

# **WARRINGTON**

## **A S S E T M A N A G E M E N T**

### **April 2017 Market Commentary**

The French election in April provided an excellent example of market participants extrapolating recent events (Brexit, US Presidential Election) to assign a higher probability of a similar result repeating itself. As the election approached, volatility (as measured by the VIX) steadily climbed and achieved levels that would be considered historically normal. This environment has provided excellent opportunities for Warrington's trading programs in the past, but the French election did not provide a surprise result and the VIX collapsed to levels last seen in early 2007.

The Strategic program was able to capitalize on the moderate volatility during the first few weeks of the month to record gains on two separate positions, each utilizing ratio put spreads designed to profit from a market decline. The volatility expansion that occurred before the election drove up the prices of the deep out-of-the-money options we often utilize in our ratio spreads. Those high prices allowed us to establish positions with much wider spreads than typical which provided increased profit potential for the same level of risk, a relationship we constantly evaluate when initiating positions. The rally and then subsequent decrease in volatility suppressed the profit potential in the end-of-month positions resulting in flat month for the Strategic program.

That same dispersion of volatility throughout the month helped the Tactical program to achieve a profit of 1.06%, its best monthly gain since the end of 2015. The increased demand for protective puts before the French election allowed Tactical to position options much further away from the market than in normal conditions, increasing the margin of safety we seek out when initiating these positions. The collapse in volatility worked in Tactical's favor, as a declining-volatility environment can be as beneficial once positions are established.

The historically low volatility seen at the end of April implies a very complacent mindset among investors. We are monitoring a number of events that could end this calm environment: the proliferation of volatility derivatives, the mounting issues of Canadian mortgage lenders, and headwinds cropping up at major car manufacturers. However, given current stretched valuations, markets are priced for perfection and are equally susceptible to a technical correction.

As always, we thank you for your support of Warrington Asset Management.