

NEWS RELEASE

October 2001

---

# Is Conservative Leverage Less Risky Than No Leverage?

## New Cut in Capital Gains Taxes Makes Strategy Better

Copyright Talbot Stevens, 2001

---

Some investors may have heard of the Efficient Frontier Theory, which shows how having *some* stocks in your portfolio results in less risk than having no stocks and only "guaranteed" investments. The bonus is that historically, having some equities has also produced higher returns at the same time.

Specifically, research shows that a balance of 10% stocks and 90% T-Bills produces less risk *and* higher returns than the "safe" portfolio of 100% T-Bills.

### Talbot's Leverage Risk Theory

A similar situation may also exist with leveraging, or borrowing to invest.

Let's define the total risk of leveraging as 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.

Now let's consider the total leverage risk associated with various amounts of leverage.

If you do not leverage at all, you will not have any financial or emotional stress due to leveraging. But if, like many investors, you have procrastinated and are behind on your financial plan, there is some level of shortfall risk that you will end up with a smaller retirement fund than you need.

Additionally, if you feel that you won't have enough money to enjoy a comfortable retirement, there can be emotional stresses as well. Unless you are already financially independent, not leveraging at all results in some level of total risk.

On the other extreme, if you leverage the maximum amount that a lender will give you and are always "in debt up to your eyeballs", there will be financial and emotional risk and stress to keep up with the loan payments.

As I've shown in the past, leveraging responsibly has the *potential* to increase investments by 50 to 100% or more. Even though the shortfall risk should go down, leveraging the maximum that you qualify for will result in a high level of total risk for most investors. Consistent with my message to consider only conservative leverage, **borrowing the maximum that you can is not recommended.**

Instead of borrowing the maximum, consider leveraging a small, conservative amount. If you leverage such a small amount that your financial and emotional risks do not increase, your total risk of leverage should actually go down. This is because the shortfall risk of not having enough retirement funds should decrease with a responsible leverage program.

After gaining an understanding of the mechanics and risks of leveraging, the critical question to answer is this:

Does leveraging a small, conservative amount result in more or less total risk than not leveraging at all?

Like the Efficient Frontier Theory, it is possible that **some leverage is less risky than no leverage, and as a bonus, produces higher returns at the same time.**

---

Talbot Stevens is a financial educator, speaker and author. For more information, visit [www.TalbotStevens.com](http://www.TalbotStevens.com).