WARRINGTON
ASSET MANAGEMENT

February 2019 Market Commentary

The pattern in the S&P 500 Index that started the day after Christmas continued through January and February: a strong rally with no material declines. One indicator we rely on when making trading decisions is our proprietary Band Chart. This daily chart of the S&P futures contract indicates to us when the market is overbought and when it is oversold, and can often predict near-term movement in the S&P. This chart indicated a developing overbought condition in January (hitting our top band for the first time since October 2011). Readings this extreme are often followed by weakness in the S&P, but in February the S&P continued to grind higher.

The Strategic Program sought to capitalize on the prospective end of this euphoria in the stock market with ratio put spreads designed to profit from a mean reversion. A slight pullback early in the month allowed us to achieve small gains on these positions. When the S&P resumed its upward trend, we were able to monetize call spread positions to add to accrued profits. We then continued to seek profits using additional put spreads, but the anticipated downside in the S&P didn't materialize and the S&P regained the psychologically-important 2800 level, last seen in early December 2018. The continued churn higher led to our put spreads expiring and leaving the Strategic Program with a slight loss of 0.27% for the month.

The Tactical Program continued to take advantage of the trending market and realized a positive return of +0.38%, with both put and call positions contributing to the positive results, even though risk triggers led to some call hedging in the middle of the month. The extended rally, coupled with the continued decline in the VIX, led to compressed option valuations. This resulted in a decision to lower our risk profile and keep positions smaller than average, opting to seek out better opportunities as the risk / reward relationship improved.

While stock market bulls have enjoyed this directional grind higher, normal and healthy markets tend to have moderate declines during extended rallies. We would argue that this market is not normal or healthy, with daily moves dominated by unpredictable news flow and presumptions of good news to come (primarily, the recycled headline of positive progress toward a trade deal with China). We continue to watch for indications of the next move in equities: will a trade deal announcement vault the S&P to new all-time highs, or will it be met with a "sell the news" reaction? Alternately, how severe of a decline would ensue if trade talks fell apart altogether? Proactively examining the events, and related outcomes, dominating the market psyche, as well as the current state of support expressed by the now dovish Federal Reserve, are components of our overall risk assessments and factor into our positioning as we seek to identify new profit opportunities for our clients.

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