WARRINGTON
ASSET MANAGEMENT

July 2021 Market Commentary

The net return of the S&P 500 Index ("S&P") for July once again masked a series of domestic and global undercurrents that had the potential to negatively impact the world economy. In the end, none of those contributors had the ability to derail the ongoing rally in U.S. equities, other than to cause a few percentage points of temporary discomfort. The biggest decline (approximately 4%) occurred in the middle of the month as fears of the spread of the Delta variant of the coronavirus stoked concern that lockdowns and other mitigation efforts could be forthcoming if the situation continued to worsen. Later in the month, the Chinese government took steps to rein in many of their own high-profile corporations undercutting some of their lofty valuations, but that action had minimal impact on our domestic markets. Large-cap U.S. technology firms also began reporting earnings in July, with Amazon being the most notable disappointment, but even that was unable to materially impact the overall market trajectory.

A critical component of our risk management process is to assess potential extremes and position our portfolios accordingly. Even though the S&P has been essentially impervious to negative news, we fully expect that this will change, and perhaps change quickly. As the S&P rolled over in the middle of July, we took steps to protect our clients from the potential acceleration by eliminating our downside exposure. This came at a cost, and the market rebounded sharply from its lows, as if the impetus to the decline never existed. The net result was a monthly loss of 1.47% for the Strategic Program.

The Tactical program was able to successfully navigate these periods of volatility to record a net gain of +0.49% in July. Even though we incurred some additional hedging costs, positive trade opportunities continued to present themselves. Market volatility started the month near the low end of its range for the past year and steadily trended higher, providing support to premiums of deep out-of-the-money options.

The VIX is a common measure of volatility in markets, but perhaps a more useful tool would be to look at the volatility of volatility itself. When the VIX is steady at a high level, the market may be volatile, but consistently so. When the VIX goes from low to high and back again, during a short period, the volatility of the VIX is high. This second derivative of volatility (known as VVIX) has been elevated this year when compared to historical norms and has seen several peak readings that have surpassed all but the most volatile periods over the last decade. This can be viewed as an underlying level of nervousness in the market and is part of the reason why markets oscillate between calm and panic and then back again in the matter of days. We evaluate this "nervousness" both quantitatively and qualitatively and use that to guide us in protecting the portfolio while continuing to look for positive trading opportunities.

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