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We Irish love investing in property, but history shows that the stock market provides significantly greater dividends, writes David Quinn

Estate agents and the media are heralding the strong recovery of Ireland's investment property market once again, with rents and yields back to pre-crash levels. And massive demand for housing and office space will continue to drive returns, particularly on the east coast and in major urban centres.

We Irish love our bricks and mortar, although the small private property investor is now less significant in the market than the private-rental-sector investment funds, international funds and the real estate investment trusts (Reits). But from an impartial perspective, how does property really stack up against shares, especially medium to longer term?

There is no denying that a house purchased in Dublin 4 in the 1980s with a high level of debt generated fantastic returns over the following 20 years or so. On the flip side, anyone who bought or held shares in Ryanair when they floated in 1997 is more than likely a millionaire by now.

When you invest in property, most of the time you are buying a physical entity that pays a regular rental income. Property values also tend to rise over time. Although there has been no growth in property values over the past 12 years, longer-term, property tends to increase in value in line with, or slightly ahead of, inflation. Owning a property comes with costs, such as management fees, repairs, maintenance, agent fees and property taxes.

When you invest in the stock market, you buy a piece of a company or a basket of companies (equity funds). As a part-owner of the business, you get a share of the profit each year, generally paid as a dividend. If the company is growing, there may be capital appreciation in the share price over time too. Historically the stock market has offered real returns of 8 per cent per annum, with dividends reinvested.

So, what are the pros and cons of these different investments, particularly for the small investor?

Pros of investing in property

1. It is a more comfortable investment for many; as a society we are motivated to own our own home, so are comfortable with the asset class and understand how it works.

2. Given the boom and bust nature of property in Ireland, we have seen significant short-term gains on property investment, both from a rental perspective and from growth in property values.

3. Real estate is tangible; you invest in something you can look at and feel, so for some, that’s important psychologically.

4. Borrowing to buy property is standard practice and can enhance returns. It is dangerous to borrow for an investment into the stock market.

5. Property assets can act as a good hedge against inflation, and property investments can be used in future years for children at university, or for plans to ‘downsize’.

6. Rental yields on property are very strong at the moment, particularly in Dublin.

Cons of investing in property

1. Compared to the stock market, property takes hands-on work. You have to deal with tenants, calls to repair damage and various negotiations. Even with a property manager, it still requires occasional intervention.

2. Property is illiquid. If the investor needs cash quickly, it can take anything from eight weeks to two years to sell a property and realise that cash, depending on the market.

3. Owning a direct property can be expensive. When property taxes, agent fees, management fees, insurance and maintenance are taken into account, the actual profit is significantly reduced. Adding in vacancy periods can make the investment less attractive.

4. The actual value of property hardly ever increases in inflation-adjusted terms (there are exceptions, of course). We have had no real growth in values for over 12 years, while in the same time the stock market has more than doubled. However, this lack of real growth is made up for by the power of borrowing. By taking a mortgage, the investor can super-charge their returns over time. A 50 per cent loan-to-value can double returns on the property. But this too has risks, as we saw in 2008.

5. We have a housing crisis in Ireland at the moment, so more measures to curb rental growth, increase supply and add regulation to the private rental sector are likely. These will impact profitability for landlords in the next five to ten years.

Pros of investing in stocks

1. More than 100 years of research shows that, despite crashes, buying stocks and reinvesting the dividends, while holding them for long periods, has been the greatest wealth creator in the history of the world. No other asset classes beat business ownership or, as with a stock, owning a piece of a business. Long-term average returns, if dividends are reinvested, is above 8 per cent per annum in real terms.

2. We fear the stock market because of horror stories about losing everything on bank shares. But a broad basket of global stocks protects against individual companies going bust.

3. Stock market investment is low maintenance. All that is required is patience and discipline.Trust the management of your basket of stocks to grow earnings over time, and reap the rewards as a small owner in those businesses.

4. The stock market can be a cheap place to invest. If you avoid expensive fund managers and high-commission contracts, then equities investments can cost little or nothing.

5. Most people understand rental income on a property, but dividends don’t get the same good press. With every year, dividends tend to grow. As Fortune magazine pointed out, if you had bought a single Johnson & Johnson share at its IPO price of $37.50 when the company went public in 1944, and reinvested the dividends, you’d now have over $900,000, an annual return of 17.1 per cent. On top, you’d be collecting around $34,200 a year in cash dividends; money rolling into your life without you doing anything!

6. It's easier to diversify in equities than property. With some equity funds, you can invest as little as €100 a month, and cheaply with companies like DeGiro.

7. Stocks are far more liquid than property. Most equities and funds are priced daily, so you can access your cash within 24 hours.

Cons of investing in stocks

1. Although proven conclusively to generate more wealth over the long run, many investors are emotional, undisciplined and fickle, and end up losing money because of psychological factors. During the most recent collapse, the Credit Crisis of 2007-09, there were record requests to sell equity holdings right at the bottom of the market in Ireland's largest life assurance company (March 2009).

2. The stock market can be extremely volatile in the short term. A diversified equity portfolio can fall 40 per cent or more in a single year, and a single stock can be wiped out.

3. There can be extended periods where equities may not look like they've gone anywhere, during sideways markets. But this is often an illusion, because charts don't factor in the most important long-term driver of value: reinvested dividends. Using the cash a company pays for owning its stock to buy more shares over time, means owning far more shares, and even more cash dividends going forward.

The bottom line

In summary, short-term trends and recent information can skew investment decisions dangerously. We see stock markets at all-time highs and global uncertainty, as well as a fluctuating property market, with talk of record highs in certain sectors. However, looking even at the medium term (the past 15 years) equity performance has been spectacular, while property has gone nowhere.

Over the very long term, there is consensus among independent financial professionals, economists and academics that the stock market will offer returns at least 2 per cent per annum ahead of property.

Irish investors tend to ignore huge weight of opinion and go with what worked over the past two years, rather than what has worked for 100 years. Individual investors need patience, discipline and emotional detachment to allow the stock market do its thing. And, for the bricks and mortar fans, property funds, domestic and global, are an alternative to spread the risk and diminish the hassle of actually managing a property.

As always, the sound approach is to take professional advice linked to your personal circumstances.

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