WARRINGTON
ASSET MANAGEMENT

# July 2007 Market Commentary

July was a month that was reminiscent of February of this year. For the bulk of the month, the S&P 500 futures were trading in a sideways pattern, echoing what was seen in June: choppy up and down trading that fits our strategy very well. Coming into the last few days of the month, we were performing positively. Then, in the final four trading days the market continued its aggressive slide, which began in earnest on July 24th, just days after trading near all-time highs. This pullback, which spanned a 6.9% decline in just eight trading days, caused the VIX to increase (up about 60% over that same period) and inflated the price of our deep out-of-the-money short puts.

As the market decline accelerated, our risk management mandate dictated that we reduce our position size. Prior to this decline, we had completed our full position of ratio put spreads. In spite of our reduced positions, our short exposure priced against us and caused a marked-to-market loss at the end of the month, as the S&P futures closed near lows. Also, the VIX ended the month near its highs, as it is usually negatively correlated to market declines.

We believe that the negative issues that keep surfacing and roiling markets (subprime loan problems, Leveraged Buy Outs drying up due to increased borrowing costs, and an overall credit crunch) are not issues that can be easily ignored, as they were in March. We are positioning the portfolio much more defensively for September, and as of this writing, we have zero uncovered downside exposure. Also, we intend to trade smaller overall positions as markets come to terms with these potentially serious risks.