# DAVIS COMMODITIES LLC

# November 2022 Macro Commentary

The macro space is currently undergoing a transition phase and trading has been limited. The market has been trying to anticipate the timing of a Fed "pivot" leading to choppy trade with limited opportunities. The biggest problem with anticipating a change in Fed policy is that the economy has stayed stronger than expected. Jobless claims are low as is unemployment. Manufacturing has slowed into contractionary levels, but services show continued expansion. Energy prices are weaker due to relatively sluggish demand. As always, timing is crucial and we want to have plenty of dry powder when the time is right to engage the markets.

As stated above, energy prices are relaxing along with the forward curve indicating adequate supplies. World consumption is slowing as high prices cure high prices. The question remains as to whether or not the rally will reengage at some point in the future. The simple truth remains that western governments continue to discourage increased production. In addition, energy companies are loathe to expand exploration and production in order to avoid the boom/bust cycle we saw back in 2014. The fossil fuels markets will continue to ebb and flow following the economic cycle. As countries hit the proverbial wall, prices ease. As prices ease, economic activity expands allowing for the next cycle up in energy prices. We are currently in the ebb cycle. As prices ease, positions will be added to the long side again.

The currency markets have been retracing much of their former moves over the past month. As the markets anticipate a Fed pivot to easier policies, the interest rate differentials that have rallied the dollar against every major currency ebbs. In addition, lower energy prices (priced in dollars) eases the inherent dollar short for the major importing countries. These two macro adjustments have allowed the dollar to ease. The idea that the Fed can back off its tightening cycle is predicated upon the thought that inflation will ease back into the 2% range according to Fed guidance. While inflation has certainly slowed from its 9% levels earlier this year, we believe that it could prove stickier than the market is currently pricing. If correct, the Fed might pause its rate hike cycle, but an easing is not in the cards. As long as the Fed keeps the short end of the curve elevated, it will be difficult to break the dollar significantly.

Regarding the stock market, earnings expectations over the next twelve months have fallen, but are still showing growth. Very simply, we think that is completely incorrect. If the US economy falls into recession (as is the base case), historically CEO's write down all of the bad investments on their books, earnings fall, and stocks move lower. While there is a chance that this time is different, odds are not in favor of that outcome. The outlook now is for a contraction in earnings as we move into the 2$^{nd}$ half of 2023 and a further decline in stock prices.

Finally, while not added to the portfolio yet, the outlook for base metals should improve as we go into next year. The biggest impetus to move base metals is the pivot in China to allow for fewer Covid restrictions. As the largest consumer of metals, a loosening of Covid policies should allow for greater demand. In addition, the Chinese government is rolling out new policies to support the housing market. Throw in the push for greener, electric vehicles worldwide and you have the makings of a bullish move in copper and aluminum. Those markets are being monitored for an advantageous entry price.

Sincerely,

Stephen Davis
December 6, 2022

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