Can you really consider equities versus property?

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"Is it better to invest in equities or property? " This very common question comes up frequently, but the answer is that they are not directly comparable as they are completely different asset classes.

Choosing to invest in either asset class will depend completely on you as an investor. But it can help if you understand your options.

Equities at a glance

Generally equities have generated a better return than property over the longer term, with the differential in the region of 2-4% per annum, but this depends on a very wide range of factors. Equities are highly liquid although short term volatility might make them less than ideal to liquidate in a bear market.

Equity investments can be accessed via owning shares directly in either listed or unlisted companies. For the sake of this comparison let's look at listed shares held via unit trusts. Here the portfolio manager builds a portfolio of underlying investments in listed companies across various sectors of the economy to give the investor a diversified range of companies from which to extract value. These investments are liquid but care should be taken not to mistakenly assume that assets that are liquid are necessarily low risk.

Volatility in the share market means that although the shares you hold can be sold, you might not find the price offered to be acceptable. You might therefore have to put off the sale until a time when the price is more to your liking. This brings a volatility risk into focus as it may affect other financial decisions if you do not have other sources of liquidity available in your portfolio. Shares generally can be bought or sold for approximately a 1% trading cost.

Property at a glance

Property prices and returns are often much more stable than those of the equity market and as such are considered a lower risk asset class. Properties are reasonably stable in price but extremely illiquid assets. They can take a long time to sell and also have an ideal holding period closer to the 7-10 year range to recoup acquisition costs. Additionally there are upfront costs including bond registration and transfer duty, which can range from a low percentage to as high as 13%. Sellers also gross up the price for agent's fees, so this is part of the price.

For most investors their experience of property is via their homes. Property can also be accessed, however, in the listed space via unit trusts. This is an investment that does not have the same liquidity constraints as direct property and also has a slightly higher growth expectation.

In South Africa, the expected return for residential property is at 7- 9%, while listed property has done even better, though past returns are not an indication of future earnings. Equities on the other hand are expected to achieve a 13% return.

Equities may seem like the better choice in terms of returns, but there are elements to owning property, which are not to be overlooked. The sense of security and pride of ownership experienced in living in and owning your own home is of a value that cannot be assessed on purely financial grounds. Employers also consider home ownership as a positive factor in assessing candidates for jobs, as homeowners are seen as more stable. The effect of gearing a property and increasing the actual yield can also go a long way to making the return more acceptable, provided interest rate hikes don't negatively affect the investment.

Much of the value driver of these investments comes from the current and expected future rental income streams associated with the investment. This in turn is generated by the relative supply and demand of available space in the market. As such there can be substantial differences in the valuations of properties depending on the area they are situated in. Within a property unit trust there are normally a large number of underlying properties giving investors diversification of risk.

If owning a property is on your priority or bucket list in favour of having an investment in equities, so be it. But equally so, investing in equities for a certain time frame can boost your savings, which could ultimately assist you in a hefty down payment on a property. So there really could be a case for having exposure to both asset classes.

Finding the right blend of various assets to build a portfolio that meets with your personal needs for liquidity, acceptable volatility and growth, within acceptable tax limits is paramount. The best way to structure a portfolio that meets with all of these needs is to approach a qualified financial adviser who will help you approach the equities versus property debate from a holistic view of your individual circumstances.