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MIXED SIGNALS:
WHAT POST-ELECTION MARKET INDICATORS ARE TELLING US

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HIGHLIGHTS

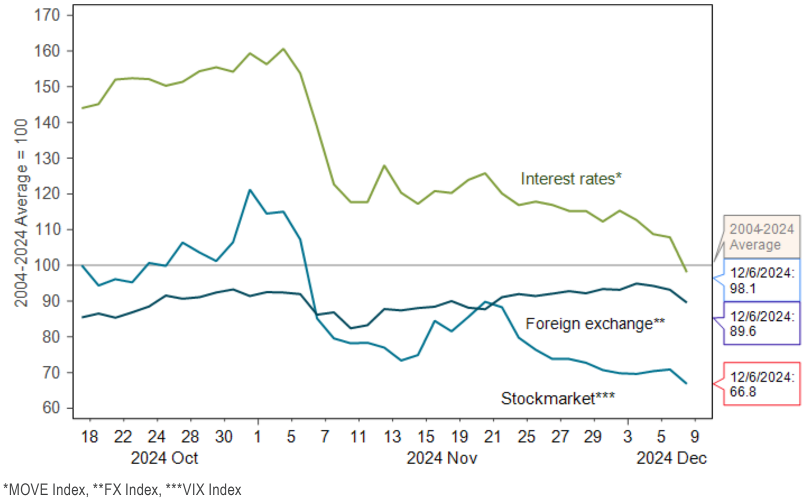
- While stock market volatility has dropped to unusually low levels after Trump's election, traders are paying record prices for protection against extreme market moves.
- Markets appear to be pricing in positive outcomes from potential tax cuts and deregulation while hedging against risks from aggressive trade policies.
- The unusual combination of low volatility and expensive crash protection suggests investors should maintain balanced portfolios rather than making all-or-nothing bets.

FINANCIAL MARKETS HAVE BEEN QUITE CALM

Financial markets have reacted to Donald Trump's presidential election victory with an unusual mix of confidence and caution. On the surface, Wall Street appears remarkably calm — major stock indices have rallied while traditional measures of market fear have dropped to surprisingly low levels (**Figure 1**). But beneath this

FIGURE 1

Calm Financial Markets:
United States, Implied-Volatility Measures



Note: *MOVE Index, **FX Index, ***VIX Index
Sources: GW&K Investment Management, Bloomberg, and Macrobond

Markets have been remarkably calm since the US presidential election, as reflected in impressive drops in volatility in key stock and bond markets.

Even foreign exchange markets have seen below average levels of volatility despite heightened uncertainty about trade policy amidst tariff war threats.

placid exterior, traders are paying record prices for protection against extreme market moves, suggesting deeper concerns about what lies ahead.

This disconnect between different market indicators tells us something important about how investors view the next four years: They're optimistic about the general direction but increasingly worried about the possibility of severe disruptions.

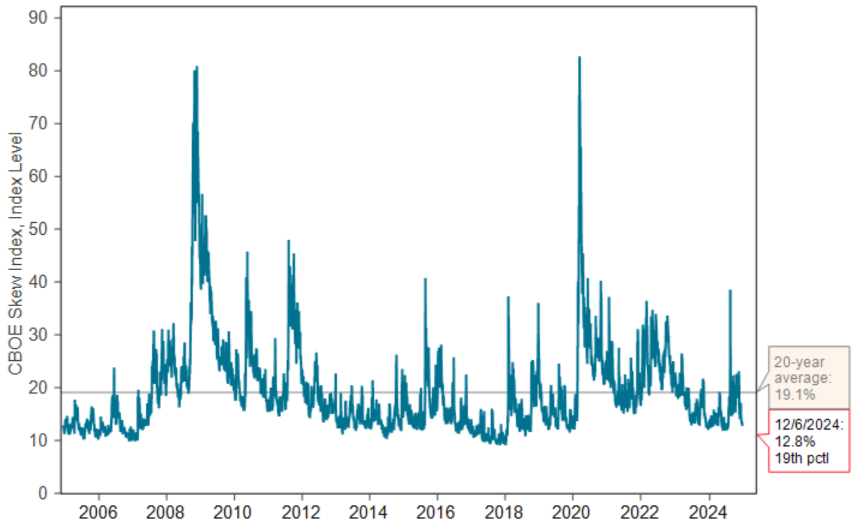
THE VIEW FROM MAIN STREET

To understand this paradox, think of the stock market as a house in a hurricane-prone area. The forecast might show clear skies ahead, but prudent homeowners still pay up for insurance against the possibility of a major storm.

That's essentially what's happening on Wall Street right now. The most widely watched "fear gauge," the Chicago Board of Options Exchange (CBOE) Volatility Index (VIX), has dropped well below its historical average. The VIX, which measures expected day-to-day market swings, currently sits at 12.8%, compared to its long-term average of 19.1% (**Figure 2**). In other words, traders expect relatively smooth sailing ahead.

FIGURE 2

The Equity "Fear Index" Shows Little Investor Fear: CBOE VIX Index



Sources: GW&K Investment Management, Bloomberg, CBOE, and Macrobond

The so-called "Fear Index" for US equities, the CBOE VIX Index of implied volatility of the S&P 500 Index, has dropped to below its long-term average level as investors welcome the election results.

A DIFFERENT STORY IN THE INSURANCE MARKET

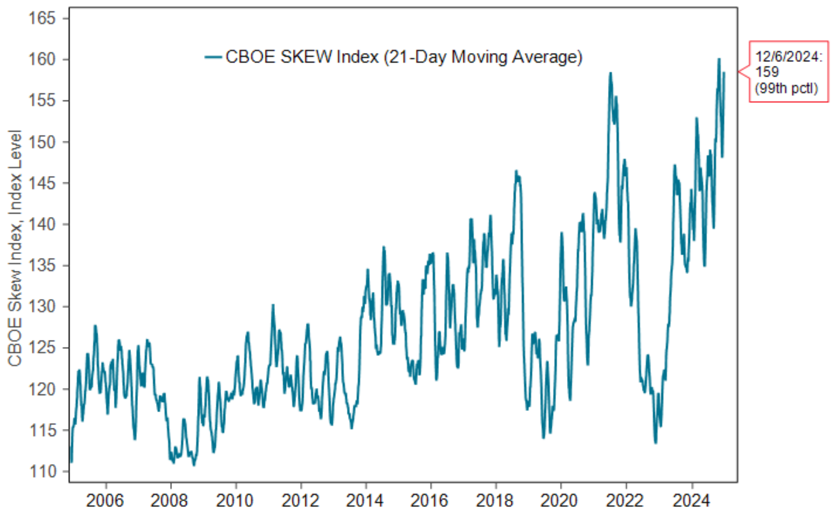
But there's another, less-known market indicator telling a very different story (**Figure 3**). The CBOE SKEW Index, which measures the cost of "crash protection" in the options market, recently hit an all-time high and remains near that peak.[1] Think of SKEW as measuring the price of insurance against extreme market moves — the financial equivalent of hurricane coverage.

[1] Saqib Iqbal Ahmed, "Investors Cling to Crash Protection Despite Sizzling US Stock Market Rally," *Reuters*, November 27, 2024.

The fact that this insurance is so expensive tells us that professional traders, while optimistic about the general outlook, are willing to pay premium prices to protect against worst-case scenarios.

FIGURE 3

Investor Demand for Crash Protection Is Extremely High: CBOE SKEW Index



Sources: GW&K Investment Management, Bloomberg, CBOE, and Macrobond

Investors are willing to pay dearly for crash protection according to the CBOE SKEW Index which reflects S&P 500 options prices focused on possible extreme market events.

READING THE TEA LEAVES

Why this mixed message? Investors appear to be focusing on the potential benefits of Trump's promised policies — particularly tax cuts and deregulation — while simultaneously hedging against his more disruptive proposals, especially on trade.

The president-elect's recent promise of substantial tariffs on major trading partners like China offers a perfect example of why traders want insurance. Such policies, if implemented, could trigger trade wars and significantly disrupt global supply chains. While markets don't view this as the most likely outcome, the possibility is real enough that they want protection.

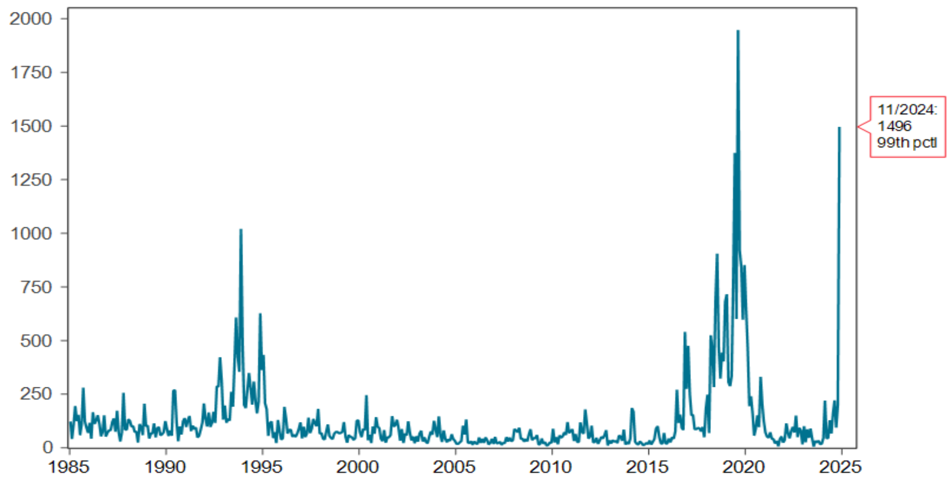
MEASURING THE UNCERTAINTY

Just how unusual is the current situation? One measure of trade policy uncertainty based on newspaper analysis has jumped to seven standard deviations above its historic norm — putting it in the 99th percentile since the mid-1980s (**Figure 4**).[2] Overall economic policy uncertainty, while not quite as extreme, still sits at the 97th percentile level (**Figure 5**).

[2] Scott R. Baker, Nicholas Bloom, Steven J. Davis, "Measuring Economic Policy Uncertainty," *The Quarterly Journal of Economics*, Volume 131, Issue 4, November 2016, Pages 1593-1636.

FIGURE 4

"Tariff Man" Is Back: US Trade Policy Uncertainty Has Surged

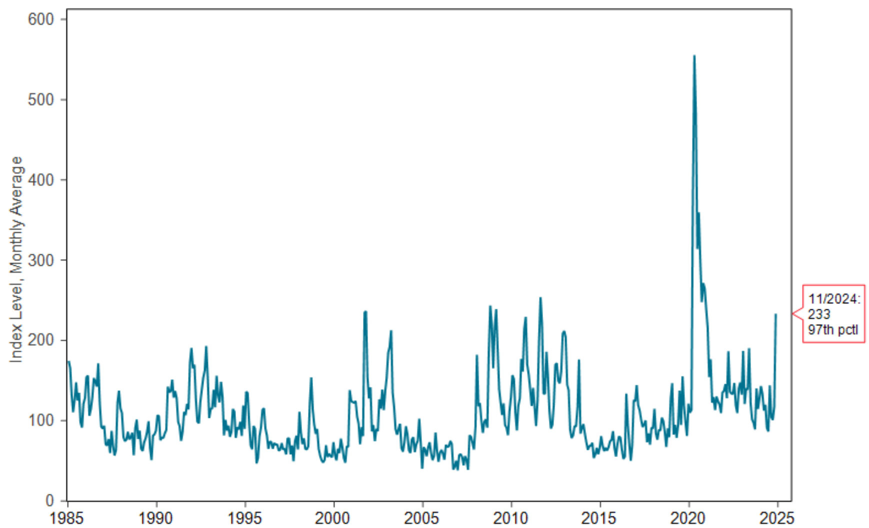


Sources: GW&K Investment Management, Baker, Bloom & Davis, and Macrobond

A measure of trade policy uncertainty based on newspaper text analysis jumped to near record levels in November, reflecting the aggressive stance of the president-elect on hiking tariffs.

FIGURE 5

US Policy Uncertainty Is Elevated: US Economic Policy Uncertainty Index



Sources: GW&K Investment Management, Baker, Bloom & Davis, and Macrobond

A measure of overall economic policy uncertainty based on newspaper text analysis also jumped in November to the 97th percentile level. Contrasting this with Figure 4's US Trade Policy Uncertainty chart shows this has happened more consistently over the various economic regimes since 1985, versus the more recent severity shown in Figure 4.

WHAT IT MEANS FOR INVESTORS

This unusual market dynamic carries important lessons for individual investors. First, it suggests that while the overall outlook might be positive, this is not the time for complacency. The high cost of crash protection in professional markets indicates that sophisticated investors see significant risks ahead.

Second, it underscores the wisdom of maintaining balanced portfolios rather than making all-or-nothing bets on particular outcomes.[3] Unlike the years of ultra-low interest rates when stocks seemed like the only game in town (the "TINA" — There Is No Alternative — era), today's markets offer more choices for diversification.

For most investors, this suggests sticking to their long-term asset allocation plans rather than making dramatic portfolio shifts. The markets are telling us to expect generally positive conditions but to be prepared for possible turbulence ahead.

The combination of calm surfaces and expensive insurance might seem paradoxical, but it actually sends a clear message: Hope for the best, but don't forget to pack your foul-weather gear.

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[3] Jonathan Levin, "Trump Is Making the 60/40 Portfolio Great Again, *Bloomberg Opinion*, November 22, 2024.