November 2019 Market Commentary

The buoyant trend in US equity markets continued in November, as the S&P 500 index ("S&P") had essentially no downside retracements. As of the end of the month, the S&P had gone 37 consecutive days where the daily return was less than a 0.5% loss, a streak achieved only one other time since the late 1960s. Concurrently, the VIX declined precipitously, reaching the near-historic low level of 11.4, which last occurred in September 2018 and then April 2019. It is interesting to note that both these lows preceded sharp increases in the risk measure as well as significant losses in the S&P.

The complete lack of volatility is often a less-than-ideal trading environment for the Strategic Program, as it focuses on spread trading where volatility is a necessary input for optimal return opportunities. For the month, the Strategic Program lost a net 0.29% as many positions were designed to capitalize on an expected pullback that did not materialize. The monthly loss is the cumulation of trading costs and net debit expenses from those spread trades.

Low volatility in November proved beneficial for the Tactical Program, leading to a positive net return of +0.45%. The low level of volatility kept put option prices subdued, which required our risk/reward analysis to maintain average sized put positions or smaller. On the call side, the S&P's steady drift higher lacked "high-velocity" moves, which mitigated demand for calls and kept their premiums from rising to our risk triggers. Despite these risk dampening factors, we were able to extract a moderate profit in a low volatility environment.

While there does not seem to be an apparent near-term catalyst to disturb the market, we believe, with hindsight of three decades' experience, that just because risk isn't obvious doesn't mean it's not there. We have shared many clear indicators over the past few months that point to possible trouble ahead. As market participants continue to show complacency, we believe that it will not take much of a negative surprise to generate much higher levels of volatility. The size of the "short volatility" trade has risen to the most extreme level in history (per the Commitment of Traders report), which is not a reason for the market to decline in itself, but would add fuel to the fire should a material increase in volatility surface.

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