WARRINGTON
ASSET MANAGEMENT

October 2022 Market Commentary

Ramifications of the Federal Reserve's ("Fed's") relentless rate hike campaign continue to surface in many places throughout the world. The most direct impact is seen in the U.S. Treasury yields, where the 10-year note eclipsed 4% in October (and reached a high of 4.33%). And, while the Euro and British Pound exchange rates have stabilized, the Japanese Yen continued to weaken versus the U.S. dollar. Despite these new global cracks appearing, domestic blue-chip stocks had their best month since 1976. The S&P and Nasdaq indices also performed well but were hampered by poor earnings results from the mega-cap tech names like Amazon, Microsoft, Meta/Facebook, and Google. Hopes that the Fed might pivot to a less restrictive stance at their meeting in early November provided a tailwind for stocks in October leading to an 8.1% return for the S&P 500 Index ("S&P").

The Strategic Program was able to realize profits on positions early in the month as the S&P slid 8% in a mid-month selloff, culminating in a strong reversal after CPI data was subsequently released. From that low point, the S&P rallied almost 12% to end October with a strong monthly gain. These dramatic swings had minimal impact on the CBOE Volatility Index ("VIX") for most of the month as it remained in a tight range until the continued rally in stocks eventually sent it lower. For the month, the Strategic Program returned -0.09% as gains achieved early in the month were offset by debit costs of expired positions later in October.

The seemingly uncorrelated VIX levels once again proved to be a challenge for the Tactical Program by hampering significant price adjustments that should have provided attractive risk/reward trade opportunities in October. The early decline in the S&P did not help to elevate the VIX, and the follow-on rally later in the month only depressed volatility further. Low volatility, coupled with large market moves, is an environment where option premium collection can encounter difficulties and where our risk indicators opt for capital preservation over undue risk. To that end, the program recorded a net return of +0.02% for the month.

We have repeatedly discussed in our commentaries that the Fed's strong inflation response will likely have future unintended consequences, and it appears that those effects are beginning to surface. One example is the news that the UK's pension system was perilously close to insolvency in late September and only government intervention to buy bonds prevented a potentially catastrophic outcome. Scenarios such as this are not surprising and if the Fed continues on this path, as is widely expected, other fissures are certain to reveal themselves. We anticipate this volatility and uncertainty to continue and, coupled with the current U.S. midterm elections, the political environment may be the next area of concern, or euphoria, for the stock market.

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