BESPOKE Investment Group
B.I.G. Tips
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Margin Debt Hits Another Record High

Margin debt for the month of August was released earlier today, and at a level of $550.9 billion, it hit a record high for the second straight month and the sixth time in the last eight months. Record levels of margin debt are often considered a negative signal for equity prices on the assumption that investors are leveraged to the hilt, and everyone that is going to get in the pool is already swimming. Charts like the one below only exacerbate the angst that surrounds record levels of margin debt. Back in March 2000 and then again in July 2007, margin debt levels peaked at record highs and not long thereafter the S&P 500 went on to get cut in half! You can bet that after this morning's release, you can expect to see a lot more headlines like this in the coming days.

Looking at the chart another way, however, provides a different perspective. There's no escaping the fact that both of the last two bear markets occurred from levels where margin debt was at a record high, but what you also have to take into account is that *margin debt is frequently at record highs*. The chart below shows margin debt readings going back to 1959, and everywhere you see red indicates a record high level. In total, *nearly one in four monthly margin debt readings since 1959 have been record highs*. So while it is true that margin debt levels may often be at record highs just before a bear market begins, there are also multiple periods where a bear market didn't follow. In the 1990s alone, 41% of all monthly margin debt readings were record highs. Imagine how you would have felt if you sold after that first record high of the decade in February 1993 or even the 20th occurrence of the decade in November 1995?

Taking a more detailed look at performance figures, the first table below shows the average historical return of the S&P 500 following record and non-record monthly readings in margin debt levels since 1959. For each reading, we calculated the S&P 500's forward three, six, and twelve month returns and then grouped and averaged the readings based on whether or not margin was at record or non record levels.

Looking at the results, there is a clear case to be made that non-record levels of margin debt have been better for forward returns than record levels, but the difference in performance isn't nearly as wide as the first chart on page one might suggest. Three months after a non-record reading in margin debt, the S&P 500 has seen an average gain of 2.1% with positive returns 65.2% of the time, whereas three months after a record high reading in margin debt the S&P 500 has only averaged a gain of 1.2% with positive returns 62.6% of the time.

In the six month time frame, the average returns are much closer between non-record and record high readings (4.0% vs 3.6%). Finally, in the one year time window, the S&P 500 has averaged a gain of 8.2% after non record readings compared to an average gain of 6.9% following record high readings.

Average S&P 500 Performance Following Record and Non Record Margin Debt Since 1959

	Three Months		Six Months		One Year	
Margin Debt	**Avg Change (%)**	**% Positive**	**Avg Change (%)**	**% Positive**	**Avg Change (%)**	**% Positive**
Non Record	2.1	65.3	4.0	68.5	8.2	75.1
Record	1.2	62.8	3.6	65.0	6.9	63.1
Overall	1.9	64.7	3.9	67.7	7.9	72.4

More recently, using data going back to just 1980, the performance spread between record and non record levels of margin debt is even smaller. While the performance disparity over the following three months is 1.2 percentage points, in the six month time frame, the S&P 500's average performance following record and non record levels of margin debt is the same at 4.9%. One year later, the performance spread between non-record and record levels of margin debt is just 0.9 percentage points (10.0% vs 9.1%).

Average S&P 500 Performance Following Record and Non Record Margin Debt Since 1980

	Three Months		Six Months		One Year	
Margin Debt	**Avg Change (%)**	**% Positive**	**Avg Change (%)**	**% Positive**	**Avg Change (%)**	**% Positive**
Non Record	2.7	68.6	4.9	73.8	10.0	80.8
Record	1.5	66.1	4.9	68.5	9.1	65.1
Overall	2.4	68.0	4.9	72.5	9.8	76.9

The chart to the right shows the S&P 500 going back to the start of 2013 with red circles denoting record levels of margin debt. While we did see two record high readings in early 2015 just before the S&P 500 made a short-term high, there were seven such occurrences from late 2013 through early 2014 and equities kept rallying even after each one of them. That includes the February 2014 reading after which margin debt went a full 12 months without a new high.