

WARRINGTON

ASSET MANAGEMENT

August 2023 Market Commentary

The recent uptick in fixed-income yields may be reaching a level of concern for domestic equities. As 10-year Treasury rates rose to levels not seen since 2007, the S&P 500 declined, albeit in a controlled fashion. However, when interest rates stabilized and stocks rebounded, August ended down -1.6% — a significant improvement from the mid-month low of -5.5%. Interestingly, the recently sluggish VIX index did not surpass 19 during this sell-off and quickly retreated to below 14 by the end of the month.

The Strategic Program capitalized on the market's steady decline in the first half of August, realizing profits through a series of ratio put spreads. This led to a net monthly return of +0.76%. By holding short-term positions across various expirations, we consistently harvested small gains, even as the S&P 500 saw its most extended decline since the downturn from February to March this year.

The Tactical Program utilized the moderate market decline and low volatility to continue profiting from credit ratio spreads. By diversifying positions across multiple expiration dates, we steadily accumulated profits, resulting in a net monthly return of +0.41%. Even in a low-volatility environment, we have been able to consistently identify attractive credit spreads, achieving returns consistent with the fund's long-term historical performance.

Many market participants contend that the VIX is “broken” and no longer accurately reflects market fears. We’d counter that the VIX is just one specific measure of market volatility, and only uses options with 24-36 days until expiration. While this was a useful metric when options had just one expiration date per month, the landscape has changed with daily expirations. Much of today's options trading and risk hedging involve options with much shorter durations, which are not considered in the standard VIX calculation. We see this discrepancy as an opportunity: when many believe the market lacks volatility, we can identify areas where volatility may be mispriced and act accordingly.

We sincerely appreciate your continued support of Warrington Asset Management.