



When Leverage is Better Than Unleveraged Investing

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An annual investment could be invested directly without using leverage, or could be used to finance an investment loan.

Generally, when you leverage — borrow to invest outside of an RRSP — the interest expense is tax deductible.

Often the most critical and overlooked parameter in analyzing financial strategies is the human nature factor: what do you do with the tax refund? The most conservative case is where none of the tax refund is reinvested. The other extreme is the disciplined investor who reinvests all of the refund, in this case to finance a larger investment loan.

When *none* of the tax refund is reinvested, leverage is better than unleveraged investing when the investment returns exceed the cost of borrowing. However, we must also acknowledge the additional *personal* value of the tax refunds produced by leveraging.

For someone in a 50% tax bracket who reinvests *all* of the refund, leverage is better when the investment returns exceed two-thirds of the cost of borrowing. For example, if you expect your long-term interest expense to be 10%, then leverage is better than direct, unleveraged investing if your returns are at least 6.7%.

The following table compares the future value of investing \$2,000 a year unleveraged vs. using leverage for someone in the 50% tax bracket, and where the cost of borrowing

averages 10%.

Future Value of Investing \$2,000/yr *			
	8%	10%	12%
Unleveraged	91,500	114,600	144,100
Leverage, 0% of refund reinvested	73,200	114,600	172,900
%Difference	-20%	0%	+20%
Leverage, 100% of refund reinvested	109,800	171,800	259,400
%Difference	+20%	+50%	+80%

* After 20 years, 10% cost of borrowing, 50% tax bracket

If *all* of the refund from the leverage interest deduction is reinvested and used to finance a larger investment loan, then leveraging an investment that produces 10% returns would grow to \$171,800 vs. \$114,600 for the unleveraged approach, an improvement of 50%.

Done properly — conservatively, long term, with a trusted advisor — leverage is always better than unleveraged investing if your investment returns are higher than your average cost of borrowing. For those in a **high tax bracket who reinvest** the refund, **leverage is better** even when your investment **returns are only as high as two-thirds of your interest expense**.

To receive the mathematical analysis, please call below.



A basic understanding of the opportunities available will help you achieve *Financial Freedom Without Sacrifice*.

Talbot Stevens is a financial educator, speaker and author. For more information, visit www.TalbotStevens.com.