WARRINGTON
ASSET MANAGEMENT

July 2022 Market Commentary

Inflation statistics, and the Federal Reserve's ("Fed's") reactions to those reported levels, are at the forefront of investor concerns. The ancillary impacts from the Fed's actions have many pundits expecting a recession in the near-term, with some commenting that it has already begun. Recessions are a normal part of the business cycle and result in a cleansing of excesses built up from prior bull markets, but recessions paired with unusually high inflation can be difficult situations for central bankers and the Fed to control. Their primary tool to combat inflation is the manipulation of short-term interest rates with the intention of slowing the economy, but the implementation takes a delicate touch to avoid an over or under correction. A widely expected 75 basis point rate hike in July was digested easily by the market, but the longer-term ramifications of such rapid interest rate hikes remain to be seen. For the time being, the S&P 500 Index ("S&P") took the news in stride and climbed 9.2%, most of which occurred in the second half of July, leaving the S&P down 12.6% on the year.

The Strategic Program was positioned for the sharp rally to reverse, as moves of that nature often do, but the debit costs of these expired positions resulted in a net loss of 0.77% for July. The relationship between options prices, specifically the relative values of options along the option chain, revealed some trading opportunities during the month even though the market volatility, as measured by the CBOE Volatility Index ("VIX") languished, and the VVIX (the volatility of the VIX) dropped near its lowest levels in the last eight years. However, without a material market decline to take advantage of those put spread positions, the option costs added to the monthly loss.

The Tactical Program saw its opportunity set compressed due to the low VIX and VVIX. This compression also had a dramatic impact on the risk-reward profile of many put option trades typically utilized by the program. With the late-month rally, call options became more attractive and contributed to the overall gains experienced by the program. Despite increased hedging costs, the Tactical Program achieved a slight net gain of +0.03% in July.

Bear market rallies can be some the more dramatic upward moves in stocks as many market participants can be caught off guard expecting continued lower prices and react quickly by covering short positions. If the rally in July was indeed just that, then a resumption of the down-trending trading pattern would not be surprising. However, if the extent of anticipated bad news on a number of fronts has been discounted by the market, then further declines would need a new source of concern for fuel. The prospect of even higher inflation in food and energy could be that catalyst, with a hurricane in the Gulf of Mexico or a colder than expected winter becoming a driving force of such price increases. We will continue to monitor the global landscape and seek out potential opportunities for our investors.

As always, we appreciate your support of Warrington Asset Management.