WARRINGTON
ASSET MANAGEMENT

November 2022 Market Commentary

Inflation statistics continued to drive market performance in November with a benign Consumer Price Index ("CPI") reading leading to a strong mid-month rally. However, the details of the announcement, combined with the prospect for upcoming difficult year-over-year inflation comparisons, may paint a much different picture. The mere prospect of a Federal Reserve ("Fed") "pivot" that would cease rate hikes and instead cut rates, has fueled further speculative behavior in markets. The S&P 500 Index ("S&P") rallied +5.6% in November, continuing its strong ascent from mid-October lows.

One statistical measure that can have an influence on the option spreads employed in the Strategic Program is called Skew. The CBOE Skew Index is a measure of potential risk in the financial markets and can be a proxy for investor sentiment and volatility. In early November, that index dropped to its lowest level since March 2003, and as the Index climbed, the quality of option spread opportunities improved dramatically. However, the S&P did not have any material declines after the mid-month positive CPI announcement, eliminating those expected opportunities and leading to a net loss of 0.31% for the month due to the debit costs of expired options.

The Tactical Program was able to identify an increasing number of attractive trading opportunities in November. The level of volatility in U.S. equities has remained muted, with the CBOE Volatility Index ("VIX") returning to its lowest levels of the year. It is yet to be seen whether these low levels can be sustained or if this is setting the stage for a new bout of market excitement. The program was able to somewhat take advantage of these opportunities but some hedging costs resulted in a net loss of 0.01% for November.

The difficult conundrum of for the Fed in its attempt to find a "soft landing," hiking rates enough to tamp down inflation but not so much as to cause a recession, looks to be an ever more daunting challenge. The labor market, so resilient for the last few years post the COVID-induced layoffs, has recently started to show weakness. Many large tech firms have announced hiring freezes and job cuts, and these companies may be the "canary in the coalmine" and act as indicators of weakness in the broader economy. Higher interest rates are the likely culprit as many firms have relied on cheap funding to fuel rapid growth, and those higher rates now are unsurprisingly having effects that spread from the job market, to home purchases, and to consumer spending habits. As the Fed has continued to broadcast that it expects rates to be at these levels, or higher, for a considerable time, the ripple effects of companies adjusting their business models has likely just begun.

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