WARRINGTON
ASSET MANAGEMENT

December 2019 Market Commentary

The character of the rally in December resembled many others during the year: a protracted ascent with almost no downside, with the 21-day moving average acting as a strong technical support level. Many of you may recall that we use that specific moving average as part of our Band Chart (a daily chart of the S&P 500 and its 21-day moving average with static envelopes above and below that level, which we use to interpret how overbought or oversold the index is at any given time). Since mid-October, the S&P dipped below that moving average on only two days, very much like the extended rally from early January into March. With such a prolonged and calm rally, it should come as no surprise that volatility collapsed, and complacency grew.

While such a benign market was not what we anticipated, the Strategic Program ended the month with a net return of +0.02%, as the small dips early in the month, and then again at the end of December, provided modest profit opportunities for our ratio put spreads. These gains were offset by the debit costs of unsuccessful spreads, which were positioned for a retracement as the S&P's rally became extended.

The Tactical Program gained +0.39% net, capitalizing on some interesting dynamics happening under the surface of the index. Even though the market had very little realized volatility there were a few incidents where the VIX increased, as deep out-of-the-money options were bid up in price. Worries around the US-China trade deal sent the VIX higher in the middle of the month, presenting profitable trading opportunities. Later in the month, concerns regarding the end-of-year repo market funding mechanism provided additional profits, even though the market reaction to this proved muted.

The stress in the overnight repo markets, which has been a common theme of ours over the last few months, has caused significant alarm at the Federal Reserve. To preempt problems at year end, the Fed added $415 billion of liquidity (and counting), which amounted to a retracement of 55% of their entire Quantitative Tightening program. This flood of money helped to preempt immediate funding issues, but now the difficult part must be addressed: how can the Fed remove this stimulus without disrupting markets? While they are quick to point out that these asset purchases were "not Quantitative Easing", we believe they may be forced to make the new purchases permanent, or risk upsetting the very asset markets they were just forced to defend. There tends to be no "free lunch" in markets, and the future impact of these interventions is unknown but steadily compounding. For this reason, we remain cautious and will continue to focus on protecting investor principal and extracting profits as the outlook becomes more clear.

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