



ALTERNATIVE INVESTING

Yes, Lever, but With Care

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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.

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