August 2015 Market Commentary

Many fund managers advertise disciplined risk management, but the extraordinary events of last month highlight the difference between talking points and execution. August was an exceptional month filled with extreme moves in a number of markets, the magnitude of which have been experienced only a handful of times since the 2008 financial crisis. While our Strategic program was down approximately 2% for the month, it remains profitable for the year, up approximately 3%. The S&P 500, which was down almost 13% at its worst point of the month, ended August down over 6%, its worst month in more than three years (and as of the first day of September was down over 7% for 2015).

The majority of the rout occurred over just three trading days, leaving many market participants in shock. Warrington, however, was quick to implement its risk management protocol, dynamically hedging positions as the market crossed predetermined trigger points and moving into a fully hedged position the Friday morning of the second day of the decline. The worst was yet to come, as most of the major stock market indices were halted limit-down at the open on Monday, August 24th (2008 was the last time any of the indices hit such limits). The Dow Jones Industrial Average traded down more than 1000 points, which was the largest point drop and among the worst percentage losses in its history. In a measure of the panic that engulfed the stock markets, the VIX Volatility Index shot up to 53.29, an almost five-fold increase over the lows seen earlier in the month at 10.88. That peak reading was the highest intraday VIX level since January 2009. While many market pundits were quick to blame the severity of the pullback on the stock market crash in China alone, we respectfully disagree and consider them to be only a contributor. The more proximate cause, in our opinion, was the release of the minutes from the prior Federal Reserve FOMC meeting, indicating to us that markets are perhaps losing their faith in the global central banks' ability to solve the ongoing financial crisis. The minutes portrayed a sense of confusion and dissention, with some Fed Governors strongly favoring a September interest rate hike while others were vehemently opposed. The stock market reacted immediately following this release and displayed extreme volatility levels through the end of the month.

Moves of this magnitude are a true test of a fund manager's adherence to risk management. While we always strive to provide positive returns, we strongly believe that our disciplined risk / reward analysis conclusively showed that the risk of a market dislocation was imminent and our actions helped us avoid additional turbulence and added portfolio losses. We believe that the heightened level of volatility has reintroduced fear and uncertainty back into the equity markets that will not dissipate rapidly. Markets that display historically normalized volatility characteristics (not too high, not too low) are our ideal trading environments, and, while August showed both unwanted extremes for us, we believe that this shock to the system will settle into a favorable risk/reward environment for our investment strategy.

We will continue to employ our disciplined, risk-based approach to the markets, focused on opportunities that will allow us to deliver strong, consistent and uncorrelated returns for the remainder of 2015 and beyond.

We thank you for your continued support of Warrington Asset Management.