WARRINGTON
ASSET MANAGEMENT

October 2018 Market Commentary

The S&P 500 Index ("Index") ended the month down 6.84%. Many factors contributed to the market unrest, and it seemed every day added a new level of uncertainty and angst. Within the first week of the month, the 10-year yield spiked to 3.25%, the highest level since 2011, after Fed Chairman Powell said the U.S. outlook was "remarkably positive". China trade tensions, the Fed reaching "terminal velocity" in their balance sheet run-off, and the upcoming mid-term elections proved to be the perfect storm that brought significant volatility back to the markets. Tech stocks declined severely: the Nasdaq 100 index was down 9% in October, its worst monthly return since October 2008. Fears of algorithmic trading exacerbating the decline also made headlines. The outcome, as we have been discussing in our commentaries for some time now, was a market dominated by fear and volatility.

The Strategic program was able to capitalize on the volatility and gained +2.4% for the month. We were initially positioned in long put spreads and short call options, seeking to capitalize on a market downtrend. After the first week of the month the decline intensified, with the S&P 500 dropping 7.9%. This rapid drop resulted in our deep out-of-the-money put spreads increasing in value significantly, leading us to monetize gains by liquidating the positions for multiple expirations, contributing the majority of our profits for the month. As the S&P remained below our downside "Red Band" for most of the balance of the month, we maintained very light positions with zero downside put exposure. For a deconstruction of our trading during October, we have included a writeup to provide more detail (see attached).

The Tactical program employed its disciplined risk management preemptively and ended the month essentially flat. The outsized market moves early in the month caused the program to hit its hedging triggers, requiring us to cover our downside put exposure. We remained holders of short, deep out-of-the-money calls through the end of the month, which offset the nominal costs from hedging trades early in the month. For a significant portion of October the S&P 500 traded outside of our defined risk parameters, helping us to avoid the outsized volatility with little risk exposure.

The fourth quarter of 2018 began with an October that lived up to its historical reputation as the month of "cursed volatility". The market had no shortage of data for investors to absorb, from indications of a slowing economy to the President's public highlighting of blame placed on the Fed Chair for raising interest rates too quickly. Wrapped in the period was also one of the most volatile Supreme Court Justice nominations, the murder of a prominent Saudi journalist in Turkey and a focus on immigration, as thousands of migrants from Central America marched towards America's southern borders. Midterm election fears have further polarized the U.S., resulting in a sense of fear and uncertainty throughout the month. We continue to believe that the VIX may not be accurately portraying the real volatility in the markets and we will monitor all these factors carefully, seeking out profit opportunities for our clients in these uncertain times.

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