WARRINGTON
ASSET MANAGEMENT

June 2007 Market Commentary

Judging by the volatility and the choppiness seen in the month of June, one could reason that the S&P 500 has undergone a change of character. No longer did the market instantly rally after trading down even a little (as was the case from mid-March through the end of May), but rather declines would persist for a few days, before dip-buyers showed up to drive the index higher. There were two such notable declines in the month of June. The first occurred near the beginning of the month, when interest rates on the 10 year T-bill climbed above 5.25%, sending fears through the markets that high rates would dampen private equity buying activity. Coming into the month, we were holding ratio put spreads to capitalize on such an event. By overlaying some call spreads on top of our put spreads, we were able to profit from the subsequent rally which ensued after the S&P 500 futures (June contract) fell by 3.5%, a loss that was erased only days later. Then, after the market consolidated for a few more days, a similar drop ensued due to news of the troubles with two Bear Stearns hedge funds, sending the S&P 500 futures (September contract) lower by 3.8%. Once again, we had ratio put spreads in place (for July expiration this time) to capitalize on such a move and, as we did earlier in the month, we overlaid some call spreads to capture a snapback rally, should one occur. The market did indeed recover to an extent, but not quite back to the previous highs seen in the middle of the month.

This type of up and down volatility, where the overall move might be significant for a one month timeframe, but no single day causes a massive spike in volatility, tends to be quite lucrative for Warrington's trading strategy. Indeed, for June, we had our most profitable month since December, 2002.