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The Federal Reserve puts out two publications that address the level, change and composition of household net worth. The most widely known is the Household Balance Sheet table in the quarterly Flow of Funds (FOF) report. This report is released about two months after the end of a quarter. The FOF for the first quarter of 2012 was released last week and shows that total household net worth rose in the quarter from $60 trillion to $63 trillion. This aggregate is now nearly back to the pre-crisis peak of $67 trillion, and is up 24% from the trough level of $51 trillion reached back in 2009.

The big drop in net worth from 2007 to 2009 was due both to falling housing prices and falling stock prices, each of which was responsible for about half the decline in aggregate net worth. Since then the equity market has rebounded nicely but the housing market has not. This has caused significant distributional effects that are not really visible in the aggregate FOF numbers.

The second Fed publication on household finances is the Survey of Consumer Finances (SCF). The SCF is a triennial survey of approximately 6,000 families. The survey captures family characteristics including age and education of head of household as well as family income, assets and liabilities. Results from the 2010 survey were reported this week and show a large drop in median family real net worth from $126,000 in 2007 to $77,000 in 2010. Since the primary asset of the median household is their home, this decline in median net worth largely reflects falling home prices. And things probably have not improved much since then. Even though equity prices have risen since 2010, the median family equity holdings are pretty modest (less than $50,000), so an improving stock market will not offset the drag from housing prices, which have continued to drift lower since 2010.

Thus, the SCF reveals a much less attractive picture than the FOF. Improving stock prices have pushed up the FOF measure of net worth. This is a good thing, and a positive leading indicator for economic activity. However, the SCF shows that the financial situation for most households has not improved much, if at all. The primary reason for this is the heavy concentration of residential housing in middle income family portfolios. Typically, young families build up savings in order to provide a down payment for purchase of a home. It has long been accepted wisdom that this should be so. This accepted wisdom is now subject to challenge in view of the miserable performance of housing prices over the past five years.

One of the unfortunate features of the housing price decline is that it reduces labor mobility. In a depressed housing market, it is difficult to sell your house in order to move to take advantage of job opportunities in a different city or state. This impairs recovery of the labor market. Retirement expert Moshe Milevsky argues[1] that home purchase should be postponed until the value of financial net worth approaches or exceeds the value of human capital. What he is getting at is that an individual's complete or economic balance sheet includes both financial assets and liabilities, as captured by the FOF and SCF, and human capital, which is the present value of future earnings. Young people have balance sheets dominated by human capital. Over time, as an individual ages and progresses in her career, the proportion of financial capital to human capital increases. Human capital is undiversified, illiquid and not tradable. According to Milevsky, it does not make sense to purchase another large asset that is undiversified and relatively illiquid, at least not until financial net worth has been built up.

Although this recommendation can be critiqued as looking through the rearview mirror, and maybe a little late for many people, it probably will gain traction in coming years. Supporting the argument is research by economist Robert Shiller who argues that investment in residential housing has not historically been a big winner. Shiller calculates that the average rate of home price appreciation over the past one hundred years or more is just about the same as the overall inflation rate. In real terms housing price appreciation has been negative. Of course, this is not a return number because it ignores actual or imputed rental income on the positive side, and maintenance expenses on the negative side. The calculation also ignores the consumption value of owning your own home, and social and community benefits from a closer knit community. Still, Shiller's research and Milevsky's human capital argument both argue against concentrating your portfolio on residential housing. The case for buying your own home at the very first opportunity is not as compelling as has been widely believed in the past.

[1]Moshe Milevsky, Your Money Milestones, 2010.