Manulife Bank

INVESTMENT LOANS

I don't understand how investment loans work.

Learn and profit!

"Borrow to Invest" – it only sounds complex

For investors accustomed to a traditional 'earn-save-invest' strategy, the idea of borrowing to invest can seem intimidating, and even counter productive. After all, how can your investment plan be better off by introducing a loan interest payment? Wouldn't the amount you are able to save be reduced? With investment loans, as with many experiences in life, things are not always as they first appear. For people who take the time to learn how investment loans work, often the only question remaining is: "How do I get started?"

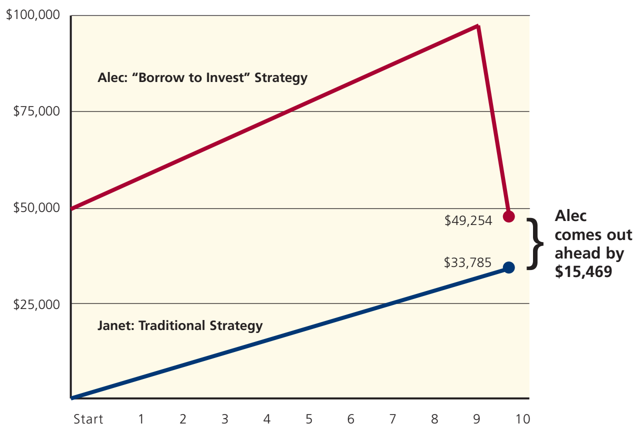
How is this different from a traditional strategy?

Traditional investors set aside a portion of their income each month to purchase investments, which means they gradually build up their portfolio over a long period of time. Conversely, investors who use a "borrow to invest" strategy invest a large lump sum on day one, and then set aside income each month to make interest payments. The 'out of pocket' cost may be the same, but the 'borrow to invest' strategy has the potential to generate far greater returns.

Consider the example of Janet and Alec . Both Janet and Alec want to start a non-registered savings plan. Alec decides to take out a Manulife Bank Investment Loan of $50,000. He invests the loan proceeds, and pays interest on the loan over the next 10 years. Janet makes end of year investment contributions that are equivalent to Alec's after-tax cost of borrowing. During the 10-year investment period, both investors earn 8% on their investment (annual after-tax return). Janet contributes a total of $25,346, and Alec's net cost of borrowing is $25,346.

At the end of 10 years, Janet and Alec sell their investments and pay the applicable taxes. In addition, Alec repays his $50,000 loan. As the illustration below shows, Alec achieves greater growth by over $15,000 even after the loan is repaid, interest costs are considered, and taxes are paid on his investment gains.

Net value of Janet & Alec's investments after 10 years



Assumptions: 8.0% investment return, 25% taxable portion of return, 30% tax rate on investment income, 7% loan interest rate, 100% loan interest deductibility, 40% marginal tax rate. Assumptions are for illustration purposes only.

Let our money work for you

What's driving this strategy?

There are two high-powered financial engines driving this strategy. And because of these two engines, a 'borrow to invest' portfolio has the potential to provide greater long-term returns than a traditional strategy.

Engine #1: Compound Returns

A 'compound return' is simply when the investment growth from one year provides a larger base for investment growth the next year. That is – the investment growth grows! With a traditional investing strategy, some contributions are not made until years into the plan, meaning they have less time to 'compound'. A 'borrow to invest' strategy harnesses the full power of compound returns by allowing a single, large contribution on day one to compound for the full investment period.

In the illustration on the reverse page, Alec makes a $50,000 contribution at the start of year one. This means that he has $50,000 growing at 8% for a full 10 years. Janet, on the other hand, spends the first year saving up for her first contribution, which she makes at the end of year one. This means that her first contribution grows for 9 years, her second contribution for 8 years, and so on. Overall, Janet's investment has much less time to take advantage of compound returns.

By borrowing to invest, Alec has made his money work harder.

Engine #2: Interest Deductibility

In general, when a loan is used to purchase investments, the interest paid on the loan can be deducted from taxable income. This effectively reduces the cost of borrowing, and consequently reduces the rate of return required for this strategy to be profitable.

In the illustration on the reverse page, Alec and Janet's investments both earned a return of 8.0% per year. However, Alec's 'break-even' return is actually 5.24%. This means that if Alec and Janet had earned an average return of 5.24% over 10 years, they would have ended up with about the same amount of money. If they had earned less than 5.24%, Janet's approach would earn her more than Alec. However if they had earned more than 5.24%, as we saw in this illustration, Alec's 'borrow to invest' strategy would have left him in a better financial position.

Also note that Alec's 'break-even' return of 5.24% is lower than the 7.0% rate of interest that he's paying on the loan. Because of interest deductibility, the break-even return for a 'borrow to invest' strategy is generally lower than the interest rate being paid on the loan.

Would this strategy work for me?

With the twin financial engines of compound returns and interest deductibility at work, an investment loan has the potential to benefit every investor. However, since this strategy involves a higher degree of risk than a traditional investing strategy, borrowing to invest is most appropriate for investors with a higher risk tolerence, and a long-term investment horizion. Your financial advisor can provide you with more information on investment loans and provide you with an illustration, taking into account your unique financial situation.

Talk to your financial advisor today to learn more about how a Manulife Bank Investment Loan can work for you!

Important Note

Borrowing to invest is suitable only for investors with higher risk tolerance. You should be fully aware of the risks and benefits associated with investment loans since losses as well as gains may be magnified. The value of your investment will vary and is not guaranteed, however you must meet your loan and income tax obligations and repay your loan in full. Please read the terms of your loan agreement and the investment details for important information, and discuss with your financial advisor before deciding to borrow to invest.

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AB0343E (04/2003)