Borrowing solutions:

Give yourself credit

Meagan Dow, CFA, CFP® • Senior Strategist, Client Needs Research

Whether it's to purchase a car or home, or buy everyday items with a credit card, most of us borrow for one reason or another. Credit gives you the ability to finance larger purchases and can be a source of short- or long-term financing. A comprehensive strategy addresses not only your savings and investment needs but your borrowing ones as well.

Report highlights

- Your investment portfolio can be a potential source of credit for your borrowing needs.
- The Edward Jones Personal Line of Credit (a margin loan) and Reserve Line of Credit (a securities-based loan or SBL) could help keep your long-term investment strategy intact by not selling long-term investments for potentially shorter-term needs.
- When considering these loans, it's important to understand:
  - The purpose of the investments against which you're borrowing
  - The risk of using those investments as collateral
  - Your ability to repay the loan
  - The asset allocation of your investments
  - The borrowing cost

While there are many potential sources of credit (including credit cards and home equity loans), one source that is often overlooked is your investment portfolio. Depending on your borrowing needs, using a margin or securities-based loan (SBL) as a personal line of credit within your investment portfolio may be an appropriate solution.

The basics of margin and securities-based loans

When a need arises, you may look to your investment portfolio as a source of cash to satisfy a short-term need. However, your investment portfolio is probably designed to provide for your longer-term goals, such as retirement. By selling investments within your portfolio, you may not only disrupt your long-term goals but also incur tax consequences.

A potential solution may be to consider using a margin loan or SBL as a personal line of credit. The Edward Jones Personal Line of Credit is a margin loan that can be taken against the value of the investments in your account. The Edward Jones Reserve Line of Credit is a securities-based loan that also can be taken against the value of the investments in your account. These loans can allow your investments to continue to help you work toward your goals, while serving as a source of collateral for credit you may use under certain conditions.

The potential benefits may include:

- Convenient and confidential access to cash
- A flexible repayment schedule
- The ability to retain ownership of your investments
- An opportunity to avoid the potential tax consequences of selling investments

How do they work?

Essentially, instead of borrowing from a bank, you are borrowing from Edward Jones, using the wealth you have created. These loans are available only on certain types of accounts, but with an eligible account, you may be able to borrow up to 50% of the value of your eligible securities. As with any loan, an interest rate is applied to the balance of the loan from its start date and will be charged to the account.

There are other important interest rate considerations, including:

Relationship-size vs. loan-size pricing

Most firms base the interest rate on the size of the margin loan, but in our view, this ignores the depth of the relationship we share. Edward Jones will base your interest rate on the size of the relationship you have with us. The more assets you have under our care, the lower your relative interest rate on a loan.

Variable interest rate

Interest rates are tied to the prime rate, which fluctuates over time but often is lower than rates on credit cards and consumer loans. This interest expense is calculated daily based on the size of your loan and is posted to your account monthly.

Investment income vs. interest expense

Since you still own your investments, you still earn interest and dividends on them that could be used to help offset the interest expense on the loan.

When can you use a margin loan or SBL?

Once you've decided borrowing is a good way to meet your short-term goal or need, start by exploring all borrowing options available to you (e.g., margin loan, SBL, home equity loan, car loan, etc.). Please see our report "Planning for short-term goals on your long-term journey" for more information.

Before deciding on a borrowing option, we think it's important for clients to explore all the borrowing options available to them. While there are many potential uses for the Personal Line of Credit and Reserve Line of Credit, it's important to understand when it makes the most sense to use it versus other sources of borrowing. We generally believe margin and SBL are more appropriate when bridge financing is needed (generally less than 12 months). Examples of bridge financing include:

- Working capital for business owners
- Education financing until student loan proceeds or other expected cash flow comes in
- Assistance for family members until they can pay you back
- Home renovations/repairs until home equity loan proceeds or other expected cash flow comes in

Understanding the risks

There are risks to using credit. While it can help increase the amount you can buy, it can also magnify the amount you could lose (or owe). Before you use a margin loan or SBL, you should always weigh the risks with the potential benefits.

First, while the repayment schedule is flexible (i.e., you can pay it back at your own pace), there's always the requirement to pay back the loan, including interest. So you must have the ultimate ability to pay off the debt in full.

A trade-off of this flexible repayment schedule is the possibility of a margin call or collateral call. Since your investments are serving as collateral for your loan, if their value declines below a certain amount, a margin call or collateral call may be issued. This could require you, on short notice, to deposit cash or additional securities. Alternatively, the securities in your account may be sold (without notice to you) to meet the call.

Does a margin loan or SBL make sense for you?

Given the benefits and risks, we recommend considering the following to help you determine whether these loans may be appropriate for your situation.

Purpose of investments
It's important to have a strategy and discipline to pay off any debt and not disrupt the long-term goals of your portfolio. For example, if you're using your investment portfolio to provide for your everyday expenses in retirement, we generally don't recommend borrowing against these assets. If you needed to sell these assets to repay the loan, they would no longer be available to provide for your income needs.

Asset allocation
Generally, the more aggressive your portfolio, the higher the potential for fluctuations in value, and therefore the greater the likelihood for a margin call or collateral call. Due to this possible volatility, it's important for you to have a diversified investment portfolio when using it as a source for a line of credit. Depending on your portfolio's allocation, we may require higher margin requirements.

Interest rate
Another important consideration is the cost of borrowing. It's important to compare the rate Edward Jones offers with other credit options to select the one that best fits your needs.

Ability to repay the debt
If you don't have the ability to repay the loan without selling your securities, or are already having issues repaying your current debt, we don't recommend using the Personal Line of Credit or Reserve Line of Credit.

Borrowing vs. leveraged investing

Another purpose of a margin loan could be to purchase additional securities, which we refer to as "leveraged investing" — buying securities on margin.

While this strategy can magnify the potential gains of an investment, it can also magnify the potential losses. For example, when you borrow to purchase investments, it's possible to lose even more money than you invested.

The use of margin loans for leveraged investing is not encouraged because of the increase in investment risk. This strategy should be considered only by individuals with a high risk tolerance and a desire to be aggressive with a portion of their portfolios.

Consider your:

- Investment experience
- Percentage of net worth the leverage represents
- Ability to make interest and principal payments
- Capacity to withstand a potential loss

Give yourself credit

The Edward Jones Personal Line of Credit and Reserve Line of Credit may be lower-cost sources of financing you haven't considered. Using your investment portfolio as collateral may provide you with additional flexibility for your borrowing needs. After considering the purpose of your borrowing, as well as other key factors highlighted in this report, you can better determine whether a margin loan or SBL makes sense for your situation.

Important considerations

Investing on margin or using a margin loan involves risk and is not appropriate for everyone. You can lose more funds than you deposit in the margin account. A decline in the value of securities purchased on margin may require you to provide additional funds to Edward Jones to avoid the forced sale of those or other securities or assets in your account. In the event of a margin call, the firm can sell securities or other assets in your accounts and can do so without notice to you. You may not be entitled to choose which securities or other assets in your accounts are liquidated or sold to meet a margin call. The firm can increase its maintenance margin requirements at any time and/or not grant an extension of time on a margin call.

