WARRINGTON
ASSET MANAGEMENT

February 2021 Market Commentary

In a pattern similar to January, the S&P 500 Index ("S&P") rallied persistently through the first half of February, but then turned and sold off substantially later in the month. The proximate cause of the late-month decline was a material rise in interest rates. The rising trend in the U.S. 10-year Treasury note yield accelerated and hit a peak of 1.6%, significantly higher than the recent low of 0.5% set in early August 2020. This caused reverberations throughout the equity and other markets, as talk of pending inflation and a "commodity super cycle" became pervasive. The S&P declined 4.4% from its mid-month highs, finishing the month with a gain of 2.8%.

The Strategic program utilized ratio put spreads to profit from the late decline and recorded a net gain of +1.71%, its best monthly return since October 2018. Profits were realized on two separate spread positions expiring during the last week of the month. Even as the CBOE Volatility Index ("VIX") climbed over 30, the increasing volatility led to additional gains for us, as we constructed our February positions with wide profitability ranges to allow for oscillations in the market.

The Tactical program recorded a net gain of +0.26% for the month, as the lower level of volatility early in the month yielded consistent trading opportunities. These gains were marginally impacted by the late month decline of the S&P, as our end of month positions required hedging as volatility spiked.

When analyzing the current volatility landscape, the recent low level of the VIX (around 20) has been tested several times, with each test followed by a subsequent volatility spike. Concerningly, the VIX futures curve, a measure of the level of implied volatility, is forecasting even higher levels ahead. Causes of this expected higher volatility include the previously mentioned rises in interest rates and commodity prices, leading to fears of overheating inflation. Should these trends continue, the Federal Reserve could find itself in a quandary, having to choose between either saving the bond market (by raising rates to control inflation) or supporting the stock market (by keeping monetary policy accommodative and possibly engaging in "Yield Curve Control".). Either choice will have far-reaching ramifications, so we will continue to closely monitor market developments and construct trades to take advantage of whatever scenario occurs, as it unfolds.

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