WARRINGTON
ASSET MANAGEMENT

September 2019 Market Commentary

The August stock market turmoil was immediately forgotten in September, as a strong rally early in the month had the S&P approaching all-time highs. However, some key interbank funding markets displayed signs of tightening, and certain repo rates (loans between banks to help with overnight financing) climbed exponentially. These rates can be indicators of the health of the "plumbing" in the financial sector. If these rates become too high, due to the perceived risks of lending or a of shortage of funds to loan to counterparties, it can precede other market stresses. Later in the month the Federal Reserve cut the Fed Funds rate for the second time this year, but markets widely expected this and the reaction was muted. The month ended with the revelation of President Trump's handling of a call with Ukraine's President, leading to rumors of a possible impeachment vote, which nominally spooked the markets. The S&P was up 1.87% in September, but tensions continued to rise amongst investors.

The Strategic Program was able to achieve a small net gain of +0.13%, due to these market oscillations. After a 4.5% rally stalled out in the middle of the month, we were able to extract profits on ratio put spreads, as the S&P dropped about 2.5% to the end of September. Given the increase in volatility, mainly due to exogenous factors, we structured our core positions to profit from much larger declines in the S&P. Consequently, overall gains from these positions were muted.

The Tactical Program achieved a net profit of +0.44% for the month, even though market rotations led us to hedge call positions during the rally early in September, but also hedge puts late in the month. Our risk management protocol dictates that we preemptively hedge or close positions if the market moves against the thesis that was used to establish them. This can at times cause us to close a trade before maximizing its profit potential, but our experience leads us to err on the conservative side when we encounter market environments that may cause adverse pricing with declining risk/reward characteristics.

While the ongoing crosscurrents will eventually resolve themselves, the potential impact of many of these underlying issues (specifically, the problems in funding markets) should not be ignored. The Federal Reserve agreed through its actions, as it reactively engaged in emergency funding measures to help alleviate the repo rate stresses for the first time in over a decade and, in doing so, also resumed its balance sheet expansion. While not on the scale of prior "Quantitative Easing" programs, this could be the tip of the iceberg should funding stresses continue, possibly leading to QE4. How the markets interpret this intervention, be it as a proactive panacea or as a distressing step taken by a central bank losing control of its economy, is the bigger question.

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