WARRINGTON
ASSET MANAGEMENT

August 2022 Market Commentary

As expected, the competing economic outlook optimism and its opposing concern over the forward interest rate guidance from the Federal Reserve heavily influenced stock markets in August. After a strong rally to begin the month that resulted in the S&P 500 Index ("S&P") climbing 4.8% in two weeks, the rally lost its momentum and steadily declined -8.3% to end August with a loss of -4.2%. At the end of the month, the Federal Reserve ("Fed") gathered at the Jackson Hole Symposium where they reiterated their intention to take aggressive measures to tame inflation. This hawkish rhetoric sent stocks lower and set the stage for continued market pessimism.

While the first half of August provided few opportunities for the ratio put spreads held by the Strategic Program to become profitable, a few similar trades near the end of the month more than offset those costs and resulted in a net gain of +0.35%. The strong recovery of almost 19% from mid-June resulted in what we believed to be a significantly overbought stock market. To capitalize on this condition, we continued to hold low-cost ratio put spreads, anticipating a market reversal. When it materialized in the second half of August, we were able to take advantage of the decline and realize gains for the program.

Similar to many previous months in 2022, the realized volatility in the stock market in August turned out to be greater than the expected volatility. This characteristic reduces the opportunity set for many trades we often use in the Tactical Program, but we were able to record a net gain of +0.07%. While we anticipate this unique volatility environment to abate, we are keenly aware of its ability to turn without notice, possibly on one innocuous headline, and therefore have opted to trade conservatively until we see potential rewards that exceed current market risks.

If it turns out that the Fed is actually resolute in their goal to quash inflation, as they have continually voiced, that will engender some second-order effects that market participants may not have fully discounted. Taming inflation will significantly slow the housing market, put downward pressure on commodity prices (barring further supply disruptions), and perhaps most impactful of all, pressure broad equity prices. In fact, Fed President Neel Kashkari said that he was "happy" to see the stock market decline after the Fed's hawkishness expressed at Jackson Hole. If inflation suppression is going to take precedence over stock market stability, then current valuations may need to be repriced lower. We expect volatility to reprice higher in that scenario, yielding an environment with increased trading opportunities.

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