March 2019 Market Commentary

After a seemingly non-stop rally dating to the end of December, the S&P finally experienced two moderate pullbacks in March. While neither decline was as significant as the sharp drops in late-2018, they may signal that the frothy, overbought environment in U.S. equity markets might be coming to an end. Early in March, the S&P had a 3.5% decline over five trading days. On March 22nd a more dramatic drop occurred, most likely due to inversions along certain points of the yield curve (historically, an accurate indicator of a pending recession), with the S&P falling 1.8% that day. This was the largest loss for the index since Christmas Eve, 2018.

These declines were instrumental in the Strategic program's gain of approximately +1.1% for the month. Our analysis indicated that a mean reversion was likely after the persistent rally, leading us to position ratio put spreads across multiple expirations to profit from this outcome. While the month ended without a further material decline, two opportunities were adequate to provide our investors with a strong gain in March.

The Tactical Program was able to record profits on both calls and puts to achieve a gain of approximately +0.45% for March. The early index weakness in the month caused the VIX to climb, reaching levels last seen at the end of January. This higher volatility helped to skew the risk / reward relationship for both calls and puts more in our favor. We continued to hold partial position sizes, even with this somewhat better trading environment, as certain indications (such as inversion of the VIX curve) led us to believe that even more volatility could be on the horizon.

The yield curve inversion that occurred late in the month will be dismissed by some, but the overall message it sends is that the Federal Reserve will need to consider cutting rates in the future to stimulate growth. This is not an indicator often seen in a strong economy. Also, earnings for the first quarter will be released shortly, and are forecast to show a dramatic drop when compared to 2018 (Q1 2018 was buoyed by the corporate tax cuts), which could be the next source of volatility in markets. We will continue to monitor earnings and look for further yield curve anomalies to provide signals as to the near-term movement of the S&P, seeking out profitable trading opportunities around our analysis.

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