CIO believes a falling-rate environment in 2025 may be one where proactive borrowing approaches, with judicious use of debt as a tool for achieving financial goals, is worthy of investors' attention. (UBS)

Prudent borrowing can play multiple roles that support financial goals

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While the Fed struck a more hawkish tone to end 2024, we expect the global rate-cutting cycle to continue next year.

Falling borrowing costs may raise the appeal of borrowing strategies as a tool to manage liquidity, diversify, boost returns, and avert ill-timed asset sales. Borrowing can form part of a financial plan, subject to awareness of its risks.

While the Fed ended 2024 in a hawkish manner, global rates looked primed to fall in 2025.

- The Fed's December rate cut was accompanied by a more hawkish dot plot and Powell commentary, with the dot plot showing a median of two US cuts in 2025.
- Nevertheless, other major central banks such as the European Central Bank, Swiss National Bank, and Bank of England look poised to lower rates next year.
- Falling borrowing costs don't just reduce returns on cash, they also potentially boost the appeal of borrowing as part of a financial plan.

Prudent borrowing can play multiple roles that support financial goals.

- Borrowing may provide immediate funds without selling assets, avoiding taxable gains and transaction costs.
- Investors with concentrated wealth can borrow against less liquid assets and invest proceeds elsewhere to diversify their overall portfolios, potentially improving risk-adjusted returns
- Borrowing to invest can yield higher long-term returns if expected returns exceed borrowing costs.

With the right risk management, borrowing strategies may grow in appeal in 2025.

- Borrowing comes with risks that investors should be willing and able to bear.
- Investors should compare loan interest rates with expected returns; if returns are lower, borrowing may not be viable.
- A borrowing strategy's robustness must be assessed against market risks and spending plans. Key factors in choosing a borrowing strategy include loan duration, refinancing potential, and interest rate expectations.

Did you know?
Historical analysis, while no guarantee of future performance, suggests borrowing to invest in diversified portfolios may bear fruit. CIO analysis of 24-month rolling returns for a 60/40 portfolio of US stocks (S&P 500) and US government bonds between 1998 and August 2024 suggests such a balanced portfolio's performance would have exceeded borrowing costs on nearly 75% of occasions (and by an average 3.4% each year).

Investment view
We believe a falling-rate environment in 2025 may be one where proactive borrowing approaches, with judicious use of debt as a tool for achieving financial goals, is worthy of investors' attention. By leveraging debt wisely, investors have the potential to enhance portfolios, manage risks, and improve the likelihood of achieving long-term financial goals.

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