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Strategic: Optimize your leverage

Optimize your leverage

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- **Why?** 1) Borrowing can improve liquidity and portfolio flexibility, helping investors meet spending needs, tax payments, or private market capital calls without selling assets at an unfavorable time. 2) Debt can support resilience, as borrowing against existing assets may be one way to broaden their sources of return or reduce the need to hold excess cash. 3) Borrowing can bring portfolios closer to financial goals, assuming adequate buffers, diversified collateral, and clear repayment plans.



Prudent borrowing can enhance liquidity and portfolio flexibility, provided leverage remains aligned with repayment capacity and careful risk management.
Source: Unsplash

Why borrow?
We believe proactive, prudent, and strategic borrowing can form part of a robust financial plan. However, investors using leverage should be both willing and financially able to bear the distinct risks of borrowing. A robust borrowing plan should remain consistent with an investor's long-term objectives even when interest rates, currencies, asset prices, or liquidity develop differently from the central forecast.

As investors enter 2027, the case for leverage needs to be assessed against a different backdrop from the low-rate environment of the 2010s. Inflation should moderate, in our view, but stronger investment, elevated fiscal deficits, and greater government debt supply are likely to keep real interest rates and bond yields above pre-pandemic norms.

The implication is that investors should not base a borrowing strategy on the assumption that financing will soon become substantially cheaper. Instead, leverage should be structured so that it remains affordable if rates stay higher for longer and manageable if markets or currencies move against the investor.

What's next for rates?
Inflation is likely to moderate during 2027, although the path may remain uneven. Several central banks may tighten policy further in late 2026 or early 2027 before the hiking cycle draws to a close.

Our current forecasts for end-2027 policy rates are 4.50% for the Federal Reserve, 3.00% for the European Central Bank, 4.25% for the Bank of England, 0.50% for the Swiss National Bank, and 1.75% for the Bank of Japan. We forecast the 10-year US Treasury yield at 4.75%, compared with 5.13% at the time of the Year Ahead 2027 forecasts.

For borrowers, the important consideration is therefore not simply the next move in policy rates. Floating-rate borrowers should assess whether their financial plan remains robust if borrowing costs rise further or stay elevated for longer than expected. Fixed-rate borrowers should consider refinancing risk, particularly where debt matures before the asset being financed can reasonably be sold or generate cash.

Borrowing to stay invested
After carefully considering the above, we believe borrowing has the potential to help investors achieve their objectives. For example, it may help them manage liquidity without selling assets at an unfavorable point in the market cycle. A flexible line of credit can provide funds for tax payments, private market capital calls, property purchases, or other large expenditures while allowing assets to remain invested.

But the purpose and source of collateral matter. Borrowing against a concentrated portfolio to acquire assets exposed to the same economic driver can increase rather than reduce risk.

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For investors using securities-backed borrowing, this means considering both the size of the loan and the resilience of the collateral. A diversified portfolio of liquid assets can generally withstand a broader range of outcomes than collateral concentrated in a single company, sector, theme, or country.

Borrowing to allow time for markets to recover
Borrowing may also help avoid crystallizing losses after a market decline. But access to credit should complement, rather than replace, an appropriate liquidity reserve. In particular, investors should avoid relying entirely on borrowing capacity for emergency spending because credit availability, collateral values, and loan-to-value requirements can change during periods of market stress.

Investors should consider maintaining sufficient liquidity and unencumbered assets to cope with both expected spending and unexpected market movements.

Borrowing to diversify
Borrowing against existing assets to invest in assets with different return drivers may improve diversification and broaden potential sources of return.

The benefits are greatest where borrowing genuinely reduces dependence on a concentrated position or single market outcome.
Borrowing should therefore be assessed at the total balance sheet level, taking account of both assets and liabilities, rather than considering an investment and its associated borrowing in isolation.

Borrowing to manage currency exposure
Borrowing in a foreign currency can sometimes lower financing costs or help offset future income, spending, or investment exposure in that currency. But a lower interest rate does not necessarily mean a lower-risk loan.

The first objective should be to align currency exposure with where an investor lives, earns, spends, holds assets, and expects future liabilities. Once that strategic currency plan is established, interest rate differentials and currency opportunities can be considered as secondary factors.

This is particularly relevant for the Swiss franc. Its relatively low interest rate can make CHF borrowing appear attractive compared with higher-yielding currencies. We expect the franc's yield disadvantage to weigh on total returns, although spot weakness should begin to stabilize. Renewed geopolitical stress, an energy supply shock, a sharper global slowdown, or a broader risk-off move could nevertheless revive safe-haven demand for the franc.

Foreign-currency borrowers should therefore ask:
- Is there a future cash flow or asset in the borrowing currency that provides a natural hedge?
- Would the loan remain manageable if the funding currency appreciated materially?
- Would an adverse currency move coincide with falling collateral values?
- Could currency or interest rate hedges reduce an unacceptable risk?
- What exchange-rate, loan-to-value, or financing-cost threshold would trigger repayment or additional hedging?

An attractive interest rate differential or currency forecast should never be treated as protection against an adverse exchange rate move.

Ways to assess borrowing in a portfolio context
Borrowing to invest can increase long-term return potential, but leverage magnifies losses as well as gains.

The relevant comparison is not simply whether the expected investment return exceeds the headline borrowing rate. Investors should compare the expected return after taxes and fees with the all-in financing and hedging cost, while also allowing for uncertainty around future returns, interest rates, and liquidity.

A narrow expected return advantage may not provide sufficient compensation for the additional risks associated with leverage.
For example, an investment expected to return 6% financed at 5% offers only a one-percentage-point expected spread before investment fees, hedging costs, taxes, and forecast error. Such a narrow margin could disappear quickly if returns disappoint or financing costs rise.

Borrowing to enhance returns therefore makes the most sense where:
- the investor can withstand material short-term losses;
- the expected return advantage is sufficiently wide and durable;
- financing costs can be serviced without selling the investment;
- leverage remains manageable under adverse scenarios; and
- borrowing does not create excessive portfolio concentration.

Matching assets and liabilities
The term and structure of a liability should reflect the assets and cash flows expected to repay that liability.

Financing long-duration or illiquid investments with short-term or callable borrowing may create a mismatch. Even if the investment ultimately performs well, the investor could

be forced to refinance or sell before the investment has had sufficient time to realize its value.

This is particularly relevant for private markets. Private equity, infrastructure, and private credit investments can involve uncertain distributions, limited liquidity, delayed exits, and underlying leverage. Investors should therefore avoid depending on an uncertain private market distribution as the sole means of repaying a loan and should maintain an alternative source of liquidity if exit timing changes.

Why stress testing borrowing is crucial

A borrowing strategy should remain viable across a range of scenarios, not only the investor's or CIO's central forecast.

Our Year Ahead 2027 considers four scenarios. In our 50% probability base case, "Resilience, sustained," growth remains resilient, inflation moderates, and bond yields decline modestly. The 20% "Goldilocks" scenario combines stronger AI-driven growth with lower inflation. The 10% "Yield reset" scenario envisions persistent inflation, higher central bank rates and bond yields, and pressure on both equities and bonds. The 20% "AI bust" scenario envisions weaker AI investment, a broader slowdown, sharply lower equities, and stronger quality bonds.

We therefore see merit in stress testing borrowing plans against outcomes that can include rising financing costs, general market declines, falls in concentrated collateral, an appreciation in a funding currency, falls in private-asset valuations, or potential delays to private market distributions. The objective is to identify circumstances in which leverage might require an investor to sell assets, contribute collateral, or refinance at an unfavorable time.

A plan can be considered more resilient when assets retain sufficient value and liquidity to meet contractual borrowing requirements with a meaningful buffer even under adverse assumptions.

Building a repayment plan: Whatever the objective of the borrowing strategy, investors should establish how the debt will ultimately be repaid.

Identify a primary repayment source: This may be the sale of an asset, business income, salary, a liquidity event, or another expected cash inflow. The source should be specific rather than simply an assumption that portfolio returns will eventually cover the debt.

Set a repayment timeline: Define when the liability is expected to decline or be repaid. A schedule can help avoid allowing temporary borrowing to become permanent leverage simply through inertia.

Establish a plan B: Identify an alternative source of repayment if the expected sale, distribution, bonus, or business cash flow is delayed or does not occur.

Define triggers for action: Set levels for loan-to-value, financing cost, collateral value, currency exposure, or time elapsed that would lead to reducing leverage, contributing collateral, hedging risk, or activating the backup repayment plan.

Preserve an operating buffer: Investors should avoid running borrowing close to contractual maximum loan-to-value levels. The appropriate buffer will depend on the volatility, liquidity, and diversification of the collateral and the lender's terms.

For investors planning to use leverage as part of their strategy, we recommend three principles:

1. **Use debt selectively to improve resilience.** Borrow where it supports liquidity, diversification, or long-term financial objectives, rather than simply increasing exposure to existing portfolio risks.
2. **Match liabilities to assets and future cash flows.** Consider currency, maturity, liquidity, interest rate structure, and the reliability of the intended repayment source.
3. **Maintain buffers and manage leverage proactively.** Stress-test the plan, diversify collateral, maintain unused capacity where appropriate, establish repayment triggers, and reduce leverage before market conditions force action.

Global asset class preferences definitions
The asset class preferences provide high-level guidance to make investment decisions. The preferences reflect the collective judgement of the members of the House View meeting, primarily based on assessments of expected total returns on liquid and commonly known indices, House View scenarios, and analyst convictions over the next 12 months.
Absolute view
Attractive: We consider this asset class to be attractive. Consider opportunities in this asset class.
Neutral: We do not expect outsized returns or losses. Hold longer-term exposure.
Unattractive: We consider this asset class to be unattractive. Consider alternative opportunities.
Note: For equities, we have a five-tier rating system with two additional preferences. When equities are included with the other asset classes in the three-tier rating system, we collapse "Most Attractive" with "Attractive" and "Least Attractive" with "Unattractive."
Most Attractive: We consider this asset class to be among the most attractive. Investors should seek opportunities to add exposure.
Least Attractive: We consider this asset class to be among the least attractive. Seek more favorable alternatives opportunities.
Relative preferences
For the multi asset view, we also include relative preferences to help investors compare between items.
Preferred: We view this item more favorably than others within its asset class.*
In line: We see this item similarly to others within its asset class.*
Least preferred: We view this item less favorably than others within its asset class.*
*In the case of cross-asset, compared to other asset classes.
Note: The tactical asset allocation (TAA) positioning of our different investment strategies may differ from these views due to factors including portfolio construction, concentration, and borrowing constraints.

Appendix

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