WARRINGTON
ASSET MANAGEMENT

September 2020 Market Commentary

In what appeared to be a classic "blow-off top", the S&P index rocketed higher at the beginning of September, peaking with a staggering 64% rally from the March lows. The consensus attributes this latest move higher to aggressive speculative call option buying in a number of technology stocks (when large numbers of options are transacted, market makers on the opposite side of trade will often hedge their exposure by trading the underlying stock, in this case driving those stock prices higher.). Whatever the cause, the rally almost immediately failed. In fact, the Nasdaq experienced the fastest 10% reversal after registering new all-time highs in history, in the span of only three days. The S&P saw similar volatility, declining 11% from the intramonth high to its lows late in September, before a rally in the final days reduced the monthly loss to -3.8%.

The Strategic Program was able to capitalize on this volatility after initially hedging positions earlier in the month before the market reversed sharply. As September progressed, we were able to profit on multiple smaller-sized ratio put spreads and achieved gains to offset those early hedging costs. At the month's end, the Strategic Program was able to record a net gain of +0.06%.

The Tactical Program experienced an early month whipsaw, as the blowoff rally in the first few days of September initially triggered our risk management hedging levels for short call option positions. Then, with the immediate sharp reversal, our discipline dictated that we close out our short put positions as the market declined precipitously. These few days comprised the majority of the monthly loss, but such an occurrence, where market movements necessitate hedging both calls and puts during a single week, is very rare. Given how far out of the money we typically position our trades, it is not uncommon to go through an entire month without having to hedge any options, which underscores the rarity of the events of early September. Despite this early hurdle, successful put and call positions deployed over the rest of the month offset our initial loss, but the Tactical Program ended the month with a net loss of -1.03%. While any loss is painful to us, it should be stressed that our strong risk management protocols limited our losses to approximately 1% during a period where the S&P declined -8.1% within days.

As we have mentioned in previous commentaries, market participants remain optimistic about further fiscal stimulus offerings. The Federal Reserve has repeatedly implored Congress to pass a fiscal relief package, effectively "passing the baton" to lawmakers instead of adding more monetary stimulus. With the election looming, the politics of such a large spending bill can be tricky, but without fiscal relief the US economy may reverse the nascent recovery experienced in the third quarter. Also, expectations for volatility around the election have been widely advertised, but the volatility futures markets are pricing in similar volatility levels for several months after the election. Whether that will be due to an uncertain election outcome, or fears of a resurgence in COVID-19 cases, volatility looks to be here to stay for the near future. We will continue to use these volatility expectations to seek beneficial risk / reward scenarios on behalf of our clients.

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