July 2015 Market Commentary

In July, Warrington was able to capitalize on the continued volatility in the equity markets to produce another strong net return of approximately +2%. With the underlying macro issues from June still impacting the markets, Warrington's performance exemplifies the strategy's non-correlation to the S&P 500. That index was essentially flat over the past two months, although this seemingly benign return understates a significant amount of intra-month volatility.

The Greek financial crisis continued to impact global financial markets until it was temporarily resolved in the same manner as previous Greek crises: its massive debts were not reduced, and the nation's creditors chose to "kick the can" to a later date for ultimate resolution. Consequently, Greece is not "fixed", contrary to its disappearance from the front-page headlines, and will not be, in our opinion, until the underlying problem of excess debt is addressed. A second concern, mentioned in prior commentaries, also roiled global markets during July as China's equity bubble finally burst. The Shanghai Composite Index dropped 8.5% in a single day, the biggest daily decline since February 2007. This crash caused the S&P 500 to open sharply lower, providing Warrington an opportunity to realize its most profitable put spread position of the month. This gain, combined with other gains from ratio put spread positions realized, contributed to the positive results that Warrington was able to provide its clients in July.

While China and Greece have dominated recent headlines, we at Warrington believe the Federal Reserve's potential interest rate increase will be a bigger issue for domestic markets going forward. Various indicators are sending conflicting signals on the likelihood and timing of this move, which will be the first increase in nine years. According to Bloomberg, the Fed Funds Futures market is signaling a roughly 50% chance of a rate hike in September and 75% chance by December, but the Ten Year Note is well off of its highest yield seen in early June (the yield should be rising if market participants are becoming more convinced of upcoming rate hikes). Additionally, many Fed governors have expressed a desire to raise rates even if only by a small amount, and many pundits have speculated that the Fed may already be behind the curve. The Fed has publicly maintained that they are "data-dependent" and will raise rates only if the economy continues to improve, but recent indicators continue to be mixed. With such uncertainty, we feel that the Fed will only raise rates once the need has been clearly demonstrated. The nascent economic recovery, while promising, might not be able to withstand a Fed with a tightening bias at this point.

At Warrington, we strive to deliver consistent, non-correlated, positive returns that are balanced with a strong focus on risk measurement and ongoing management. We will continue to position the portfolio opportunistically, weighing the risk / reward ratio of our existing positions or any new trade opportunities as additional information becomes available. With Greece still in flux, Chinese markets in turmoil and uncertainty surrounding the Fed, Warrington anticipates continued volatility which should be favorable for our trading strategy.