<u>BORROWING TO INVEST</u>

QUESTION: Being an optimist, I am considering borrowing money to invest in non-registered mutual funds. Do you have any comments?

ANSWER: Yes I have some comments, based upon my opinion. Leveraging, which means borrowing to invest, can increase your net assets over time, provided it is practiced in moderation and fits within your comfort zone. Personally, I feel that it increases your risk - significantly.

If the market behaves in a rational, growth-oriented fashion, leveraging may prove successful. However, when the market stumbles, you may be requested to repay some or all of the borrowed money to your lender. This is referred to as a margin call. Margin calls can be difficult situations as the money you invested in funds may now be ten to twenty per cent lower than a year ago, forcing you to sell at a loss increasing your overall negative growth. It's important to note that some loans do not have margin calls.

This strategy works best if your investments will provide a rate of return greater than the cost of borrowing the money.

If everything runs smoothly, leveraging increases your overall profit. However, any sort of turbulence increases the risk of significant overall losses.

From a taxation point, Canada Revenue Agency (CRA) allows you to deduct the interest expense associated with leveraging, provided that there is a legal obligation to pay the interest and the amount of interest is reasonable for the situation.

Finally, the money borrowed must be to earn income from a business or property. (*Remember, the interest for borrowing for registered retirement savings plans is not tax deductible – there are other conditions, you should seek professional tax advice when considering this strategy.)*

One method used to minimize tax losses (by using the interest expense deduction) is to use existing investments to pay off your non-interest deductible debts (such as principal residences or vehicles) and then, borrow new money to invest in recognized investments that allow you to deduct your loan interest.

Again, leveraging is not for everyone. It is for the more aggressive who are able to tolerate market fluctuations, both emotionally and financially.

Caution

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