WARRINGTON
ASSET MANAGEMENT

October 2021 Market Commentary

After a choppy start to the month for the S&P 500 Index ("S&P"), the release of positive earnings reports sent the markets into an unabated upward trajectory with the indices quickly reaching new all-time highs. These strong gains were in the face of continued supply chain disruptions, rising energy prices, and the looming showdown over the debt ceiling which will return to the forefront of investors' concerns in early December when the current stopgap measures will expire. The S&P climbed 5.5% over the last half of the October ending the month with a gain of 7.0%, its strongest monthly gain of 2021.

The Strategic program was able to record profits early in the month when stocks were oscillating and trending downward but once the mid-month rally commenced, the ratio put spreads held in the portfolio expired out-of-the-money. For the balance of the month the portfolio was positioned to profit from a resumption of a choppy trading environment, which has been a recent market characteristic, but the continued rally did not allow for additional profits to be added. For the month, the Strategic Program recorded a net gain of +0.27%.

The mid-month rally also suppressed volatility levels, sending the CBOE Volatility Index ("VIX") from a range of 18-25, back to its lows from earlier in the year of 15-17. This decline in volatility, coupled with the widely discussed views of market pundits that believe all will remain calm for the foreseeable future, lowered option premiums on the deep-out-of-the-money options utilized by the portfolio. This decrease minimized the profit opportunities for the Tactical program, but we were still able to deliver a net gain of +0.28% for October.

In what could be an interesting schism in the leadership stocks that have driven markets higher in recent years, Apple, Amazon, and Facebook (soon to be renamed Meta) had their stock prices decline materially from September highs, even though the market indices continued their ascent. The handful of stocks leading the market winnowed, with Microsoft, Google, and Tesla now responsible for much of the overall gains. In a notable and worrisome development, Tesla went on a parabolic rise, gaining 44% in October. This rally was fueled in part by a "gamma squeeze" whereby options helped pull the stock higher (similar to what occurred in a number of stocks like GameStop earlier in the year). Should this massive rally be built solely on speculation, the unwind will likely be as extreme as the run up. When such volatility happens in small-cap or micro-cap stocks, the ancillary impacts are often minimal. But when such an extreme event happens on one of the largest stocks in the S&P, the potential knock-on effects are much harder to anticipate. We will continue to monitor these situations and seek out positive risk/reward opportunities for our clients.

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