November 2016 Market Commentary

It is often said that the stock market tends to do that which will confound the most people, and it would be difficult to find an instance where that was truer than in November. Many professional polling firms and political pundits predicted that Hillary Clinton was a lock to win the US Presidential Election, and the consensus view was that if she lost, US Equity markets would decline precipitously. In fact, the forecast of a decline on a Trump victory was initially correct as the S&P futures declined 5% the night of the election, but by the morning open most of those losses had been erased. From there, the US equity markets rocketed higher into the end of the month, gaining 9.1% from those post-election lows to the peak occurring on the final day of November.

As the market continued to rise throughout the month, our analysis and risk metrics indicated that the rally was overdone and that a decline was imminent. We deployed multiple ratio put spread positions anticipating a decline, but that expected result never materialized. The short-biased positioning resulted in a small loss for the Strategic program of -0.61% for November.

For the Tactical program, short call exposure was limited and no short puts were initiated prior to the election given the opinion that a surprise result could be a negative for US equities. As the market rallied sharply, we proactively reduced the short call exposure and initiated short put positions to profit from the advance. The rally over the remainder of the month allowed those short options to expire worthless, leading the Tactical program to a gain for the month of approximately 0.36%.

With Republicans taking control of the White House and both chambers of Congress, some are drawing comparisons to 1980 when Ronald Reagan was first elected. We generally disagree with this “paradigm shift” argument, specifically the significantly different market valuation metrics between then and now. The Price to Earnings ratio is one of the most widely used valuation statistics, with lower figures representing cheaper stocks, and this metric was 9.19 in November of 1980 vs 24.14 in November of 2016. Additionally, the stock market in 1980 did not rally continuously after the election. In fact, it wasn't until mid-1982 that the great bull market of the 80s commenced after a 27% decline from the post-1980 election peak. President-Elect Trump has been very vocal about his disdain for the ongoing actions of the Federal Reserve stating "the US Federal Reserve has created a false economy." We believe the return to a market driven by fundamentals is underway and the removal of the "artificial interference" from the Fed will create an environment of increasing opportunity sets for our Warrington trading programs.

We thank you for your support of Warrington Asset Management.