WARRINGTON
ASSET MANAGEMENT

April 2019 Market Commentary

One quick look at a year-to-date chart of the S&P 500 might suggest a strong, healthy stock market. The 27% rally from the December lows to new all-time highs in late April appears to indicate that all is well, and stocks face no issues in the foreseeable future. We feel that this is not the case for several reasons. One aspect of our research uses technical analysis to assess the current market and help us determine the health of the index. If those indicators do not convey similar bullishness in the overall index, this creates a "negative divergence." At the end of April, two indicators (the MACD Oscillator, and the Relative Strength Index) were telling us that the stock market rally has not been as strong as previously rallies, even though it was reaching new all-time highs. This waning strength can often be a precursor to volatility, as both indicators were giving similar signals in late September 2018. Additionally, we have noted recently that the volume of various short volatility trades has reached the highest point in market history. Similar extremes were seen in late January 2018, just prior to a massive explosion in volatility in early February. Although no single indicator can give perfect clarity to the near-term direction of the S&P, we feel the confluence of some very reliable indicators increases the probability that this rally may soon be tested.

As the market continued to climb higher in April, we positioned the Strategic portfolio to take advantage of a pullback, but no material declines occurred during the month. In fact, the largest drop in the S&P during April was a 1.2% intraday drop that was spread over two days, which was recovered shortly thereafter. Conversely, we used some deep-out-of-the-money ratio call spreads to attempt to capitalize on the continued rally, but those were unsuccessful as the strength of the rally began to wane. The Strategic program ended April with a loss of approximately -0.64%.

The lower volatility and declining strength of the rally proved to be beneficial for the Tactical program. With our indicators telling us that the rally may be stalling out, we generally maintained a full position of short calls well above the market, and a partial position of puts. The combination of those positions allowed us to record our best return in the past seven months of approximately +0.58%.

Rallies and declines generally indicate a healthy market, but directional moves (either up or down) are often negative indicators seen at market extremes. With market internals continuing to degrade, we believe we could be approaching such an inflection point. We also find the current expectations of the Federal Reserve, as reflected in the Fed Funds futures pricing in a 25% chance of a rate cut, are highly improbable given the over-extended level of the major stock indexes and strong economic news. We will continue to seek profitable, risk based, trading opportunities for our clients regardless of the overall market direction.

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