WARRINGTON
ASSET MANAGEMENT

December 2017 Market Commentary

The bull market of 2017 has repeatedly produced notable statistical achievements, and December was no exception: for the first time in the history of the S&P 500 Index ("S&P"), the total return of the index (including dividends) was positive for every month of the year. There have only been four other years recording 11 months of gains, with two of those years (1936 and 2006) preceding massive declines in the market. It is also apparent that exuberance from the tax reform bill fed into the continued buoyancy exhibited by U.S. stock indices. We look towards 2018 to ascertain if that exuberance will remain rational, or if the statistical anomaly in the S&P is a precursor to a broader market event.

After what was eventually determined to be an erroneous report about former national security advisor Flynn agreeing to testify against President Trump, the S&P dropped over 40 points in a matter of minutes. Declines of this magnitude generally occur over longer periods, and this rapid drop caused the S&P to cross our pre-determined risk levels resulting in an initial hedging trade for the Strategic program. The S&P recovered those losses and then resumed a steadily higher trajectory, closing near the high for the month. With no other material declines for the rest of December, the nominal cost of that hedge combined with the costs of ratio spreads (which mostly expired worthless) led to a small loss of approximately -0.14% for the Strategic program.

The Tactical program recorded a small loss for the month of approximately -0.19%. The decline was primarily attributable to the cost of hedges implemented during the large drop on the first day of the month. The volatility environment following that quick drop did not create new trading opportunities with improved risk/reward characteristics that we often see after such events, which impeded us from fully recovering the losses from the hedging trade early in the month.

While 2017 has been a disappointing year for those looking for an increase in volatility, Warrington's two programs ended the year with positive returns. Going forward, we continue to see a number of indicators signaling that this "no vol" environment may be coming to a close (U.S. interest rates continue to rise and global central banks continue to tighten monetary policy and reduce balance sheet accommodation). Warrington's strategies will continue to identify and seek to extract profits for our clients as we look to balance the perceived risks versus the potential rewards in any trade opportunities, as we have done through all market climates now for over twenty years.

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