WARRINGTON
ASSET MANAGEMENT

April 2018 Market Commentary

The first trading day of April had similar directional volatility as February and March. The 3.5% decline that day pierced the S&P's 200 day moving average to the downside, a widely-used technical indicator which often portends further losses. However, that was not the case in April, as that move marked the lowest point for the month and the index quickly traded back above the 200 day moving average. The S&P continued to trade higher, climbing 6.5% from those early lows. The rally then stalled out, and the S&P declined into the end of the month. Several factors influenced the market, although we believe the most notable was rising interest rates. The US 10-year Treasury note surpassed 3% for the first time since January of 2014. Much of this recent run-up in rates can be attributed to the Federal Reserve's announced plan to reduce the size of its balance sheet. This "Quantitative Tightening" has decreased asset holdings only nominally so far, but should prove to be a contributor to driving rates significantly higher going forward, if they follow their announced path.

The Strategic program ended April with a slight loss of -0.54%. The large directional moves that began in February continued throughout April, with five days exceeding a daily range of 2%. For context, there were zero instances in 2017 of a daily range that large. The moves in April required us to incur costs hedging positions in the portfolio early in the month, but gains in the latter portion of the month from both ratio put spreads and ratio call spreads allowed us to partially offset those losses.

The Tactical program was able to successfully navigate the continued volatility and recorded a gain of 0.39% for April. As with the Strategic program, the outsized moves early in the month dictated we hedge our positions, but the continued volatility led to opportunities throughout the month to erase those initial losses. By decreasing the time before expiration when we are initiating option positions, the impact from volatility can be somewhat mitigated. Continued strict risk management will occasionally lead to closing options positions quickly (sometimes prematurely), but that same disciplined risk management has been instrumental in avoiding many large equity market dislocations.

The projected path of the Federal Reserve's interest rate hikes could lead to continued volatility in the fixed income markets, which would most likely impact other markets adversely. After years of ultra-low rates, the run up in yields will at a minimum lead to unexpected outcomes. One that we follow closely is the spread between the 2 and the 10-year Treasury yield, which continues to decline and is at its lowest level since late 2007. Should the yield curve invert, history has shown this to be amongst the most accurate predictors of recession, which could lead to the next stock market correction. We continue to monitor these developments closely, as our long term discipline dictates.

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