March 2017 Market Commentary

The first sign of the stock market's impatience with the new Presidential administration appeared in March. As the proposed changes to the Affordable Care Act were debated in congress, the S&P 500 started to decline. The weakness in equities continued as the bill was abandoned prior to a vote, which cast doubt on the future effectiveness of the Trump administration to implement an aggressive agenda, including eagerly anticipated tax and financial regulation reforms. From the peak reached on the first day of the month, the S&P declined 3.25% before rallying into the end of March to close basically unchanged.

The Strategic program was able to capitalize on this moderate volatility and record a positive return of approximately 1.9%, net of all fees. The fund held multiple ratio put spreads in the portfolio throughout the month, with varied expirations. Using our proprietary market timing indicators and prudent risk management, we were able to successfully realize gains on all of these positions, including our end-of-March positions which were profitably liquidated prior to the significant month-end rally.

The Tactical program was also able to profit from this moderate volatility, and produced an estimated positive return of 1.00%, net of all fees. As the weakness in the market began to accelerate, the VIX climbed to 15.11, the highest level since the election in November. This increase in volatility allowed the Tactical program to sell options deeper out-of-the-money, and also produced gains for each expiration cycle of the month.

We believe the volatility in March is a precursor of what to expect in coming months, as markets try to adapt to the new unpredictability and divisiveness in Washington. Additionally, the S&P 500 index is currently priced for perfection, with one widely-respected valuation metric reaching levels seen only in 1929 and late 1999. The cyclically adjusted price-to-earnings ratio (CAPE) has risen to 28.88, which far exceeds the long-run average of 16.74. To return to that historical mean, corporate profits would need to rise dramatically or equities would need to decline by approximately 40%. While the CAPE ratio can become even more extended, with many factors contributing to its current level, its history as a long-term gauge of valuation is flashing a clear signal that the next few years could be challenging for equities. We at Warrington welcome this renewed volatility, as reflected in our +8.5% rolling twelve month performance, demonstrating our ability to profit in uncertain markets.

Thank you for your continued support of Warrington Asset Management.