DAVIS COMMODITIES LLC

September 2022 Macro Commentary

The month of September was anything but dull as volatility was high across the spectrum. Currencies started out just churning and then broke sharply to the downside as the new English Prime Minister, Liz Truss, announced a new economic package. Within a couple of days, the British Pound had fallen almost 10%. The euro followed suit and fell alongside. First the Bank of England intervened to stabilize the market and then the economic proposal was shelved. Now, things are moving back to the levels where the whole deluge started. Alongside the slide in the currencies, other than a few days early in the month, most risk assets were offered. Stocks and commodities all fell in unison. As we turn the calendar to October, most assets are stabilizing/rallying back. All of this sound and fury leaves us asking the question, where do we go from here?

Regarding the core currency positions of the yen and euro, this is most likely the pause that refreshes. Positioning had gotten lopsided to the downside. That is being cleaned up in relatively short order. With the Bank of Japan still involved in yield curve control, the fundamentals still support a weaker yen. In addition to the monetary policy, Japan imports most of its raw materials. With the recent rally in most commodities, supplies of “stuff” are not getting any cheaper for them. Their consistent need to buy dollar denominated goods will continue to weigh on the currency. For the eurocurrency, the incongruous energy policy in the Eurozone will stifle economic output. With Nordstream 1 and 2 both out of commission for the foreseeable future, the politics of natural gas imports are no longer the primary issue. Even if they wanted to play nice with Russia, it would take months to get either one of those pipelines back into working order (Nordstream 2 has never even been used). With current supplies of natural gas in storage and lack of further piped imports from Russia, it appears that most of Europe will run out of natural gas supplies by sometime in February with a normal winter or the European Union will move to freeze usage by the biggest industrial users. If the projections are correct, the economic outcome will be bad or worse. Either they shutter usage by the biggest users (metals, chemicals, etc.) or people freeze. If they shutter the industrial operations, thousands will lose their jobs which will lead to more handouts from the government. Increased debt will simply lead to more printing of euros, thus, bearish. While it is possible for Europe to escape their current trap, that outcome is not likely. The short eurocurrency position will be a part of the portfolio for the foreseeable future.

Recent headline information indicates that some of the inflationary forces in the US could be abating. The bulls in the stock market think that this will lead to a Fed pivot on monetary policy and the rate hikes could be coming to an end. While that theory is certainly possible, it is not something that we think is likely just yet. If the Fed does stop their hiking cycle, then the economy should rebound. With greater economic growth, there will be greater usage of fossil fuels. This would be coming at the same time that the US government is ending its sales of crude oil from the Strategic Petroleum Reserve (SPR). Greater demand plus less supply should lead to higher energy prices which circles us right back to what started the inflation in the first place. Throw in the upcoming decision by OPEC to lower oil production. Rumors are swirling for a cut of 1-2mm barrels per day. All of this points to the potential of higher crude oil prices, higher inflation, and the Fed needing to step on the inflation brakes all over again which would undermine their current credibility. While we might see this Goldilocks position play out, it does not seem likely. While the portfolio doesn’t contain a short stock or long energy position at this time, they are on the radar for an opportune time to enter.

Sincerely,

Stephen Davis

Stephen Davis
October 4, 2022

9047 Poplar Ave; Suite 101
Germantown, TN 38138

sdavis@daviscomllc.com

T: 901-766-4446
F: 901-766-4406