WARRINGTON
ASSET MANAGEMENT

July 2014 Market Commentary

A litany of global events negatively impacted the stock market in July. The Russia – Ukraine situation deteriorated when it was suspected that pro-Russian separatist shot down a commercial airliner using suspiciously advanced weaponry, but that alone was not sufficient to cause more than one day of losses in the S&P. Following this event, Portuguese bank Banco Espirito Santo teetered on the brink of failure at roughly the same time as Argentina defaulted on $13 billion of bond payments. The culmination of these events eventually led to a -2.1% loss on the final day of the month, and was part of a -3.1% loss from all-time highs seen just days prior and a -2.7% weekly loss that was the largest weekly slide in two years.

Warrington held both regular and end-of-month ratio put spreads in the portfolio, anticipating a pullback. As the end of July neared, the manager began to close out the positions, selling a portion of the long puts each day and covering some of the short puts concurrently. These trades netted modest profits as the options were only nominally in the money. On the final day of the month when the market experienced its strong, single day decline, the remaining position was closed out for additional profits. In a month where the S&P lost about -1.5%, Warrington's overall net gain is evidence of the non-correlation and diversification provided by manager's trading strategy. The expansion in volatility is a welcome occurrence in the opinion of Warrington's manager as the magnitude of that single-day decline caused spreads to widen just as new positions are being added for August expiration.

According to market research firm SentimenTrader, the stock market may be in the "Last Gasp" phase of a bull market. They believe that the recent highs may be a resistance level and any subsequent rallies might retest those levels but prove to fail, leading to a series of lower lows. While Warrington's manager may agree with this to a certain extent, the overwhelming influence of the Fed on asset prices cannot be dismissed, especially if they choose to begin another round of stimulus after the "Taper" is complete.