WARRINGTON
ASSET MANAGEMENT

June 2022 Market Commentary

The results for the first half of 2022 are in and they are historically "bad returns" for some of the largest asset classes: stocks (measured by the S&P 500) had the worst first-half decline since 1970, and bonds (as measured by the US Aggregate Bond Index) recorded the worst first six-month return in its history (dating to 1973). The driver of much of this angst was the Federal Reserve's response to skyrocketing inflation, where they have tightened rates significantly this year and are poised to continue that trend.

The Strategic Program continued to capitalize on the down-trending markets and recorded a net gain of +0.99% in June. While the monthly decline in the S&P was significant (down -8.4%), the loss occurred in essentially three days. The Index dropped 8.9% in the middle of the month, providing an opportunity for the program to capture the majority of its gains for June, and retain them as the market rallied off the lows into the end of the month. The VIX remained relatively subdued during that mid-month market swoon, only briefly rising above 35, a surprisingly low level for such a rapid and extreme decline.

The Tactical Program relied on tight risk management to minimize any negative impacts from the quick S&P pullback, but hedging costs resulted in a net loss of 0.23% in June. As implied volatility (measured by the VIX) has remained low compared to realized volatility in the market, we have continued to use smaller positions and hedge exposure quickly. While we are not content with the absolute performance of the Program so far this year, we recognize that the opportunity set of attractive risk/reward trades has severely been impacted by current market factors including the absence of anticipated volatility and the actual volatility of volatility (VVIX) with levels last seen in 2019. We believe these are temporary and so will remain patiently focused on the return of opportunities commensurate with market risk.

Inflation and monetary policy tightening are at the forefront of headlines and investors' discussions, but in looking at longer-term signals, the prospect of the Fed cutting rates may be much nearer than many expect. Currently, Fed Funds futures are pricing in rate cuts starting in early 2023, much sooner than most would anticipate given the outsized rate hikes so far this year. With the prices of energy futures and many other commodities declining (whether due to recession expectations or short-term market forces), the upward pressure on inflation could be abating, which would decrease the need for such a forceful response from the Fed. However, if these price declines are fleeting and inflation continues to surge higher, the Fed will have no choice but to remain aggressive. Such crosscurrents should increase trading opportunities as decades-long trends in many markets come to a halt.

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