WARRINGTON
ASSET MANAGEMENT

May 2012 Market Commentary

The same pattern has now repeated a number of times: global stock markets weaken on rising European interest rates and default risks and eventually crack from those burdens. Rumors of bail-outs or other quick-fix schemes will then lift markets temporarily until the true details and inherent flaws with whatever plan was floated come to light, which ultimately results in markets retracing gains and heading lower.

May experienced just such a cycle, but the bounce was short-lived. The month opened on its highs but then rapidly declined 8.6% with the S&P futures closing higher on the day only three times in the first 14 trading days. In fact, during the week of options expiration the S&P 500 closed lower all five days in a row, an event that has occurred only three other times since index options began trading in the early 1980s (this is significant as there is usually quite a bit of trading back and forth during options expiration week, so one-way moves all week long are very rare). This long, slow decline is precisely what Warrington wanted to see and the fund manager capitalized on the move to lock in profits of over 2%. After expiration, rumors were floated about a Euro-wide deposit insurance program, but critical details were missing (such as where the money to fund such a program would be sourced). The S&P 500 rallied 3.4% on this news but then fell 2.8% to begin the next down leg in the market.

In regards to the Euro zone issues, Greece may be getting most of the headlines and it is definitely part of the overall problem, but Spain is a much bigger issue. With massive structural problems (unemployment near 25%!), one of the country's largest banks being nationalized and a weakening GDP, the country has some very real issues. The main problem is Spain's debt load is so large that it cannot be bailed out in the same manner as Greece. As such, the country is deemed to be "too big to fail, but also too big to bail out". This, among many other facts, has tempered the manager's bullishness over the past few months, as realistic solutions to these and other issues are few and far between.