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Investment Research

Does borrowing make sense in 2025?

UBS House View Briefcase

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Key message

The Federal Reserve is likely to cut policy rates further in the coming months, and rates are already low in much of Europe. Lower borrowing costs may raise the appeal of borrowing strategies as a tool to manage liquidity, diversify and boost returns, and avert ill-timed asset sales. Borrowing can form part of a prudent financial plan, although the risks should be carefully considered.

01 The global easing cycle from central banks has continued, raising the appeal of borrowing strategies.

- Evidence of a weakening US labor market led the Federal Reserve to cut rates by 25bps in both September and October, with further reductions likely.
- The Swiss National Bank has brought its policy rate down to zero.
- The European Central Bank has cut its deposit rate eight times in total since June 2024, bringing it to 2%.

02 Against this backdrop, prudent borrowing can play multiple roles that support financial goals.

- It may provide immediate funds without selling assets, avoiding taxable gains and transaction costs.
- Investors looking to fund new private market investments may find it more efficient to borrow against diversified bond portfolios rather than hold excess cash to meet capital calls.
- Borrowing to invest can yield higher long-term returns if expected returns exceed borrowing costs.

03 With the right risk management, borrowing strategies may grow in appeal this year.

- Borrowing comes with risks that investors must 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.

New this week

The Federal Reserve cut the federal funds rate by 25 basis points on 29 October, its second consecutive reduction.

One liner

Subject to careful planning and risk management, borrowing may help manage liquidity, improve portfolio diversification, help navigate currency swings, and boost return potential in the year ahead.

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 finds such a portfolio would have generated returns ahead of US dollar 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 accommodate proactive borrowing approaches, with judicious use of debt as a tool for achieving financial goals. 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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