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The Trump trade: Does recent market volatility spell opportunity?

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In our recent publication, *"Quick Thoughts: Why are equity markets sinking?"* Stephen Dover explored the catalysts behind the recent market correction, highlighting (geo)political tensions, macroeconomic concerns, and the potential risk of stagflation.

The US equity market has now corrected by approximately 10%, prompting investors to question whether this downturn presents an attractive buying opportunity or signals deeper underlying risks.[1]

To address this question, we shift our focus to technical and sentiment indicators, which form an essential part of our investment decision-making toolkit.

By analyzing market price action, we aim to better understand investor behavior. Our focus is on asset prices. As we show below, an examination of supply and demand indicators provides insights into the likelihood of a market rebound or further setback.

We begin with an historic perspective. Since 1950, the S&P 500 Index has experienced 38 corrections, defined as declines of 10% or more. Of these, 26 occurred during periods of positive economic growth, while 12 took place during recessions (Exhibit 1).

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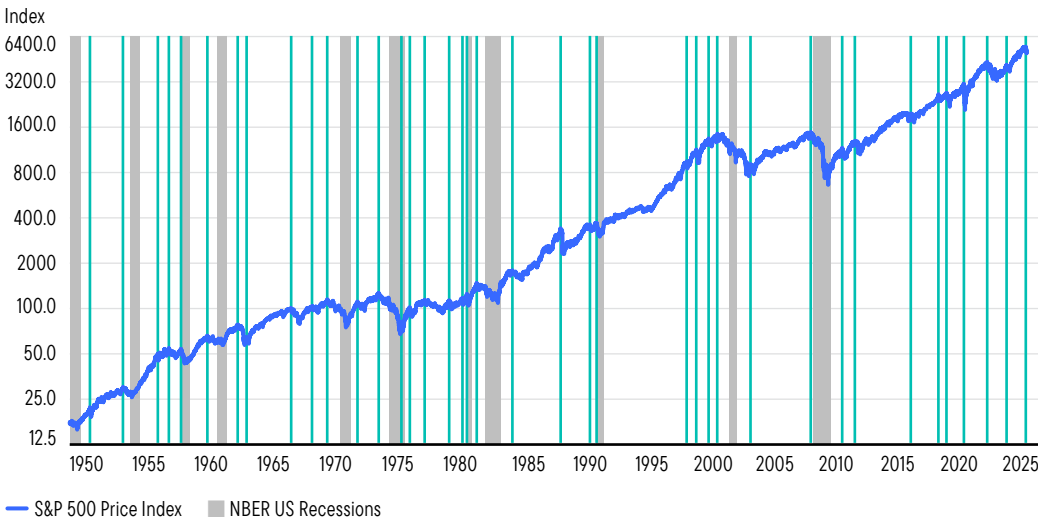
Exhibit 1: All S&P 500 Index Corrections Since 1950

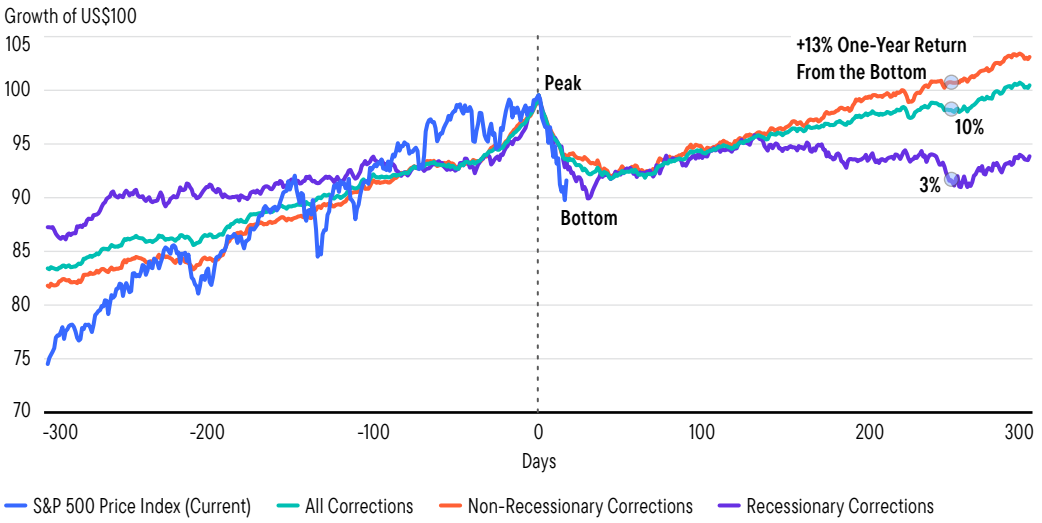


Sources: S&P Global, Bloomberg, Macrobond. Analysis by Franklin Templeton Institute. As of March 15, 2025. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses and sales charges. **Past performance is not an indicator or a guarantee of future results.** Important data provider notices and terms available at www.franklintempletondatasources.com.

For each of these corrections, we then calculate the S&P 500's returns over the subsequent 12 months and classified those outcomes based on whether they occurred during a recession or not. We then constructed average return trajectories to illustrate the typical S&P 500 performance following a 10% (or greater) correction.

As Exhibit 2 shows, on average, the market rose 13%, on average, from its trough following non-recessionary market corrections.

Exhibit 2: S&P 500 Index Trajectories During Market Corrections



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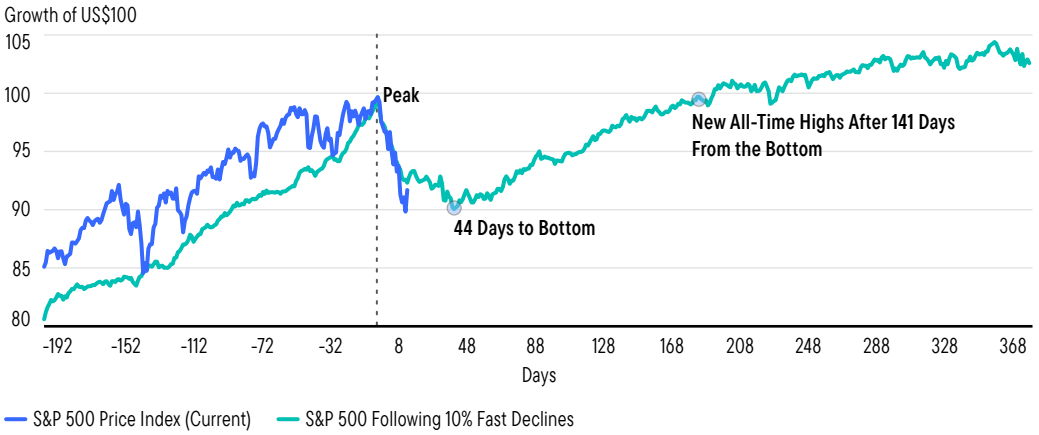
Our findings also reveal a key tactical consideration. On average, the market has bottomed within a few days of a 10% drawdown, irrespective of whether recession followed or not. And while market recoveries during recessions have tended to be weaker, during non-recessionary corrections the market typically has rebounded and set fresh highs over the ensuing 12 months.

Notably, the ongoing correction has been rapid. The S&P 500 has shed 10% of its value in just 16 days, making it the fifth-fastest correction since 1950.

That is unsettling. But history does not suggest that the speed of the decline impairs the recovery, as shown in Exhibit 3. Historically, the market has bottomed within two months following its peak, and has recovered to new highs within six to seven months.

Exhibit 3: Fastest 10% Decline From the One-Year Highs



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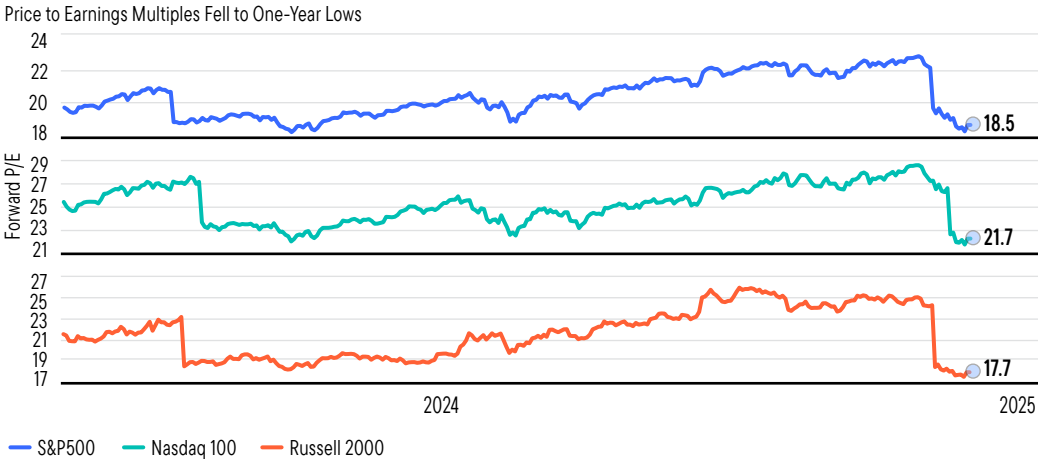
Not just prices: Fundamentals repriced as well

Beyond history, there are other reasons to believe the market may soon regain its footing. The recent market selloff compressed valuation multiples. For example, the forward price-to-earnings (P/E) ratio of the S&P 500 has slipped from 22.5 to 18 during this correction. Similarly, forward P/Es for technology and small-cap indexes have declined to one-year lows.

Exhibit 4: Fundamental Investors Might Find the Current Repricing Attractive



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Falling multiples indicate that stock prices are falling faster than earnings expectations. For long-term value-oriented investors, lower valuations present an opportunity to buy fundamentally resilient companies at a discount.

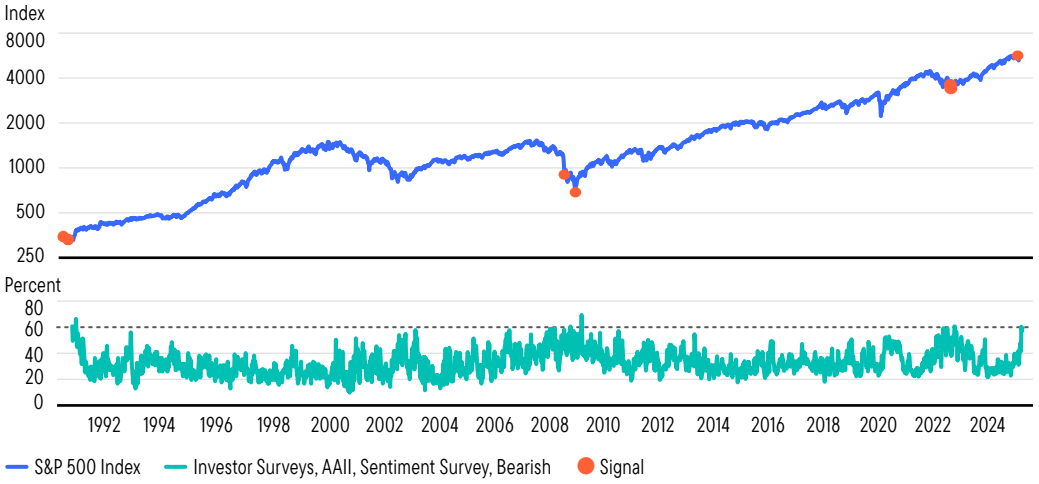
Extremely negative sentiment

Moreover, investor sentiment has turned sharply negative, as reflected in recent AAII surveys, where the percentage of bears has climbed to 60%,a level reached only a few times in history, and typically around major market bottoms (see Exhibit 5).

Interestingly, extreme pessimism is typically only seen in corrections of 20% or greater but is already present after today's 10% decline. Sentiment is already at extreme levels.

History suggests that fear often creates opportunities for long-term investors willing to accept near-term volatility in exchange for future price appreciation. With valuations now more attractive and sentiment deeply negative, this may be one of those moments.

Exhibit 5: Investor Sentiment Reaches Extreme Negative Levels—but is This Bearish?



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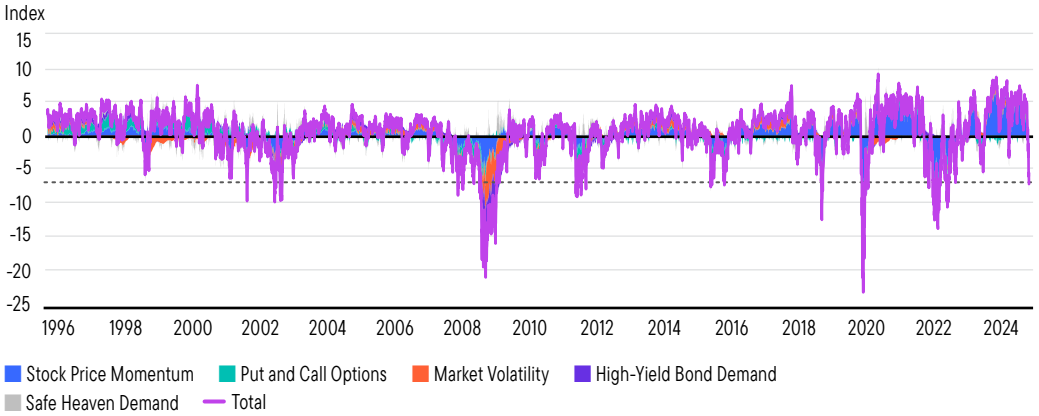
Other measures of sentiment concur. Our proprietary Fear & Greed Index (Exhibit 6) signals that investors are deeply concerned, which is typically a good contrarian indicator. Similar readings in the past have marked attractive entry points to add equity exposure.

Exhibit 6: Fear and Greed: Z-Score Model



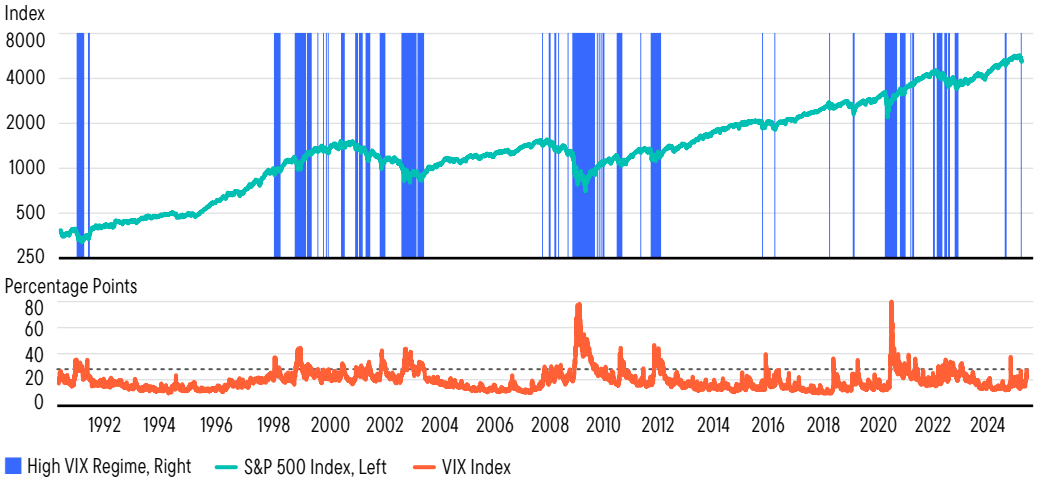
Sources: S&P Global, CBOE, Fed, US Treasury, Macrobond. Analysis by Franklin Templeton Institute. As of March 15, 2025. Important data provider notices and terms available at www.franklintempletondatasources.com.

High volatility provides opportunity

Similarly, periods of elevated volatility often create dislocations in and within markets, creating opportunity for long-term investors. This past week volatility spiked, with the CBOE VIX index[2] reaching an intraday high of 29.57 on consecutive days, a level historically associated with heightened fear and uncertainty. But as history shows, when volatility reaches extremes, it has often marked attractive entry points for investors.

The chart in Exhibit 7 highlights that past episodes of the VIX above 27.8 (end-of-day measure) have occurred only 12% of the time and have typically coincided with strong subsequent market performance, generating, on average, 19% return over the ensuing 12 months.

Exhibit 7: Volatility Index Has Spiked to Extreme Levels



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Additional concerns: short-term economic pain

President Trump has recently suggested that he is willing to accept short-term economic pain —even a recession—to achieve longer-term policy goals. As a result, recession fears have become one of the main risks weighing on Wall Street. However, we believe it is far from clear how a recession would help resolve trade imbalances, nor do we see a recession as a likely near-term outcome.

In fact, a snapshot of February's incoming data paints a very different picture from the increasingly negative sentiment. Remaining data-driven, we note that the most recent employment data confirm that the job market remains on solid footing. Moreover, as the latest Consumer Price Index report showed, consumer prices rose at a slower pace than expected in February, keeping the door open for further rate cuts. Currently, markets are pricing in three cuts in 2025.

As shown in Exhibit 2, recoveries have tended to be faster and more substantial following non-recessionary corrections, while corrections that occur during recessions have typically more prolonged. Therefore, we believe it is important to emphasize that the Institute does not expect the US economy to enter a recession.

Broadening remains our key message

Notably, despite the recent market selloff, the distribution of market returns continues to broaden, underscoring our key equity investment thesis of 2025.

The equal-weighted S&P 500 Index has outperformed both the market capitalization-weighted S&P 500 Index and the Nasdaq this year by 2.36% and 4.45%, respectively.[3]

As we highlighted in our recent piece, *Get ready for a broader US equity market*, the conditions for broadening remain in place. Despite noisy headlines and elevated geopolitical uncertainty, value has outperformed growth and there has been a significant rotation across different segments of the market. Going forward, we expect a broadening trend to continue in the United States, as well as globally (e.g., European outperformance).

In sum, corrections offer opportunity. Moreover, if we assume the US and world economies avoid a recession, the recent market correction and bout of volatility present an ideal opportunity for long-term investors to increase equity exposure to our broadening market theme.

Endnotes

1. S&P 500 drawdown from February 19, 2025 to March 13, 2025 was -10.13%. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results.**
2. VIX is the ticker symbol and the popular name for the Chicago Board Options Exchange's CBOE Volatility Index, a popular measure of the stock market's expectation of volatility based on S&P 500 index options. Past performance is not an indicator or a guarantee of future performance. Indexes are unmanaged and one cannot invest directly in an index. Important data provider notices and terms available at www.franklintempletondatasources.com.
3. Source: Bloomberg. Analysis by Franklin Templeton Institute. As of March 14, 2025.

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All investments involve risks, including possible loss of principal.

Equity securities are subject to price fluctuation and possible loss of principal. Small- and mid-cap stocks involve greater risks and volatility than large-cap stocks. There can be no assurance that multi-factor stock selection process will enhance performance. Exposure to such investment factors may detract from performance in some market environments, perhaps for extended periods.

Active management does not ensure gains or protect against market declines.

Investments in fast-growing industries like the **technology sector** (which historically has been volatile) could result in increased price fluctuation, especially over the short term, due to the rapid pace of product change and development and changes in government regulation of companies emphasizing scientific or technological advancement or regulatory approval for new drugs and medical instruments.

Diversification does not guarantee a profit or protect against a loss.

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