WARRINGTON
ASSET MANAGEMENT

May 2007 Market Commentary

The pervasive bullishness seen from mid-March through April continued unabated into early May, pushing the S&P 500 to new all-time closing highs by the end of the month. We entered the month holding a normal contingent of ratio put spreads, with little call exposure. Given the velocity of the up move from March through April, we were not eager to have too much long delta, anticipating some retracement and better pricing. In a break from the trend of previous months, the futures did experience a few single days in May where they were down about a percent (on the 10th and the 24th). We used these opportunities to add some long synthetic call exposure to take advantage of a move higher in the market, while still holding our put spreads should declines continue. In fact, each decline was followed by a rally, erasing losses within a few days. As the market rallied we exited the long call spreads, realizing profits.

While the month of May was positive for the market (June S&P futures were up a little under 3%), the fact that there were a few retracement days gave us an opportunity to modify our position and add long S&P exposure. This ever so slight increase in market volatility (as compared to April where only one such day occurred, on the last day of the month) allowed us to realize gains and have a positive month.

We ended May holding an average position size of ratio put spreads, as well as adding a partial position of protected, out of the money ratio call spreads. While we still believe the market to be more vulnerable to downside movements, we recognize that bull markets can go on longer than may seem rational. These call spreads should help us benefit from continued up moves in the S&P, while at the same time our ratio put spreads should help us capitalize on a pullback in the market.