invest what they don’t have all the time when it comes to real estate. A 5-to-1, 10-to-1, even 20-to-1 leverage is becoming the norm. A person who buys a $600,000 house has a relatively flat exposure to the real estate market. The exposure grows only with house price appreciation and not with increased savings. The key is that your exposure to the real estate market is based on the full value of the house, not just your down payment or your current equity position.

Retirement accounts should take a lesson from home ownership. Retirement programs should allow people to take out mortgage mortgages to buy more stock when they are young. Just as home mortgages become less leveraged over time, so would the retirement investment mortgages. You can’t do this now, at least without resorting to options and the like. But even allowing retirement savings to start off with the allowable 2-to-1 leverage leads to much better and less risky retirement outcomes, but to date we know of no 401(k) or self-directed IRA plan we know of permits margin buying.

To test how our theory would work in practice, we took historical stock-and-bond-return data collected by Robert Shiller and added margin rate information. Following Shiller’s approach, we ran simulations on the returns for 910 cohorts of workers, those retiring in 1913 through 2004. We calculated the real investment return (the return above inflation) from an investment strategy that began with a 2-to-1 leveraged investment in stock at age 65 reducing to an unleveraged 50% investment in stock at age 65. We found that none of the cohorts ended up with less than a 2.5% real return on their investment (and only 2 of the 910 cohorts fell below 3%). In contrast, what would seem to be a much more conservative strategy of starting with an 85/15 stock/bond split at 25 falling to a 15/85 stock/bond split at retirement produced 29 cohorts with real returns that fell short of 3%. Because of the longer investment in equities, the average real return for the leveraged strategy across the 91 cohorts was more than double the conservative strategy.

In real estate the most important rule is location. For investments, it’s diversification. Investors understand the value of diversifying across domestic stocks and many appreciate the advantage of including international stocks in their portfolio. The big missed opportunity is to do a better job diversifying over time, getting an early (and leveraged) start in stocks. We do this with houses, why not stocks?

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