WARRINGTON
ASSET MANAGEMENT

July 2016 Market Commentary

After the Brexit vote in the UK near the end of June, global markets – stocks, bonds, and currencies– all exhibited a great deal of volatility. This volatility proved to be short-lived, as many stock indices returned to pre-Brexit levels within days of the referendum. The sharp advance in the S&P 500 continued into July, propelling the index to new highs with a 9.3% rally from the Brexit lows in June. In a strange turn of events, the market then entered into one of the most stagnant periods in recorded stock market history. For the next eleven straight trading days the S&P 500 traded in a range of less than one percent, a stretch unmatched in over 45 years.

Many of the technical models we use indicated that the market was overbought after the strong rally at the beginning of July. We sought to take advantage of a potential reversion to the mean by using ratio put spreads, which could have been profitable if the market declined back into recent trading ranges. The anticipated decline did not materialize and the Strategic program lost the cost of these spreads, a loss of approximately 0.6%, net of all fees for the month.

The sharp decline in volatility worked in favor of the Tactical program. We were able to sell put options significantly out of the money near the beginning of the month when many market participants were expecting continued fallout from the Brexit decision. Those profits, bolstered by additional gains from our short call option positions, led to a cumulative profit for the Tactical program of 0.84%, net of all fees for the month.

With current volatility low and recent realized volatility even lower, we continue to focus on risk management to mitigate a possible material increase in volatility while positioning the portfolio to profit from a potential market decline. As the market has gone sideways in the last several weeks of July, the overbought condition in the S&P has been relieved. However, the volatility futures curve implies an increase in volatility expectations for the near term, which contradicts the recent lack of volatility and could indicate an imminent increase in market choppiness.

Thank you for your continued support of Warrington Asset Management.