WARRINGTON
ASSET MANAGEMENT

June 2019 Market Commentary

Over the two-month period from May through June, the S&P 500 Index made an almost complete round trip. After falling 193.8 points in May, it recovered 189.7 of those points, ending with a negligible net loss of 0.1%. The pace of the decline and subsequent rally was similar as well, as the initial drop played out over the course of the entire month, and June's rally was equally extended as the Index hit its high point near the end of the month. During May, the VIX climbed as the market declined, but even though the S&P recovered almost entirely, the VIX did not collapse back to prior low levels. This may be attributed to the G20 meeting occurring at the end of June, leaving the market to impute the attendant event risk causing the VIX to remain higher than it might otherwise have been.

The Strategic program incurred slight net losses of -0.18% even though the relentless rally left limited opportunities to profit on put spreads. By keeping the cost of spreads low, we were able to minimize the aggregate monthly debit. The strong rally at the beginning of the month was never retraced, leaving the program with small losses across all contract expirations. On balance, over the previous two months, the Strategic program was able to achieve a net gain of approximately 1.0%, through two very different market environments.

The slow, steady climb higher in the S&P allowed the Tactical program to record a net gain of approximately 0.76%. All contract expirations traded were profitable with only nominal hedging expenses incurred throughout the month. We began the month with no positions carried over from May, and after what appeared to be an overbought rally in early June, we were able to opportunistically trade limited call positions. The lack of any material declines in the S&P also provided opportunities to profit on our put positions, leading to the best monthly return for the Tactical program since September 2018.

Even though the S&P has recently hit all-time highs, there are some concerning divergences in other markets. Specifically, fixed income has traded in an inverse manner to stocks since December. While the S&P rebounded sharply, bond yields decreased, perhaps in anticipation of further Federal Reserve accommodation. The falling yields along the curve imply aggressive future easing from the Fed. Should the Fed not decrease rates, they risk falling behind the markets as several indicators are flashing recessionary signals. Fed funds futures are pricing, with almost near-certainty, the chances of a 25 basis point cut in July, and odds of a 50 basis point cut are fluctuating on a daily basis. The dichotomy of the stock market's euphoria and the bond market's bearishness tells us that both cannot be correct (generally, stocks have a strong positive correlation with bond yields). Either stock prices will decrease or bond yields will increase to address this divergence. We will continue to assess trade opportunities and seek profitable positions in light of this contradiction.

As always, we appreciate your support of Warrington Asset Management.