July 2019 Market Commentary

The S&P 500 continued to climb steadily up to the last trading day of the month even though market participants knew that day could bring volatility, as the U.S. Federal Reserve (the "Fed") was scheduled to announce their latest monetary policy update on July 31st. Speculation about their intentions to lower interest rates for the first time in ten years had been a market focus for months. Fed Funds futures pricing is often used to estimate the probability of pending Fed interest rate changes, and had signaled the most likely decrease to be between 25 and 50 basis points. However, when Charmain Powell announced the 25 basis point cut he also implied it might be a "one and done" scenario rather than a prolonged rate cutting cycle favored by market participants, causing an immediate decline in stock prices. The selling in the S&P was strong, sending the Index to its largest intraday decline since early May. In fact, prior to that drop, the S&P had not had a 1% daily gain or loss in the previous 36 consecutive trading days, the longest streak since early October 2018.

As we anticipated the Federal Reserve announcement could be a potential source of volatility, we structured trades in the Strategic Program to profit from a market pullback. Specifically, we held ratio put spreads which were deep out-of-the-money when initiated, with the goal that they profit should the S&P drop after the Fed announcement. The dramatic decline in stock prices provided an opportunity to realize profits, which offset the accumulated small losses from expired positions held earlier in the month. As a result, the Strategic Program was able to record a slight gain of +0.25% for July.

The nominal volatility continued to benefit the Tactical Program, helping it record another strong gain of +0.76% in July. We successfully collected premiums from both put and call options, as the steady volatility and defined event risk of the Fed announcement lead to consistent profitable trades. As the Fed announcement approached, we decreased position size to more conservative positions of calls and puts, allowing us to retain additional profit potential from the reaction to the Fed announcement while also protecting prior accrued profits.

Even though the VIX had declined an astonishing 45% for the year up to the Fed meeting, our risk indicators signaled that the Fed announcement might be a precursor to more volatile market activity. With the prospect of an uncertain monetary policy path, every future Fed meeting will engender a possible market-moving surprise. Additionally, domestic uncertainty is mirrored by international issues, as global slowdown fears increase, Brexit continues to be an ongoing concern and the percentage of global government bonds with a negative yield continues to rise (currently $14 trillion dollars of sovereign and corporate debt are priced at negative yields, a record).

These issues do not appear resolvable in the near term so we will remain vigilant, looking for profit opportunities where the risk/reward is in our favor. We will continue to closely monitor the relative level of market volatility, which we believe will move to higher levels than in prior years, which should provide more favorable trading opportunities for our strategies.

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