



Cliff's Perspective

Yes, Lever, but With Care

February 13, 2015

Conventional wisdom holds that sensible investors avoid leverage. This is unfortunate. Sadly, the valuable role of leverage, applied prudently and used to diversify, not simply amplify, is widely misunderstood. In an [Institutional Investor](#) article this week, I seek to address this misunderstanding with knowledge of how portfolio leverage can be prudently employed and why it can be beneficial in modest doses with proper concern for its dangers.

Consider how investors often seek higher returns through more concentrated portfolios, say through greater equity exposure (concentrating in the more aggressive asset class). However, modest use of leverage can allow investors not to take on more risk, but to take the same level of risk but with a more diversified, more balanced, higher-return-for-the-risk-taken portfolio. This is not esoteric but one of the first things taught in finance class!

In this way, modestly leveraging a better, more diversified portfolio may improve upon an unlevered, much less diversified one — a rather sensible approach; one that is consistent with finance theory and will likely compensate investors for the necessity of employing some leverage.^[1] The article discusses this in more depth, and several things you must do to avoid the dangers that can come along with leverage.

Yes, lever, but in pursuit of diversification not just amplification, and prudently.

[1] This earlier Perspectives piece applies these ideas to risk parity portfolios.

To read other posts by Cliff Asness or to subscribe to future posts, please visit www.aqr.com/cliffs-perspective

The views and opinions expressed herein are those of the author and do not necessarily reflect the views of AQR Capital Management, LLC, its affiliates or its employees.

This document has been provided to you solely for information purposes and does not constitute an offer or solicitation of an offer or any advice or recommendation to purchase any securities or other financial instruments and may not be construed as such.

The investment strategy and themes discussed herein may be unsuitable for investors depending on their specific investment objectives and financial situation. Diversification does not eliminate the risk of experiencing investment losses.

Please note that changes in the rate of exchange of a currency may affect the value, price or income of an investment adversely.

The factual information set forth herein has been obtained or derived from sources believed by the author and AQR Capital Management, LLC ("AQR") to be reliable but it is not necessarily all-inclusive and is not guaranteed as to its accuracy and is not to be regarded as a representation or warranty, express or implied, as to the information's accuracy or completeness, nor should the attached information serve as the basis of any investment decision.

Information contained on third party websites that AQR Capital Management, LLC, ("AQR") may link to are not reviewed in their entirety for accuracy and AQR assumes no liability for the information contained on these websites.

No part of this material may be reproduced in any form, or referred to in any other publication, without express written permission from AQR.