WARRINGTON
ASSET MANAGEMENT

August 2007 Market Commentary

August was a month where the issues we have been concerned about finally started to have an impact on the stock market. Subprime loans (and the derivatives made from them) have been causing problems for the majority of the year, but it was not until August that they began to affect stock market activity. A similar story can be told about over-leveraged hedge funds and a tightening credit market. These are not problems until the market deems them to be, and at that time, they can become major issues in a matter of days.

We entered the month having hedged the majority of our downside market exposure, but remained very cautious, given the skittish nature of the stock market. The intra-day volatility was extremely high, with 20 to 30 point S&P 500 moves in a matter of minutes. In this type of environment we often choose to keep our positions very wide and give the S&P 500 ample room to fluctuate. Even with these fluctuations, we had one of the most profitable months on record for the Warrington program, and we were able to make back the majority of the marked-to-market loss that we showed at the end of July.

In the position we put on for September expiration we were able to buy ratio put spreads that were very wide with significant profit potential, and yet had less overall exposure than positions from a few months ago. This is due to the higher VIX. As the VIX hovered in the high 20s range (as opposed to the lower 12 – 18 range seen from March through mid-July), we were able to sell options further away from the market (as they were more expensive) when putting on our ratio put spreads. In previous months, we have been buying put spreads that were approximately 90 points wide but, with the higher VIX, we were able to buy spreads approximately 140 points wide, a significant improvement. In this way, a high VIX can greatly benefit Warrington's trading strategy.