WARRINGTON
ASSET MANAGEMENT

October 2006 Market Commentary

As the market surged ever higher, making new annual highs every few days, the hallmark of this rally continued to rear its head: no volatility. This can be measured in a variety of ways, from an historically low VIX to a lesser know statistic that we follow: the number of consecutive days that the S&P 500 cash index has gone without closing down 1.00% or more in a day. On average since January 1950, the S&P cash index has experienced a 1.00% or greater down day every 11 trading days, roughly once every two weeks. However, as of the end of October, the S&P cash index had not had a 1.00% or greater down day in 77 trading days, which is the 18th longest streak since 1950, and the longest such streak since December 1995. (As of this writing on November 20th, 2006, that current streak has continued up to 90 days and counting.)

This speaks to overwhelming complacency in the market and thus Warrington has continued to hold full-sized positions of put spreads in preparation for when the market will have increased volatility, but in October, we overlaid a larger-than-normal component of synthetic calls to capitalize on the directional nature of this current market environment. This added exposure worked to our benefit, allowing us to capture some of the upside movement in the S&P futures, even though our put spreads finished out-of-the-money.