Election Year Hedging: When It Works, and When It Doesn't.

Election years tend to stir up anxiety for investors. Uncertainty is the market's least favorite thing, and elections dish it out in spades. But if history tells us anything, it's that elections themselves aren't always the biggest drivers of market volatility. Instead, broader economic forces—whether it's a tech bubble, a financial crisis, or a pandemic—often dictate how markets react more than the results of the election. Hedging around elections, therefore, isn't as simple as it seems. You're not just hedging against a political outcome—you're hedging against how the market interprets that outcome. And getting that right is trickier than it looks.

Opportunistic Hedging: The Challenges of Timing It Right
Opportunistic hedging sounds appealing: hedge when the market seems vulnerable and avoid paying for protection when things look calm. But timing it right introduces a lot of complexity.

To make opportunistic hedging work, you need to get a few things right:

The Outcome: Predicting who will win an election is tough. Polls can be misleading, as they were in 2016, and the political landscape is often unpredictable.

Market Sentiment: Even if you guess the outcome correctly, you still have to predict how the market will react. Will it rally or sell off? In 2016, many expected a prolonged selloff, but the market did the opposite.

Magnitude of the Move: Guessing the size of the market's move is another challenge. A short-term volatility spike might not justify the cost of a hedge, especially if the market quickly stabilizes.

The Cost of Hedging: As key events approach, the cost of hedging rises. Before an election, demand for protection spikes, and that increases the cost of hedging tools like options or inverse ETFs. In short, opportunistically hedging for an election introduces several layers of difficulty. You have to be right about the result, the market's reaction, and the scale of the move, all while navigating rising costs.

The Last 25 Years of Elections and Volatility

Calm Election Years (From a Vol Perspective)
These are the election cycles where markets remained relatively stable and hedging offered little benefit. The economy was often in good shape, and the election outcome was either predictable or had limited impact on market sentiment.

1996: Clinton vs. Dole
The 1996 election was a non-event for the markets. Bill Clinton was running for re-election, and the economy was strong. The VIX, a key measure of stock market volatility, stayed calm in the **10-14 range**, and the MOVE Index, which tracks bond market volatility, was similarly tame at around **40-50**[1]. The markets simply weren't concerned about the outcome, and investors who hedged missed out on steady gains.

2004: Bush vs. Kerry
In 2004, the U.S. was recovering from an early-2000s recession, and while the Iraq War was a significant political issue, it didn't create much market anxiety. The VIX fluctuated between **12-17** before Election Day and fell after the results were clear. The MOVE Index remained stable at **50-60**, and markets reacted with little volatility[2]. Once again, investors who hedged would have lost out on potential upside.

[1] Data provided by Bloomberg database.
[2] Data provided by Bloomberg database.

Elections Where the Election Wasn't the Only Thing to Worry About

In these years, while elections were significant, they weren't the primary driver of market volatility. Instead, the real volatility stemmed from larger macroeconomic or geopolitical forces. Hedging in these periods would have been valuable not because of the election itself but because the markets were already dealing with major external risks.

2000: Bush vs. Gore

The 2000 election coincided with the bursting of the dot-com bubble. While the recount drama in Florida created election-related uncertainty, the real driver of market volatility was the implosion of tech stocks. The VIX spiked above 30, and the MOVE Index rose as bond traders worried about the broader economic picture[3]. Hedging made sense here, but the election was just one piece of the puzzle—the broader market was already primed for a downturn.

2008: Obama vs. McCain

In 2008, the Global Financial Crisis dominated market sentiment. The VIX surged into the 50-80 range, and the MOVE Index shot above 150 as the entire financial system teetered on the edge[4]. The election itself had little influence compared to the looming economic catastrophe. In this environment, hedging with a 1x inverse S&P 500 exposure was essential, *but the real driver wasn't the election—it was the crisis.*

2020: Biden vs. Trump

The 2020 election took place amid the COVID-19 pandemic, which created unprecedented economic uncertainty. While the election was contentious, *the real driver of volatility was the global health crisis and its impact on the economy.* The VIX spiked to 40 before the election, but much of that was due to pandemic-related concerns. An 1x inverse S&P 500 exposure performed well in the lead-up to the election, but after the election, markets rallied on positive vaccine news, rendering hedges less effective if held too long[5].

Elections Defined by Controversy and Uncertainty

In these elections, the political landscape itself created market anxiety. The result was highly uncertain, and the market feared that the election outcome could lead to unexpected shifts in economic or foreign policy. These were the years where hedging was more attractive, as the volatility directly stemmed from election uncertainty.

2016: Trump vs. Clinton

This was a unique year. Donald Trump was a political outsider, and no one quite knew how he would govern. The market hates unknowns, and Trump was a giant question mark. That uncertainty caused anxiety, which was reflected in the VIX, the market's "fear gauge." The VIX climbed steadily leading into the election, peaking at around 22 just before Election Day[6].

But then, something unexpected happened: after Trump's surprise victory, the market rallied. The VIX sold off the day after the election, dropping below 14, and continued to fall into the end of the year. For investors who hedged expecting prolonged volatility, it was a tough pill to swallow[7]. Not only did the market rally, but hedging tools like options became more expensive as demand surged ahead of the election. And when the market flipped, those hedges turned into costly drags on returns.

January 6th Insurrection

The January 6th, 2021 Capitol Insurrection was a pivotal moment in recent political history, and it had a significant impact- albeit short lived-on market volatility.

[3] Data provided by Bloomberg database.
[4] Data provided by Bloomberg database.
[5] Data provided by Bloomberg database.
[6] Data provided by Bloomberg database.
[7] Data provided by Bloomberg database.

On January 6, as the insurrection unfolded, the VIX actually closed lower on the day from where it opened and compared to the previous session. The S&P 500 also closed near the session highs for the day, and above the previous day's closing price. A 1x inverse S&P 500 exposure, obviously, closed lower on the day[8].

In the weeks following the insurrection, heading into Inauguration Day, the market found its footing, and volatility began to subside. By mid-January, the VIX had fallen back to around 20, and inverse S&P 500 exposures gave back its gains as the index rallied into the new administration. For investors who held their hedges too long, the recovery in equities meant missing out on the post-insurrection rally.

Current Cycle 2024: Trump vs. Harris

Fast forward to 2024, and the landscape looks very different. Coming into 2024, the market faced a different environment. Both Donald Trump and Joe Biden were known entities. Unlike 2016, when Trump was an unknown variable, the market already had a sense of what governance under either candidate would look like. Additionally, the low likelihood of a single-party sweep in November further reduced political uncertainty.

While there have been notable political events this cycle—two assassination attempts on Donald Trump and Joe Biden dropping out of the race—the market has remained relatively calm. The VIX and MOVE Index have responded to these events with brief spikes, but the reactions were far more muted than one might expect.

After the first assassination attempt, the VIX briefly rose into the high teens, but the market quickly stabilized. An 1x inverse S&P 500 exposure provided a minor hedge for those expecting sustained volatility, but the move was short-lived, and the S&P 500 quickly recovered.

Following the second assassination attempt, the VIX again spiked but stayed within the 15-20 range, suggesting that the market wasn't bracing for extended turmoil.

When Joe Biden dropped out of the race, there was a similar brief reaction. The VIX ticked up, and inverse S&P 500 exposures offered some protection, but markets showed little sustained concern, likely because investors were already familiar with both Trump and Harris and didn't foresee major policy surprises under either administration.

Through these events, the VIX has ranged from below-average to average levels, hovering around 20, while the MOVE Index has remained relatively stable[9]. Markets seem comfortable with the landscape, and while hedging strategies provided some protection, they weren't essential for capturing upside in this environment.

The year's volatility has had nothing to do with politics, actually. Earlier in the year, the VIX maintained a low-teen average reading, but the Yen trade unwind shook up the volatility market, temporarily pushing the VIX to 65. Since then, the VIX has ranged between below-average and average levels, hovering around 20, indicating the market is not bracing for extreme election-related turbulence.

Coming into the year, if I offered you the foresight to know we'd have 2 assassination attempts, the incumbent first-term president dropped out of the election due to his age, and a decade long ZIRP leverage funding unwind - you might think carrying a hedge (like SH) would be beneficial for the year. But through the beginning of October SH has lost 13% of its value while the S&P 500 has climbed by more than 20%[10].

[8] Data provided by Bloomberg database.
[9] Data provided by Bloomberg database.
[10] Data provided by Bloomberg database.

Hedging for 2024: Is It Necessary?

If election-related anxiety is prompting you to consider adjusting your investment strategy, it's worth reflecting on whether that's the best approach. Speculating on the outcome of an election within your portfolio is more of a risk seeking behavioral trait than it is risk averse in my eyes. After all, a hedge is essentially a bet on market reactions, but it's important to recognize that capital markets are rarely driven by simple, binary outcomes.

Unlike financial markets—where volatility can stem from multiple factors and outcomes are rarely black and white—other markets offer more direct speculation on political events. Separating this kind of speculation from your long-term investments can help ensure your portfolio remains aligned with your broader financial goals, providing a clearer distinction between short-term speculation and your ongoing strategy.

Given what we see right now, should you hedge ahead of the 2024 election? Well, if we were to try and bucket this cycle into one of the three groups that we divided the previous cycles into, we'd say no. This election falls somewhere between a calm cycle, and a cycle where the election hasn't been the only thing to worry about. The VIX and MOVE Index are stable, suggesting that markets aren't expecting a major shock. While there are always risks, the current environment doesn't seem to carry the same level of uncertainty we saw in 2016 or 2008.

If broader economic risks emerge, such as rising inflation or geopolitical tensions, hedging could become more attractive. But none of these are election dependent variables. So, for now, with both candidates being known entities and market volatility remaining modest, it's worth asking whether the cost of hedging is justified.

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