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READER PORTFOLIO

'Should I invest in shares or buy-to-let?'

Our reader has £50,000 to invest for retirement and is weighing up his options. Our experts say there is less risk in the stock market than property

CHRIS DILLOW & COLIN LOW

Vikas Solanki is 36 and has been investing for four years. He wants to accumulate enough capital in his individual savings account (Isa) by the age of 60 to produce an income of £15,000 a year. This will top up the £17,000 that he is expecting from his civil service pension. He has another £50,000 cash that he could invest in the markets, along with around £1,500 a month for at least 10 years. However, he is considering using the £50,000 cash as a deposit on a buy-to-let property in London, Oxford or Cambridge.

He says: "I am inclined to opt for the stock market as it helps me to diversify away from property, as I already own a house. However, buy-to-let property also seems attractive as I am left in disbelief at just how quickly after the credit crunch crash in 2008 the London housing market is once again enjoying record inflation."

He has £15,000 in cash Isas for a rainy day. He is married but has no children.

Chris Dillow, the Investors Chronicle's economist says:

You are in an enviable position, in the sense that with moderate luck you should be able to achieve your target retirement income quite comfortably. You say you'd like an income of £15,000 by the age of 60. Assuming – cautiously in my opinion – no rise in annuity rates, this means you need a pension pot of around £280,000. If you put your £50,000 of cash into equities then a real return of 5 per cent a year – which I think is a reasonable working assumption – will get you there.

Of course, even over a period as long as 24 years, there's still considerable risk in real returns; I reckon there's a one in six chance of you falling £100,000 short if you fully invest in equities. But three things mitigate this risk: you have the ability to save, thus increasing future wealth greatly; you might be able or willing to sell your house to release pension wealth (compare house prices in London to those in nicer parts of the country!); and it's likely that annuity rates will rise.

I say all this because it means you don't have to take great risks, or make great sacrifices, to achieve your goals.

The big question, then, is: should you put that £50,000 into equities or towards a buy-to-let property? The choice is moot.

In theory, returns on housing over the long run should be around the same as those on equities because both are plays on long-run economic growth. And the historic data doesn't rule out the possibility that returns on the two are indeed very similar. Several things, however, make me urge you to think very carefully before using buy-to-let.

First, whereas housing seems expensive by historic standards, equities don't. Against this is the fact that, as you say, politicians seem keen on inflating the house market still further. But how strong a consideration is this? Economists of all persuasions pretty much agree that such measures are undesirable. It's possible that, over a 20-year horizon, policy-makers will come to agree with economists and do something to reverse house price inflation. Even if they don't – and I'll concede that the risk of sensible policy-making is a small one – there's a danger that support for house prices will eventually fail in the face of huge overvaluation; as Lady Thatcher used to say: "you can't buck the market."

Even leaving aside such futurology, there are risks in buy-to-let. There's the risk the property will need emergency repairs. There's idiosyncratic price risk; you're not buying an index, remember, but a particular house, and just as individual shares are more volatile than the All-Share index, so individual houses are more volatile than house price indices. Then there's the risk of voids; going a few weeks without a tenant can make the difference between profit and loss if you have a big mortgage.

And then there's interest rate risk; eventually, mortgage rates will rise. And on top of all this, there's liquidity risk. It's difficult and stressful to sell property quickly if you need to raise cash. Personally, I much prefer activities

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Vikas Solanki's Isa portfolio

Name of share or fund	ISIN or TIDM	No. of shares/units held	Price	Value
Alliance Trust	ATST	276	442.3p	£1,220
BP	BP.	196	465.32p	£912
Invesco Perpetual High Income Fund No Trail Acc	GB00B1W7HH10	1,938.52	143.58p	£2,783
Caledonia Investments	CLDN	95	1,894p	£1,799
Aviva	AV.	266	365.1p	£971
Centrica	CNA	480	372.4p	£1,787
City of London Investment Trust	CTY	367	366p	£1,343
GlaxoSmithKline	GSK	43	1,754.5p	£743
Invesco Perpetual UK Smaller Companies Investment trust	IPU	923	278p	£2,565
Lloyds Banking Group	LLOY	887	67.08p	£594
M&G Recovery Fund R Acc	GB00B7759738	727.863	113.62p	£826
Artemis Strategic Assets Fund I Acc	GB00B3VDD431	4,060.76	78.3p	£3,179
Invesco Perpetual High Income Acc	GB0033031484	442.35	679.38p	£3,005
Royal Bank of Scotland Group	RBS	114	311.7p	£355
Royal Dutch Shell B	RDSB	130	2,309.32p	£3,002
Newton Real Return Inc	GB0006780323	1,988.49	286.11p	£5,689
Tesco	TSCO	462	353.74p	£1,634
Vodafone Group	VOD	1,194	194.15p	£2,318
Cash				**£67**
Total				**£34,792**

Source: Investors Chronicle. Price and value as at 12 July 2013

that don't require the use of a lawyer to activities that do.

I suspect that the risks of buy-to-let are probably as great as those of equity investing. It's just that the latter are more salient, and more quantifiable, than the former. The fact that buy-to-let has paid off for many people recently does not overturn my scepticism; we invest in the future, not the past. You already have more than 10 times as much exposure to property as you do to equities – do you really want to increase the ratio further?

Colin Low, a chartered financial planner at Kingsfleet Wealth, says:

In any journey, it's imperative to understand three things: where you are, where you are trying to get to and how you are going to get from one to the other? That's essentially what we do as chartered financial planners, and I am encouraged to see that this is the way you have addressed your own personal finances.

It is good to see that you have a clear objective for your income needs at age 60 and the fact that you have an employer's pension arrangement is of significant assistance in meeting this target. It is important that you maximise the use of Isas as your timeframe is such that you are likely to benefit from some significant capital gains over the term, so sheltering these gains would be a major enhancement to total returns.

Time could well be your greatest asset but also your greatest area of concern. On the one hand, it could give a clearer picture regarding the most suitable assets in which to invest but, on the other hand, inflation could also erode value. This is something that you appear to have considered, as you have targeted, quite correctly, an income level in today's prices. So often people fail to do this in pension planning – they look at the projection from their provider and forget that it will not have the same purchasing power as today.

Due to this very real risk of erosion of value through inflation, you are prudent to look at investing in assets that target real returns, such as equities and property. There are obvious risks attached to the ownership of gilts and corporate bonds, but the often unseen risk is the erosion of value over the longer term through inflation.

You appear to have an excellent understanding of risk and I am encouraged by your reference to 'learning to live with volatility'. I would concur with your view that at your age there is little value in holding fixed-interest assets. With so many years investing ahead of you, I would encourage you to keep costs down and maximise stock diversification by using passive index or tracker funds for your core holdings, and then add individual stocks as your 'satellite' holdings. As the overall investment pot increases further individual holdings can be purchased.

You have expressed an interest in purchasing a residential property and letting it out. But, while I can totally understand the attraction of being a landlord, as this can be a potentially rewarding form of investment, there are many issues to consider. We recently summarised these to a client in this way:

Advantages

- Potential for long-term capital growth.
- Potential for income.
- More tangible than some share certificates or a valuation in an investment vehicle.

Disadvantages

- Costs which include, but are not limited to: solicitor's fees; surveyor's fees; mortgage arrangement fees; letting agent initial and ongoing fees; landlord insurance; repairs and maintenance; gas and electrical safety certificates.
- Property is illiquid – that is to say that a landlord is unable to sell just a part of it, and if property needs to be sold, it takes, at best, several weeks to realise the cash.

It's not quite as glamorous as some of the TV shows make letting appear and, after all, your own portfolio has shown that you can enjoy investing without the significant initial costs that property requires.