WARRINGTON
ASSET MANAGEMENT

February 2016 Market Commentary

In February, global central banks appeared to be engaged in a "race to the bottom." Japanese and European interest rates have been slashed repeatedly into negative territory, while the US Federal Reserve has raised rates, but in doing so might have contributed to the heightened volatility of early 2016.

Because U.S. monetary policy is so out of step with the rest of the world, the logical extension might be that the Fed may look to cut rates into negative territory should market conditions continue to erode. The specter of negative interest rates caused volatility to resume in early February, culminating with Janet Yellen's testimony in front of congress where negative rates were not ruled out, but deemed worthy of further study. While it may be prudent to explore all options, the potential unintended consequences from such a drastic move could severely undermine investor confidence. With this possibility weighing on markets, the S&P fell sharply from the end of January until February 11th, dropping over 7% in rapid fashion to the new low for the year at 1810.10. A rumor attributed to the UAE Energy Minister that OPEC might look to cut production caused crude oil to climb 33% through the end of the month causing the S&P to rally in concert. This rise in the stock market continued through the balance of the month, helping equities to lose only a fraction in February, down -0.41%.

Warrington entered the month with small ratio spread positions as the disconnect between implied volatility in options prices compared to the actual volatility in the market made a strong case for conservative trading. The dramatic move lower in the S&P and then subsequent quick rally impacted our ratio put spread valuations, but the call spreads, opportunistically purchased when the S&P was trading near the lows for the month, helped offset those losses.

We will continue to analyze and seek out profit opportunities as we focus on what the Federal Reserve's next move may be. Continued tightening seems almost as remote as a rate cut at this point, given the negative market reaction to the last rate hike, which many commentators point to as a cause of the early 2016 volatility. The same cannot be said for the ECB and Bank of Japan, who look to continue the rate freefall, even though years of stimulus and ultralow interest rates have yet to have the desired effects on their respective economies.

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