The events of January included: the inauguration of one of the most controversial U.S. Presidents in history, worldwide marches in protest of the inauguration, the signing of 20 executive orders that made significant changes to key economic and immigration policies - the latter of which sparked additional protests, and the cancellation of a meeting between President Trump and Mexican President Enrique Peña Nieto due to tension over the Trump Administration's talk of building a wall along the Mexican border. Despite all of this, the equity market not only advanced but the Chicago Board Options Exchange (CBOE®) Volatility Index (the VIX®) averaged just 11.61 for the month, its lowest monthly average since June of 2014. Realized volatility for the S&P 500® Index in January was even lower, coming in at an annualized standard deviation of 6.65%. With so much political turmoil — why is volatility so low?

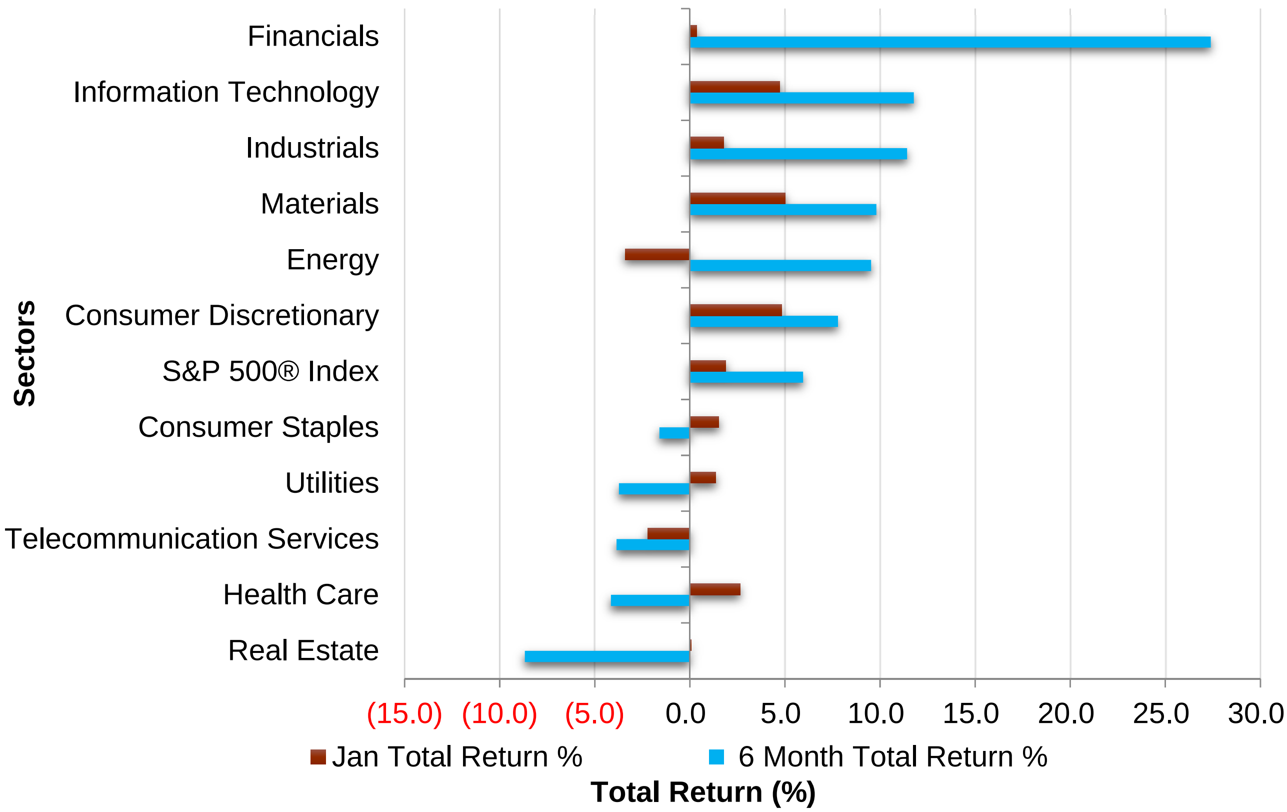
Often times when volatility is persistently well-below average, people wonder if it is due to an increase in call writing and other forms of volatility selling. Barclays Equity Research recently studied this question from multiple perspectives and determined that such activity is not likely contributing to low volatility.[1] This is consistent with our own observations.

Looking past headlines focused on politics to factors more directly impacting the broader market shows certain conditions are fairly consistent with market tranquility. The first round of 2016 quarterly earnings reports show that the earnings recovery that began in Q3 has continued into Q4. Fed Funds futures pricing suggests the Federal Reserve isn't in a hurry to hike short-term interest rates. Throughout January, futures indicated less than a 50% probability of a rate hike before June. After spiking post-election, long-term interest rates have stabilized with the 10-year U.S. Treasury oscillating between 2.3% and 2.5% over the last month. These are all positive factors for equities which may have contributed to the market calm.

However, it would be a mistake to conclude that all areas of the market are behaving the same. While surface volatility has been low, a cross-sectional view of the market tells a more turbulent story. As the bar chart shows, there has been significant dispersion across equity market sector returns, with some sectors negative over the past six months and one month, even though the broader market has had a healthy advance over both periods. Any investors with significant exposure to real estate,

[1] *Index Volatility Weekly*, "Is Volatility selling contributing to low volatility?", Barclays Equity Research, January 25, 2017

health care or utility stocks over the last six months probably aren't feeling so sanguine about equity market conditions. Investors who have been lacking in exposure to financial companies probably feel the same as that sector has been the largest contributor to the market's return. While January returns indicate that sector dispersion lessened somewhat, the energy and telecommunications services sectors delivered losses while the broader market continued its advance. This lack of correlation across sector returns can dampen market volatility in the same way that portfolio diversification can lower volatility in investor portfolios. In the event that sector returns start to sync up, market volatility may increase, even if sector and market returns are positive.



Despite this low volatility period, index option premiums remain attractive. The at-the-money index call option with a February 17th expiration written by the CBOE® S&P 500® BuyWrite℠ Index on January 20th had an annualized cash flow rate of 10.64%. While low by index call option premium standards, this rate was well above current bond yields, even low-quality bonds. It remains to be seen if the very low volatility of January will persist. Even if it does, option writing remains a viable and attractive tool for managing risk and generating return.

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