To assess your *ability* to take risk, you would look to the factual details laid out in your financial strategy or retirement plan. If your retirement plan cannot sustain higher expected risk (in other words, your cash flow is tight), then this investment strategy is not something you should consider.

Borrowing to invest is a better strategy for investors who have excess cash flow and need help building long-term equity outside their principal residence and/or business. Those who typically might benefit from this strategy are professionals with their own practices, such as partners at law, accounting firms, doctors or dentists.

Next, consider your *willingness* to take risk. If you can't sleep at night because your portfolio of investments using your own money has declined in value – never mind other people's money that you are considering borrowing from the bank – then this strategy is not right for you. However, if you are among the investors who have survived previous "bear markets" (i.e., stocks declining 20% or more) and have not panicked, then this strategy is one for you to consider.

Another situation that favours this investment strategy is that Canadians are traditionally very good at paying down debt, but they may struggle with building equity through savings outside their registered RRSP and TFSA accounts. So, this leveraged strategy of borrowing to invest could make sense – it forces the investor to save while they focus on paying down debt, which they have historical experience doing aggressively.

Your leveraged investment plan: A double-edged sword

Whether you acquire real estate with a mortgage or a stock portfolio using borrowed funds, the returns on those investments are magnified by the use of leverage and the cost of borrowing. As a result, you will see an enhanced and asymmetric impact on returns – the returns swing up and down.

In plain language, this means that if your portfolio (half borrowed and half not borrowed money or "equity") earned or lost 10% in a given year, the impact on the equity within your portfolio will move up and down by 17% and 23% (this is a highly simplistic example that assumes a 3% per annum cost to borrow). You can see that although the portfolio returns were symmetric – both up and down 10% – the equity return is asymmetric: it is higher and lower than the portfolio return, and it increases and declines by unequal amounts.

The enhanced equity returns up and down are caused by the use of leverage, while the asymmetry in returns is caused by the cost of borrowing. This asymmetry in returns creates the added need to get the timing right on your leveraged investment strategy. If you implement the leveraged investment strategy and your portfolio declines in value, stress and emotion can kick in and derail even the most seasoned investor's plan, resulting in a bad outcome overall.

Keep your leveraged investment plan clean and tax deductible

Borrowing to invest is tax-deductible in Canada when money is invested in a non-registered account. To keep your cost of investing clear for the Canada Revenue Agency (CRA), set up a line of credit dedicated only to your leveraged investment strategy. That way, it will be crystal clear how much it cost you to invest.

Success is based on diversification

Although we like to believe we can predict the future, we must accept that uncertainty is a part of the investing process, so with this realization you should spread out your investment risk to accommodate various scenarios. One way to achieve this is by owning stocks in different sectors that are thus exposed to different economic influences.

A common idea behind this leveraged strategy is to cover your cost of borrowing by purchasing dividend-paying stocks. You can find dividend-paying securities in almost all sectors of the economy, not just in the long-established Canadian banking sector.

Another way to diversify is to look at your portfolio in a North American context, and not just focus on Canadian stocks. Although you can realize tax advantages to owning Canadian dividend stocks through the dividend tax credit, tax considerations should be secondary in your mind to enhanced diversification.

Canadians who invest a portion of their leveraged strategy in the United States are likely to find many more stocks in a wider range of sectors of the economy (technology, health care, consumer discretionary, etc.), which can enhance your portfolio's diversification and outcomes. In addition, exposure to the U.S. greenback has historically provided Canadian investors with an enhanced source of diversification against market uncertainty.

The golden rule

Ignoring all the factors already discussed, the golden rule for anyone contemplating borrowing to invest is to look at the worst-case scenario.

Consider what would happen if your leveraged investment strategy went to zero and you still owed the bank the loan and interest. If this scenario would impair your family's current and expected lifestyle, then you should reconsider this strategy. Because, in essence, this strategy should be viewed as being more aspirational: We are trying to achieve the lifestyle we want in future, but not by losing the foundation (our needs) we have at present.

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