February 2023 Market Commentary

The resilience of consumer spending and labor markets continued to confound the plans of the Federal Reserve (the "Fed") for tighter financial conditions to tamp down inflation. The growing realization amongst market participants that higher interest rates could be on the horizon led to a weaker stock market and stronger interest rate yields during February. The S&P 500 Index recorded a loss of -2.6%, as weakness occurring over the course of three days during the middle of the month was the driver of the losses. Conversely, interest rates generally climbed relentlessly throughout February with the ten-year note climbing to near the psychologically-important 4% yield. Also, the two-year note reached levels not touched since 2007.

The Strategic Program recorded a profit of +0.04% as our posture of holding multiple ratio put spreads allowed us to realize gains during the mid-month S&P pullback. These different spreads targeted varying levels of S&P declines, and we were able to monetize some positions when Fed hawkishness led to investor nervousness and a drop in stock prices. By holding spreads that could profit in both moderate and more dramatic declines, we were able to achieve profitability during the middle of the month and retain the opportunity for further profits had the pullback become more severe.

The Tactical Program continues to find value in credit spreads as outright options have dropped in relative value. This approach allowed Tactical to have a +0.15% return for February. Even though volatility was low, the realized volatility was subdued as well. When both realized and implied volatility (using the VIX as a proxy) are compressed, we can still find many trading opportunities that allow for profitable trades. When the relationship becomes skewed with realized volatility increasing too much, we often reduce our risk posture and wait for the VIX to rise or market volatility to calm down.

We continue to use the phrase "Don't Fight the Fed" as they have repeatedly stated their desire for tighter financial conditions, even though asset markets don't seem to appreciate how serious they are about this. As economic growth is still strong, the Fed is choosing to focus on the other facet of their dual mandate, price stability. This pursuit of lower inflation may eventually cause disruptions in asset markets, but so far during their tightening cycle, the unwinding of years of loose monetary policy has been surprisingly orderly. While this may continue, we anticipate losses to surface in previously unexpected places, similar to the failure of two Bear Stearns mortgage hedge funds in July 2007. As we look for these warning signs, we will continue to seek out attractive risk/reward trade opportunities.