WARRINGTON
ASSET MANAGEMENT

May 2013 Market Commentary

After the first day of the May (when the S&P experienced a 1% drop), US equity markets resumed the all-too familiar uptrend. From the lows at the first of the month, the S&P climbed 6.9%, and Warrington's manager sold out of the long puts held in the fund to recoup some value at the regular expiration. When Ben Bernanke spoke in front of a congressional hearing on May 22nd, he indicated that the Federal Reserve might take steps to reduce its bond buying programs "in the next few meetings." Given the high correlation between the S&P 500 and the growth of the Fed's balance sheet (0.87, almost perfect correlation), market participants reacted negatively to this disclosure and the S&P 500 declined 2.3% from the intraday high. As the month progressed, the market trended lower, but not materially so until the last day of the month when the S&P declined 1.8% from the highs that day. This selloff (and corresponding increase in volatility as the VIX rose 33.4% from its lows earlier in the month) caused the ratio put spreads for June expiration held by the fund to show marked-to-market losses at the end of the month, accounting for most of the month's performance.

Overall, equity markets are increasingly disconnected from economic fundamentals. For instance, the S&P 500 has posted a positive return for seven months in a row, which is the longest streak since the rally off of the lows in March of 2009, while U.S. economic data has been deteriorating for the past three months. This contradiction, taken together with the sharp increase in bond yields during May, causes Warrington's manager to be wary that this complacent, ever rising market might be experiencing a change of character, potentially leading to more volatility and lower prices for stocks and bonds. To attempt to capitalize on this outlook, Warrington's manager positioned the fund with June ratio put spreads looking for a market retracement, while remaining vigilant with risk management protocols should a mild decline become more severe.