordability is now at the same level it was in the early 2000s (before the housing bubble). This, coupled with the drivers mentioned above, makes us believe the luxury housing market in 2014 will post another year of strong performance (see summary table on cover).

The wealth effect: Higher equity prices benefit luxury housing sector

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Many overseas buyers, few trophy properties add to sector strength

It’s not just increasing wealth in the United States that is driving the domestic housing market:
Many overseas investors continue to perceive the U.S. housing market as a safe haven and store of wealth, thereby creating a large pool of potential buyers for luxury homes. At the same time, the supply of trophy properties nationwide has fallen sharply since 2008. The laws of economics tell us that, with rising demand and tight supply, prices are likely to adjust higher over the medium term.

Contact your J.P. Morgan team for additional information.