September 2023 Market Commentary

Interest rates persistently climbed in September, with rates across the curve surpassing levels unseen in the last 15-20 years. Notably, the rate on the three-month bill achieved a level last observed in 2001. The increases are happening in such a rapid manner that the repercussions are yet to be fully transmitted to markets, and evidence of this lag can be seen in the mortgage market. Many homeowners are reluctant to sell their homes with a low interest rate loan, as any new mortgage will invariably be more expensive. Thus, the true impact of the interest rate surge has not been fully absorbed by market participants. Goldman Sachs reports that approximately 70% of all existing mortgages bear a rate of 4% or lower, a figure significantly beneath current market rates. Perhaps due to the substantial shifts in the bond market, the S&P 500 saw a -4.8% decline in September, a majority of which occurred after the Federal Reserve issued hawkish comments late in the month.

Even amidst rising rates and a stumbling S&P, volatility remained restrained. The VIX index did not surpass the 20 level in September, despite encountering several significant headwinds. In this environment, the Strategic Program managed to record a net gain of +0.52% by monetizing some long ratio put spreads during the market decline. The Fund was poised for a larger decline, but even the -4.8% loss in the S&P facilitated a commendable return.

The Tactical Program used the combination of moderate volatility and an equity decline to record a net profit of +0.31% for September. The lack of severe downside trading allowed for the various credit put spreads in the portfolio to all expire worthless. Owing to the relatively low level of volatility, juxtaposed with the magnitude of the S&P's decline, we maintained positions that were somewhat smaller than in recent months, foreseeing a possibility for volatility to "catch up" to the market decline.

The prospect of the Federal Reserve successfully engineering a "soft landing"—where the market does not incur significant damage while inflation is effectively tamed—is a factor in maintaining the S&P at relatively high levels. Given the massive increase in rates, the profitability of the index constituents should be negatively impacted. Should the soft-landing scenario fail to materialize, the potential correction in equities could be severe, and as rates remain elevated, such a risk grows each day. In this context, we perceive that the risks presented by high interest rates are still notably underappreciated. We continue to seek profitable trading opportunities while vigilantly monitoring economic data for indications that fissures are emerging beneath the surface.

We sincerely appreciate your continued support of Warrington Asset Management.