WARRINGTON
ASSET MANAGEMENT

September 2017 Market Commentary

According to research from JP Morgan, the S&P 500's annual peak-to-valley drawdown has averaged 14.1%. Even in strong bull markets such declines are common, as rallies tend to chop higher rather than trade directionally without retracement. The S&P 500's maximum pullback this year has been -3% (through September), which is tied for the lowest intra-year decline in almost 40 years. Additionally, the CNN Fear and Greed Index (an indicator of investor sentiment) ended September at a reading of 92 (the scale is 0 to 100). Using data back to 1998 (approximately 5000 trading days), this index has reached such an extended level only 76 times, less than 1.5% of all observances. With such evidence of an overbought market, 2017 stands out as an outlier even when compared to prior extreme environments.

The Strategic program would generally seek to capitalize on mean reversion from these exceptional levels, and although such a retreat did not occur in September, the program was still able to extract a positive net return of approximately +0.21%. The slight pullback at the beginning of the month provided an opportunity to harvest profits on a weekly ratio put spread position. Shortly after that reversal lower, North Korea launched another missile over Japan. In an atypical response to what historically would have spooked markets, stocks instead rallied the balance of the month.

The Tactical program recorded a gain of approximately 0.59% for the month as consistent weekly profits were realized from short put positions that expired worthless. Tactical also held short calls in the portfolio but focused on strikes well out-of-the-money to ensure minimal risk exposure in a bullish market. All positions proved profitable for the month.

Markets historically tend to mean-revert over time. This current bull market, dating to March of 2009, is one of the longest and strongest in history. While this certainly can continue, we feel that there are a number of indicators flashing caution signs, from weakening market internals to anecdotal evidence of excessive bullishness. In light of this data, we will continue to seek out trades with positive risk / reward characteristics while being conscious stewards of our clients' capital.

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