

TRENDMACRO LIVE!

On Ryan at the RNC

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The battle is joined. Volatility is too cheap coming into what is now a referendum election.

Vice presidential nominee [Paul Ryan's speech](#) at the Republican convention last night should ease concerns that his strong message of growth and reform will be shoved aside on the ticket, as Bob Dole's VP candidate Jack Kemp's was in the disastrous 1996 campaign (see "[On Ryan as VP Nominee](#)" August 13, 2012). Indeed, Ryan addressed this head-on, explicitly embracing his former mentor by saying, "I learned a good deal about economics, and about America, from the author of the Reagan tax reforms -- the great Jack Kemp."

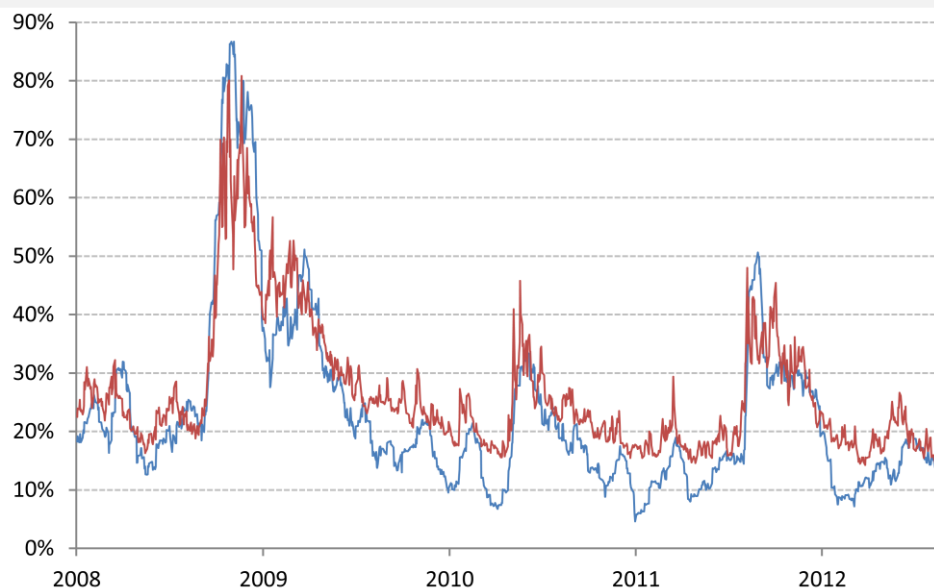
- Ryan didn't strongly emphasize painful fiscal austerity, with which the Obama campaign is so eager to associate him. He said, "Medicare is a promise," and he committed himself to "protect and strengthen Medicare."
- Ryan risks disappointing conservatives for whom the deficit, the debt and the burden of future entitlements are the dominant issues. But to our ears this is a realistic and politic way of taking on those

Update to strategic view

US STOCKS: The battle is joined. In Ryan's speech last night he presented himself as an energetic and fearless reformer -- not an advocate of painful austerity. This election is now surely a referendum on economic policy. If Obama wins, there is a significant risk of a catastrophic bargaining failure at year-end, as tax provisions expire and the debt ceiling is reached. Markets seem calm, but that's only because it's so difficult at this stage to price the starkly binary possibilities in the upcoming election. Volatility is the best buy in the market.

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— 30-day S&P 500 volatility — CBOE VIX volatility index



Source: Bloomberg, TrendMacro calculations

issues. It is entirely consistent with his [budget plan's](#) approach, which has always come at Medicare in the spirit of reform, not abolition.

- The GOP's austerity message was delivered not by Ryan, but by Chris Christie the night before, in [a very harshly toned speech](#) dominated by calls to "say no" and "sacrifice."
- By comparison, Ryan's message of reform looks moderate, emphasizing growth over austerity -- which we have no doubt was the intention of juxtaposing the two men in this way.

Thus the battle is joined. It reinforces both our enthusiasm and our concern that this election is shaping up as an explicit referendum on economic policy (see ["New High, Fat Tail"](#) August 22, 2012).

- Setting aside the many deep long-term implications of such a referendum, the impact in the near-term will likely be enormous.
- If Obama wins the election, he will be a lame duck who perceives himself as having (indeed, he *will* have) a mandate to take a hard-line position on not extending expiring tax provisions at year-end. Defeated Republicans will have little reason to compromise with him, and will take an equally hard line about not raising the statutory debt limit. The result could be a catastrophic bargaining failure that would throw the economy off the fiscal cliff, and usher in a deep recession in early 2013.
- The election is a coin-flip at this point, so this is hardly an unlikely scenario. Yet as we talk to clients every day, we find almost everyone, very nearly without exception, thinks that this will all somehow turn out just fine.
- Markets would seem to agree, with both actual and implied volatility at sleep-inducing levels (please see the chart on the previous page). Stocks are undervalued -- but volatility is more undervalued still. It's the best buy in the market.
- We caution against false complacency. Markets are terrible at pricing starkly binary outcomes. Now they are in a metastable equilibrium -- poised between two very fat tails, one very bad in the short term and the other very good in the long term. No matter which way the election goes, stocks will have to revalue sharply when the outcome is known. Just because they *appear* tranquil doesn't mean there is no danger -- a deer caught in the headlights isn't moving, either.

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Bottom line

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