WARRINGTON
ASSET MANAGEMENT

June 2010 Market Commentary

Given the violent market action during the month of May, the fund manager for Warrington prepared for continued volatility by scaling back to smaller than average positions in the portfolio and by implementing tighter hedging triggers. As anticipated, the S&P 500 futures abruptly declined by 5.8% in just four trading days at the beginning of the month and, almost as rapidly, turned and rallied 8.3% from those lows over the following two weeks. Because Warrington was holding hedged ratio put spreads in its portfolio for regular expiration, the portfolio would have been most profitable at the lower end of the recent trading range. However, the quick 8.3% rally from those lows caused the put spreads to move out of the money and expire worthless, with the fund incurring a loss from the cost of the spreads and the hedging trades.

As the S&P 500 crested and began to turn lower immediately after regular options expiration, the protected ratio put spreads that the fund held for the end of the month were becoming profitable. The S&P fell 9.3% to end the month down 5.7%, and the realized gains from the end-of month ratio put spreads held by the fund helped offset the losses from earlier in the month to end with a small net loss for June.

Volatility continues in the stock market, but the trading activity has been much more linear than normal. The market will go down many days in a row, and then quickly turn and go straight up for days in a row. This "binary" market (where it is either trading directionally higher or directionally lower) can be frustrating for Warrington, as the fund's core strategy does best in choppy markets, not ones that trend for 10% moves in rapid succession.