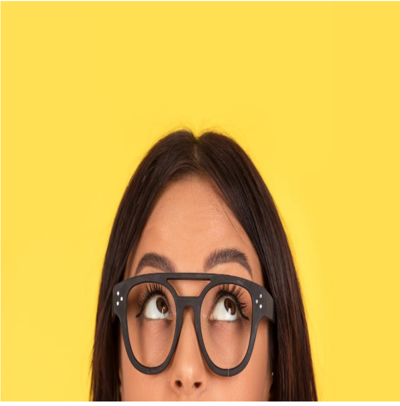

Should You Borrow to Invest in a Market Correction?

Description

It may not look like we're experiencing a market correction when the Canadian stock market proxy, the **iShares S&P/TSX 60 Index ETF**, is trading near its all-time high. The Canadian stock market is weighted more heavily in the financial, energy, and basic materials sectors that have either been holding steady or making new heights lately. This is why the Canadian stock market's recent dip of about 2% is immaterial when we look at the big picture. However, certain parts of the market have corrected meaningfully — tech stocks, other growth stocks, and industrial stocks, to name a few.

Everyone knows to make meaningful money, you should buy low and sell high. So, we should all be loading up on tech, growth, and industrial stocks, right? Would you go as far as borrowing money to invest in these cheap-looking stocks? There are pros and cons when it comes to borrowing to invest.

Why you should borrow to invest in a market correction

If you enjoy investing, then it's a fun activity for you. People pay for experiences, but investing is an experience that can make you more money while you have fun!

Using leverage or borrowing money to invest provides more capital for you to work with. Leveraging works in your favour if you're right. All you need to do is make returns on your investments that are greater than your borrowing costs.

According to Bankrate.com, the best personal loan interest rate is currently between 3% to 36%. "The actual rate you receive depends on multiple factors, such as your credit score, annual income and debt-to-income ratio." If you have a good credit score, annual income average or better, and a low debt-to-income ratio, your interest rate should be at the low end of the spectrum. Canadians' average salary in 2020 was $54,630.

Let's say you could borrow at a 3% interest rate. If you can find a solid dividend stock providing a safe 4% yield at a discounted valuation, you could consider borrowing to invest in it to increase your net worth.

Why you should NOT borrow to invest

Many Canadians already have a mortgage on their backs. They probably would appreciate not having to manage even more debt.

Moreover, debt is a two-way street, or a double-edged sword. It's great when it works in your favour. Unfortunately, it can hurt you if your investments don't work out. When that happens, it means you paid extra and got poor or even negative returns.

For example, some investors got really excited when **Shopify** stock retreated from the $2,200 level. They might have bought at the $1,700 range, but who would have thought that the stock would drop all the way to the $600 level today? That's more than a two-thirds correction from the peak! Shopify is not alone. Many growth stocks fell from space down to Earth. How would you feel if you borrowed to invest in stocks like that?

If you invest with your own money that you don't need for the long term, you have greater holding power than investors who borrowed to invest, especially as interest rates rise.

Additionally, chances are that stocks you're investing in have underlying businesses that are already leveraged. Businesses either borrow or sell shares of the business to finance their assets. So, it's only natural for businesses to have debt. Depending on the industry, stocks would have higher or lower levels of debt. For instance, utilities like **Fortis** stock tend to have high levels of debt, because they usually generate stable and predictable earnings.

To sum it up, because businesses are typically already leveraged, you do not necessarily need to take the extra risk of borrowing to invest, especially if your borrowing cost (interest rate) is high.

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