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Warrington Asset Management

Best-kept secrets

Advisor chooses stability over outsized gains

By Philip Scipio

Publisher's note

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Best-kept secrets

Advisor chooses stability over outsized gains

By Philip Scipio

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Vital Statistics

Assets under mgt	$42.6 million
Minimum Investment	$100,000
Registration	NFA
Fee Structure	
Management fee	2%
Incentive fee	20%
Avg commission	$25.0
Ratios	
Avg margin-to-equity	25.0%
Ann comm-to-equity	4.0%
Roundturns/$M/year	1,400
Auditor	D.E. Harrington & Co

Scott Kimple

Scott Kimple, principal of Warrington Asset Management, is among the best kept secrets in managed futures.

During the last eight years, he has quietly built a more than respectable track record trading S&P 500 Index and other stock index, bond, currency, metals and crude options. The S&P is his primary contract, accounting for 90% to 95% of trading during the last year.

The long track record has two distinct halves. The first four years reflect a highly aggressive strategy that sought outsized returns.

The last four years reflect Kimple's dedication to managing risk. In fact, Warrington recently ranked seventh in an MAR poll ranking the top 10 advisors from January to December 2000 on a risk adjusted basis. Warrington was ninth in a ranking of advisors by returns during the 36-month period from January 1998 through December 2000.

Warrington, with a compound annualized return of 23.6%, compares more than favorably with the median of the MAR stock index. The program also outperformed the S&P 500, which posted a 17.3% return during the period from April 1993 through November 2000.

Kimple started Warrington as a broker trading managed accounts at Salomon Smith Barney, and transitioned his business into a full-fledged trading advisor in April 2000. But despite a strong track record that spans eight years, the firm has not amassed assets commensurate with its profile. The program has $2.8 million under management.

"I have focused my time on developing a great strategy, not marketing and raising money. I have always believed that if I produced superior numbers, the money would follow."

Kimple began trading stock and bond positions for his own account in 1984. He first traded commodity futures and options in 1989, two years before joining Shearson, Lehman Brothers. In July 1995, he was named a vice president/financial consultant at Smith Barney, which had acquired Shearson in 1993.

Kimple has been an associated person with Salomon Smith Barney since 1998. He continues to do some brokerage business at the firm, and SSB brokers can, on a limited basis, raise money for Kimple's program.

When he started Warrington in 1993, he couldn't have hoped for better numbers. That first year, he posted a near 50.0% gain and a 67.0% gain in 1994, outperforming the S&P's 5.5% and 1.3% gains for the same periods.

"When I started in April 1993, I was very aggressive, always in the market and always had positions on," says Kimple. The goal was to produce big returns. But the risks one takes for outsized gains often leaves one exposed to outsized losses.

Kimple got to see the flip side of the aggressive strategy he employed after posting a 1.1% loss in 1995 and a 27.2% loss in 1996. Those losses triggered the end of an era for Kimple.

Retooling time

"For a futures guy, my approach is extremely cautious now," says Kimple. "In 1997, I made a substantive change to the entire program."

After posting losses in 1995 and 1996, Kimple reviewed every trading sheet he had accumulated since the program's inception. He examined his charts and models and determined that he needed to change his strategy.

"Prior to 1997, I was always in the market; when we'd have a radical move one way or the other, I'd be fighting fires," says Kimple. "One thing my 1996 analysis told me was that if I stuck to the lower volatility trades—the trades that line up perfectly with my strategy—I could consistently make 20% to 30% a year. I pick and time my trades a lot better now."

Kimple also changed his view of what

was an acceptable maximum monthly decline. Before 1996, 15% was acceptable given that he was aiming for returns above 30%. After 1996, he ratcheted that number down to 5.0%, which he has hit only twice in four years: declines of 5.3% in October 1997 and 4.6% in October 1999.

As a result of the risk controls Kimple has been using since 1997, the program hasn't posted a double-digit loss since December 1996. The program's standard deviation during the last four years is 9.5%, while its Sharpe ratio for the four year period beginning January 1997 is a lofty 2.6. "I call 1996 my apotheosis from a trader into a portfolio manager," says Kimple.

Befriending bulls and bears

Kimple describes himself as a discretionary trader, even though his approach is somewhat systematic. "I take a dynamic approach to markets; I am waiting for a confluence of signals across different indicators and different time frames," he says. "The goal is to produce consistent nonvolatile returns no matter what the market does."

Warrington's strategy is technical with a fundamental overlay. Kimple first uses a number of conventional and proprietary indicators to develop a market opinion. He then looks for options strategies that best suit that market opinion.

Warrington Asset Management

PERFORMANCE HISTORY

April 1993–November 2000

	Warrington Asset Management	Median of MAR Stock Subindex	S&P
Return (%)			
Annual comp rate	23.57	1.80	17.28
1993 (9 mths)	49.84	2.32	5.47
1994	66.96	0.20	1.32
1995	(1.11)	0.43	37.59
1996	(27.24)	2.72	22.96
1997	28.33	15.64	33.38
1998	35.37	35.37	28.57
1999	33.56	16.06	21.03
2000 (11 mths)	21.62	3.56	(9.53)
December estimate	1.19		
Risk (%)			
Annual std dev	17.56	13.96	13.94
Semideviation	11.05	9.48	8.30
Maximum decline	(28.40)	(14.83)	(15.38)
Return/Risk			
Sharpe Ratio	1.05	(1.00)	0.87
Comparison with MAR Stock Subindex			
R-Squared	0.08		
Alpha	1.56		
Beta	0.48		

He uses directional and nondirectional strategies. The former include multileg spread strategies. The nondirectional strategies include selling premium. "I look to sell significantly away from the market, as much as 8% to 15% away from where the market is. I don't sell much premium, hence the low margin to equity ratio."

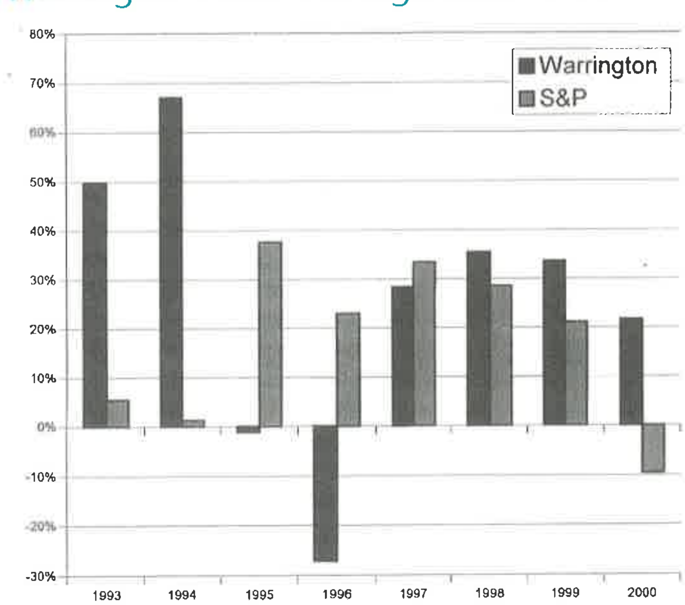
Regression is also a common theme, he says, noting that he will wait for a market to spike up or down and engage in directional strategies if he thinks it will regress back to the mean. He may also sell premium if he thinks the move will slow or get some regression.

"When I use these nondirectional premium selling strategies, I am very aggressive about hedging," says Kimple. "I have custom-designed models where I monitor delta and gamma analysis as well as real time profits and losses. So intraday, I'm monitoring my position delta and gamma to determine if I'm getting up to unacceptable levels. The goal is to be delta neutral."

Every quarter he returns profits to the investor, and essentially starts each account at $100,000 or a multiple of $100,000 each quarter. He also builds positions into option expirations that allow him to start fresh the next month.

"I build my positions around the option expirations for the markets that I trade," he says. "If I go to a drawdown, I know that at expiration, I'll be out of the position and in cash." It fits with his philosophy of seeking to 20% to 30% returns a year by hitting singles and doubles instead of home runs. ■

Warrington Asset Management vs S&P



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