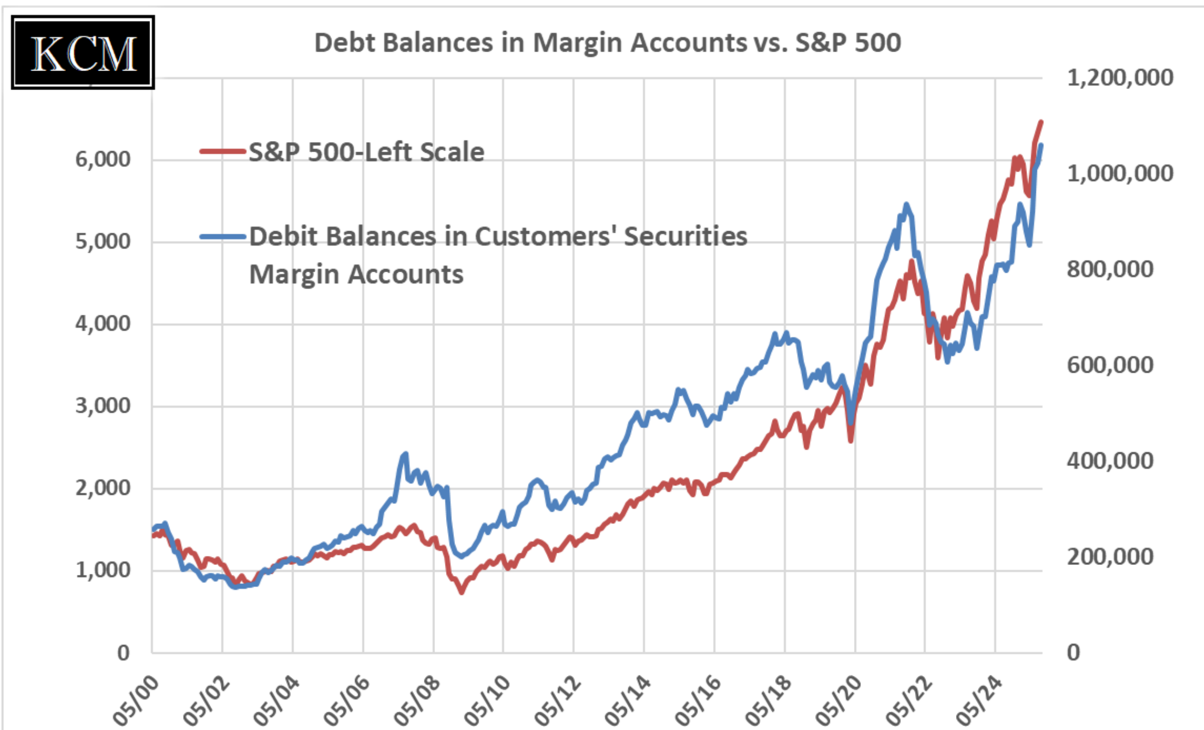
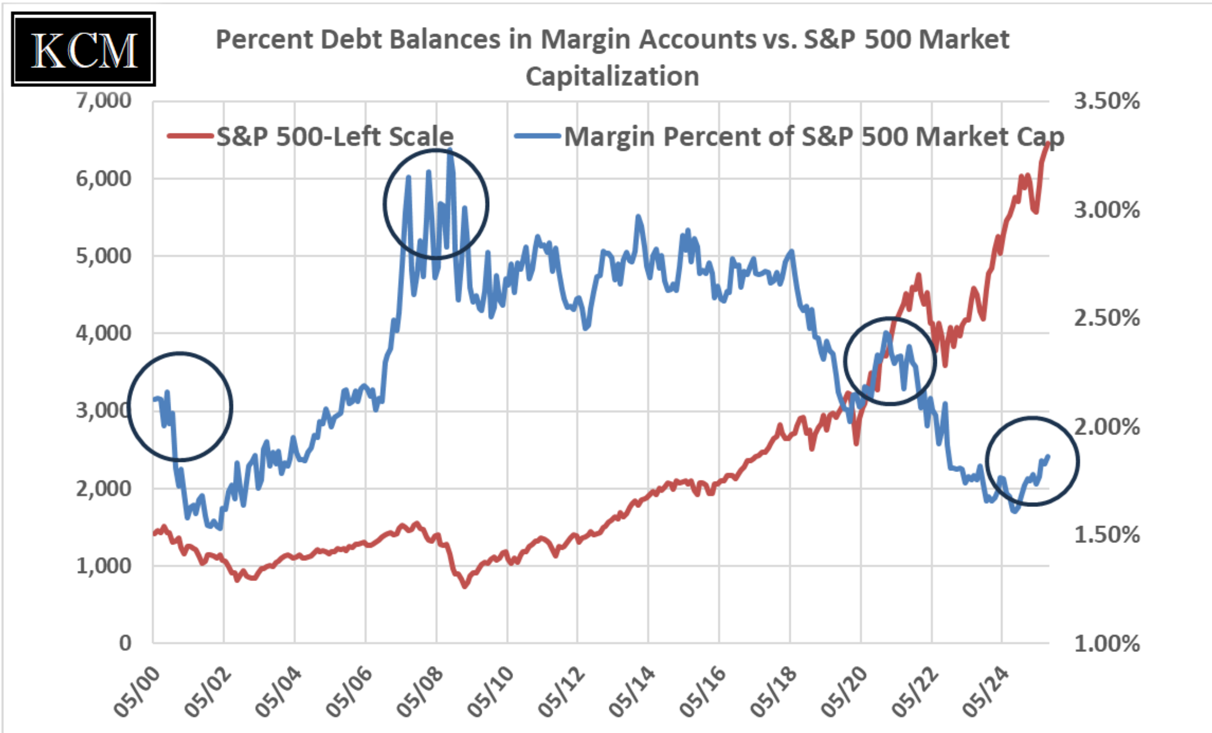
Margin Debt and Market Peaks

These two charts illustrate the relationship between stock market performance and investor borrowing, but they do so from two different perspectives.



The above chart compares the level of the S&P 500 index (red line) with the total dollar amount of money investors have borrowed in their margin accounts (blue line). The key takeaway here is the strong positive correlation between the two. As the stock market rises, the amount of margin debt also tends to rise. Conversely, when the market falls, margin debt also falls. When stocks go up, investors feel more confident and are more willing to borrow money (use leverage) to buy more stocks, hoping to amplify their gains. Also, as their portfolios increase in value, their borrowing power increases.

This chart indicates that margin debt is a good general indicator of investor sentiment. Rising debt suggests optimism, while falling debt suggests pessimism or forced selling (margin calls).



This chart also shows the S&P 500 (red line), but it plots the margin debt differently. The blue line now represents margin debt as a percentage of the total value (market capitalization) of all the companies in the S&P 500. This provides a much more powerful insight into market risk. Instead of just looking at the raw dollar amount of debt, it measures the level of leverage relative to the size of the market. This chart is often used as a warning indicator. Notice that the blue line tends to spike to high levels right before major market downturns, such as in 2000 (Dotcom bust), 2008 (Financial Crisis), and late 2021. When this percentage gets high, it suggests that speculation is excessive and the market is over-leveraged, making it more vulnerable to a sharp sell-off.

The key difference: While the first chart shows that debt grows as the market grows, this second chart normalizes that data. It helps to identify periods when investor borrowing is growing faster than the market itself, signaling potential froth and instability.

We note the blue line on the second chart clearly shows an upward trend from its low point sometime in 2023. This indicates that following a period of caution, investors are once again increasing their use of leverage to buy stocks. This rising confidence often accompanies a rising stock market.

It is not historically concerning yet. As the chart shows, the peaks of speculative excess that preceded major downturns were at much higher levels:

- 2000 Dot-com Bubble: Margin debt exceeded 3.0% of the S&P 500's market cap.
- 2008 Financial Crisis: The peak was even higher, approaching 3.25%.
- Late 2021 Peak: The level reached approximately 2.5% before the 2022 market decline.

Currently, the blue line is still below the 2.0% mark. While it is rising, it has not yet entered the territory that has historically signaled immediate, widespread danger of an over-leveraged market.

In summary, investor confidence is returning, but leverage has not yet reached a level of extreme speculation seen at the top of previous major market cycles. It is a trend worth watching closely, but it is not yet flashing a definitive red alert.

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