Near 0% Interest Rates: Should You Borrow and Invest in This Cheap Market?

Description

Typically, a loan consists of the principal plus interest for the term of the loan. When you're applying for a loan, you go for the lender offering the lowest rate. But how good is the deal when you can borrow at near 0% interest? As well, would it be wise to borrow then invest in this bear market?

You can make a lot more money if you can borrow interest-free to invest in stocks. Veteran stock traders have been using borrowed money (with low interest) to purchase stocks. Investors are confident in leveraging the money because the expected investment returns are higher when compared to the cost of borrowing.

Not a perfect formula

Assuming zero financing is available to you in the bear market, it's still a risky proposition. Your amortization is fixed, but the gains from the stock market are variable and unpredictable. Right now, an epidemic is sweeping the market such that selloffs are happening in almost all sectors.

Even amid a rising market, regular investors shouldn't leverage debt to buy stocks. The formula isn't perfect because you can either win or lose big time. Some seasoned traders became rich because of the practice, but many became poor for not containing the urge to borrow in the desire to get rich quick.

Drawing from a credit line

A home equity line of credit (HELOC) can be an option for some intending to borrow funds for investment. This is a secure form of lending where you use your home as a guarantee to pay back the loan.

Losses, however, are inevitable even if the lender charges no interest. If your stock appreciates 10%, your return is $1,000 in a year on a $10,000 home equity loan. In a bear market, losses can be more than 10%. Hence, when the stock value drops by 10%, you have zero profit and have to pay back the loan.

Remember that stock investing is a speculative play. When the market is crashing, you're not sure when stock prices will hit rock bottom.

Consumer-defensive asset

If you have free or idle cash you want to grow, choose stocks that can outperform during periods of recession. The business model of **Loblaw** (TSX:L), for example, is resilient in tough times. People will continue to patronize grocery and pharmacy service providers.

Last year, Loblaw's revenue grew by 2.9% versus 2018. Despite the cost pressures, same-store sales in the food and drug sector delivered 3.6% and 1.1% growth, respectively. Revenue and earnings should remain constant and stable in a long-drawn recession.

Currently, the stock is trading at $71.94 per share, with a year-to-date gain of 7.93%. Its dividend yield of 1.84% should also be safe given the low 42.76% payout ratio. As one of the country's leading grocer and pharmacist, Loblaw can weather the impact of the coronavirus outbreak.

This consumer defensive stock will fit well in your Tax-Free Savings Account (TFSA). All modest gains or dividends from Loblaw will be tax-free.

No borrowing in a market crash

Even with low rates or zero interest, it's advisable not to borrow and leverage money to invest at this time. My best suggestion is to stay put and return to the market when the fog clears.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:L (Loblaw Companies Limited)

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1. Business Insider
2. Msn
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