WARRINGTON
ASSET MANAGEMENT

September 2009 Market Commentary

The S&P 500 posted yet another strong month in September, completing a string of seven positive months in a row. The lows for the month were posted very early with a 2.8% decline from the close of August. From that point to the middle of the month, the S&P rallied 8.5%, making new highs for the year. A small decline of 3.1% closed out the month.

The manager has recognized a recent market phenomenon that has been difficult to trade, given the manager's current market opinion that generally stocks are no longer undervalued yet the rally must be respected. When stocks decline for 2 to 3 days (in relatively small percentage drops) the VIX spikes appreciably (22% and 33% in two small declines from late August to early October) and the anecdotal "fear" in the market climbs rapidly. This rapid escalation in "fear" (both measured and anecdotal) tends to dampen market downside moves, as the worst declines tend to come when market participants fail to fully appreciate the magnitude of the decline until significant damage has already occurred. In the current environment, as the market continues to "bend but not break," stock buyers become more emboldened and are reticent to sell their shares into these modest declines hoping not to miss the next rally. It is precisely this attitude that the manager believes will lead to more meaningful declines in the near future. The manager is positioning the fund to potentially profit from these anticipated declines (with the idea that they are not expected to be as severe as the events of fall, 2008).

The recent small declines in the stock market are so ephemeral that the ratio put spreads in the fund only appreciate mildly before the next rally gets underway. Small profits for the Warrington fund are the result of such a situation, which are far superior to losses.