WARRINGTON
ASSET MANAGEMENT

August 2012 Market Commentary

Even though a large percentage of recent stock trading is fully directed and executed by automated computer trading programs, the stock market is not immune to the doldrums of late summer. While computers do not go on vacation, the humans that oversee them do. News on the European front was (relatively) quiet during August and the main Federal Reserve event happened on the last day of the month (Ben Bernanke's speech at the Jackson Hole conference), so trading activity for most of the month was extremely lethargic. Volatility (as measured by the VIX) dropped to the lowest levels since June 2007 (the month immediately preceding the start of the Global Financial Crisis) and average daily trading volume was similar to what is usually seen on quiet holidays (i.e., the day after Thanksgiving which is traditionally one of the lowest-volume trading days of the year).

This complete lack of upside or downside volatility meant that the ratio put spreads held in the Warrington fund slowly declined in value, with the manager salvaging some of the value in those positions to partially mitigate the small loss for the month. Despite the low realized volatility in August, expectations for increased future volatility in September and beyond allowed the manager to enter into very wide ratio put spreads for September's expiration cycle, much wider than would normally be the case given the lethargic market activity. These wide spreads provide great profit potential in September, even though total position sizes are still quite small. This intentional posture for the portfolio illustrates the manager's view that the market is rather extended and due for a pullback.