WARRINGTON
ASSET MANAGEMENT

May 2017 Market Commentary

Volatility is generally regarded negatively by most investors, who tend to focus on the risks to a portfolio, but opportunities can arise as volatility increases. This has historically been true for Warrington, as we have seen some of our best opportunities during periods of market turmoil.

In recent years, unprecedented Central Bank actions have dominated the US stock market, leading to extended rallies with minimal pullbacks. These periods have been followed by short bursts of higher volatility, which are then rapidly retraced as markets advanced to new highs. This pattern was displayed again in May, as there was limited action during the first half of the month until the S&P fell 1.8% on May 17th and the VIX rose 46.4%. This was the 7th largest daily increase in the history of that index. From this low, the S&P rallied to the end of the month, reaching a new all-time high in the process, as the market ignored both political and economic issues.

The Strategic program was well prepared for the volatility spike, as we had decreased the duration of positions due to indications of increasing risk derived from our dynamic risk monitoring processes. With short-term ratio put spreads making up the majority of positions held in the portfolio, the decline allowed us to overlay long call spreads to lock in profits in anticipation of a market rally after the one-day decline. This analysis proved correct, and the Strategic program returned its second best month this year.

The Tactical program employed the same risk management indicators and focused on shorter-term positions in May, which protected the portfolio during the dramatic move lower on the 17th. We hedged a portion of the position to protect against the possibility of an accelerating decline, and placed additional trades to capitalize on the dramatic increase in volatility. The 2.3% rally into the end of the month negated our hedges but other trades proved successful, leading to gains of approximately 0.82% for the month, net of all fees.

We believe that May is a template for projected uncertainty over the near term, as political instability continues to impact markets even though realized volatility has been suppressed. The Warrington programs continue to benefit from our ability to employ opportunistic trading within a defensive posture, anticipating that periodic bouts of volatility will lead to a higher average level of implied volatility than what is currently priced into markets. Our patience and risk focus have been rewarded, as both the Strategic and Tactical programs recently achieved new all-time highs, with a rolling 12 month return of approximately +8.3% for Strategic and +8.4% for Tactical.