WARRINGTON
ASSET MANAGEMENT

April 2023 Market Commentary

By the end of April, the VIX had dropped to levels not seen since November 2021, which was coincidentally near the all-time highs in the S&P 500. While the S&P is still significantly below those record high levels, it's hard to argue that the market has experienced any degree of volatility recently. The S&P barely moved in April, recording a high to low trading range of under 3% for the entire month. This calm trading came in the face of more regional bank stress and further expectations of Federal Reserve rate increases at the early May meeting. In all, the S&P gained +1.5% in March, effectively ignoring the potential issues beneath the surface.

As the Strategic Program uses ratio option spreads to express a market opinion, a degree of volatility is necessary for it to record meaningful profits. Those market oscillations were essentially nonexistent in April, and the Strategic Program recorded a loss of 0.24% due to the debit costs of spreads that expired worthless. In markets such as these, where the index becomes overbought but has yet to retrace, we opt to use lower cost spreads to avoid accumulating a large drag from debit expenses, while retaining profit opportunities should volatility return to markets.

The Tactical Program has recently been using credit spreads rather than outright option sales to collect premium, and that trend continued in April. Those ratio spreads have a different risk/reward profile as they are structured with a long option closer to the money and short options sold against that, deeper out of the money. That means that if the positions expire worthless, then the credit from the spreads is the profit for the position. However, if the market were to move into the spread as expiration approaches, the spread could increase in value, adding to those gains. These spread trades allowed the Tactical Program to record a gain of +0.11% in April.

As April came to a close, market participants turned their attention to the Federal Reserve's early May meeting, where another 0.25% interest rate hike was expected. This rate hike cycle has been extremely rapid with the initial rate hike occurring in March 2022. However, the Fed's interest rate actions take some time to filter through into the economy (estimated at about one year), so essentially those first rate hikes are just now being felt, with significantly more still yet to come. With that in mind, we are seeing further regional bank stresses as First Republic comes under duress, so what other unforeseen problems will arise as the economy digests the last year's worth of rate hikes? Only time will tell but we anticipate problems in areas previously unforeseen and we will continue to look for attractive trading opportunities in this evolving landscape.

As always, we thank you for your support of Warrington Asset Management.