WARRINGTON
ASSET MANAGEMENT

October 2015 Market Commentary

October was another example of the extreme volatility experienced by the markets where the vagaries uttered by domestic and global central banks, and their varied interpretations, continue to drive nervous investor actions. During the sharp mid-month decline for equities of over 11% in August, many market participants were quick to draw parallels to the October 2014 decline, which saw a rapid descent followed by an even faster recovery to new highs. While history did not repeat itself, it certainly did rhyme. The recovery did not happen immediately after the initial drop in August, but rather the market oscillated in September before dropping over 7% from its peak then launching back to levels just shy of all-time highs in October. The S&P 500 opened the month with strong gains, never closing on any day with cumulative losses for the month. The persistent, strong gains eventually saw the index climb almost ten percent before closing the month up 8.4%.

The relentless rally provided scant opportunities for the ratio put spreads held in the portfolio to result in profits for the fund. We are often asked why we have rarely employed ratio call spreads in this recent environment and the October market behavior is a perfect example of the outsized risks involved: ratio call spreads cannot capture enough range (at the limited cost that we generally prefer) to protect against moves of almost 200 S&P points. This type of strong rally would cause the risk/reward relationship to be skewed against such a position. In a market rally such as we saw in October, we often look for mean reversion and position our low-cost put spreads to capitalize on such a retracement. This approach has worked for us in the past, and as a result, we have historically had minimal correlation to the S&P itself and have acted as a diversifier for traditional and alternative investment portfolios.

In large directional moves, to the upside as in October or to the downside as in August, capital preservation becomes our overriding mandate. Rallies and declines such as these can go much farther, much faster than market participants generally believe. Because of this tendency, we will continue to consistently employ our risk management principals during such severe market moves and wait for the return of historically normalized volatility which affords us an investing edge.

We thank you for your continued support of Warrington Asset Management.