WARRINGTON
ASSET MANAGEMENT

October 2014 Market Commentary

If one viewed October from the perspective of the month-end return statistics in isolation, one might assume that stock market action was similar to prior months: a steady advance ending with a moderate gain of approximately 2.5%. That conclusion would be far from reality, as the S&P 500 experienced its most extreme decline dating back to the summer of 2011.

Following a negative 1.4% performance in September, the S&P continued its precipitous rout in early October, cratering almost 8% in four trading days alone. At the lows, the futures declined exactly 10% from the all-time high experienced only a few weeks before. Per its risk-management discipline, Warrington's manager actively implemented the predetermined hedging trades designed to reduce downside risks for the portfolio as the market breached targeted levels, and concurrently purchased call spreads to take advantage of the market oscillations. After making a low at 1813 on October 14th, the S&P then turned and rallied an astonishing 205 points, basically in a straight line. As the market rebounded and went on to new highs, Warrington lost the value spent on the initial positions and hedges plus a small amount committed to end-of October ratio put spread positions, producing a small loss for the month despite extremely volatile market conditions.

The proximate cause of October's extreme slide and subsequent rebound could be due to a number of disparate events: Ebola cases in the US, general European economic weakness (especially in Germany, its pre-eminent economy) or the Fed ending the QE asset purchases. Regardless of the cause, the volatility and uncertainty was real and fear was palpable in the equity markets. The main question now is: will this decline emulate others from the past two years and simply be a launching pad to new highs, or will markets revert to more normalized patterns of volatility and returns? The manager is well-positioned for the latter, as healthy markets typically experience higher volatility and more frequent, milder corrections that are less extreme than those experienced the last few years.