

Responsible Leverage

Less Risky Than No Leverage?

Evaluating the strategy of leveraging should not be an “all or nothing” decision.

The total risk of leveraging is the sum of the financial risk of losing money, the emotional risk of stress, and the shortfall risk of not having enough money to meet your retirement goals.

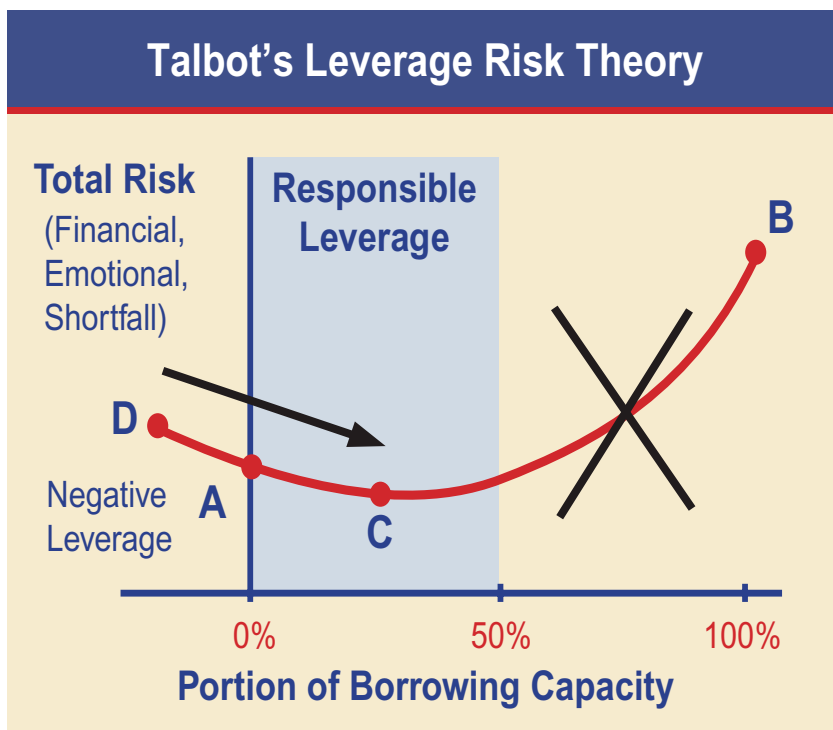
Unless you are already financially independent, not leveraging at all results in some shortfall risk and thus some level of total risk (point A). Leveraging the maximum that you can causes high levels of financial and emotional risk (point B).

Understood and implemented responsibly with long-term time horizons, leverage should magnify positive returns and decrease shortfall risk.

Consider such a small portion of your borrowing capacity, say 10-30%, where for you, the financial and emotional risks are negligible.

If the shortfall risk goes down and there is near zero financial or emotional risk, the total risk of leveraging a small, responsible amount is lower than the total risk of not leveraging at all (point C).

Many people use bad debt (i.e. negative leverage), borrowing at expensive rates to buy personal items, that only drop in value. This results in high financial, emotional, and shortfall risks (point D). Avoid negative leverage and never leverage the maximum. Only consider leveraging a small, comfortable amount that results in negligible financial and emotional strain.



Ironically, a small, responsible amount of leverage could be less risky than no leverage, and as a bonus, produce higher returns.