WARRINGTON ASSET MANAGEMENT

October 2020 Market Commentary

After a strong S&P 500 Index ("S&P 500") rally of 5.6% at the beginning of the month, stocks reversed course and spent the balance of the month churning lower. The prospect of a contested U.S. Presidential election and the increase in early voting (which can be slower to process than votes cast in person) has raised the odds that a clear winner will not be determined on Election Day and, as history has proven, markets hate uncertainty. Additionally, many high-flying Nasdaq stocks reported stellar earnings but still saw their share prices decline as those numbers fell short of investor expectations. At the end of October, the S&P had reversed its early gains and finished down -2.6%.

The Strategic Program realized profits early in the month from both call and put spreads. During the subsequent decline, the velocity of the drop led to the fund incurring increased hedging expenses and to a decision to close all positions heading into the upcoming election period. The result was a gain of +0.04% in October.

The Tactical program also identified a period of outsized risks due to elevated implied and actual volatility, combined with significant "event risk" from the imminent election outcome. In this type of situation, we err on the side of smaller, short-dated positions as we do not feel that we have a tradeable edge. Even with the increased risk and additional hedging costs incurred, the program ended the month with a gain of +0.31%.

One factor that separates Warrington from the litany of option traders that have come and gone since our founding in 1997 is our steadfast adherence to program risk protocols. We prefer to let questionable market events play out before risking significant client principal. The lead up to Election Day on November 3rd is an example of an event where we (and other market participants) have an opinion about what the results may be, but with no measurable degree of certainty. Will the same polling errors that surprised markets in 2016 repeat themselves? What other factors will arise that could upend the assumptions that most are making about these elections? These "unknown unknowns" are always present but are much more acute given the nature of such an election where turnout and changing preferences of the electorate can vary dramatically from the 2016 playbook that most are using. Our philosophy requires we invest only when the calculated risk/reward favors an outcome likely to benefit our clients so we will continue to focus on identifying those opportunities.

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