January 2022 Market Commentary

Despite prior warnings from Federal Reserve officials that interest rates would need to rise, and Quantitative Easing ("QE") would be ending, markets continued to ignore those signals until early January. The first shock came when minutes from the previous FOMC policy meeting were released and clearly indicated that those comments were supported and represented the Fed's goal, not just empty threats. This caused a 4.9% decline over the next few days, but that was just a prelude of what was to come. Later in the month, Fed speakers reiterated their stance multiple times, reinforcing their outlook which sparked a continued decline of 11.1% over the next ten days. When the Fed made its "official" announcement near the end of January, the selloff stalled, and the market churned sideways before a sharp rally over the last two days of the month. The S&P ended the month down 5.2%, but that result obscures a decline of 12.4% at the lows in January, the largest such drop since March 2020.

The Strategic Program was able to use moderately out of the money ratio put spreads to achieve a net gain of +0.80% for January. The dramatic increase in volatility caused us to close positions as many key technical levels were breached indicating that the pullback could accelerate. Additionally, many former bellwether stocks in the tech sector declined rapidly, raising concerns that a much larger selloff in the broader market may be near.

The Tactical Program began the month with a partial position of both calls and puts, seeking to capitalize on the relative calm in markets. The quick drop on January 5th breached pre-determined risk levels and led us to hedge some downside positions, incurring a small loss. Once the selloff accelerated, the extreme volatility levels (as well as a skyrocketing VVIX, which reached levels last seen in March 2020) led us maintain a cautious stance holding minimal positions. This action limited the premiums we were able to collect but also insulated the portfolio from the extreme movements in the underlying S&P 500 Index. The Tactical program ended January with a net loss of 0.3%.

While January may have ended with a sharp rally, we do not feel that this decline will be bought and immediately drive stocks back to their all-time highs, as has been the pattern in recent years. What is different now is the reality of interest rates increasing and the tailwind of QE going away, both of which have been massive contributors to the extreme gains we have seen over the past few years. Market expectations of future interest rate hikes have escalated but time will tell if the weight of those expectations will drive stocks lower, making it more difficult for the Fed to follow through on their intended plan. We anticipate volatility will remain elevated in such an environment, providing increased trading opportunities for our programs.

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