DAVIS COMMODITIES LLC

September 2023 Macro Commentary

The month of September was marked by continued dollar strength, surging interest rates (especially the long end of the curve), stronger energy, and weaker stock indexes. Intuitively, it all makes sense. With the US basically energy independent, strong energy prices actually support the dollar. Interest rate strength also supports the dollar while hurting stock multiples as the higher rates force a larger discounting to forward earnings.

Interest rates (specifically differentials) remains the core theme of the program and will probably stay that way for the next year or more. The last month has seen a sharp steepening of the yield curve as rates on the 10 year T-note have outpaced the gains on the 2 year. This is called a bear steepening. A big part of the rise in longer-term yields has come from the pace of issuance of new debt by the US Treasury. Since the expansion of the debt ceiling in June, issuance of new debt has totaled ~$2 trillion. The weight of the massive debt selling and Fed speak of "higher for longer" has pushed deferred interest rates sharply higher. While this can continue for a while longer, the market will eventually shift into a bull steepening when unemployment begins to tick up. A bull steepening happens when interest rates start to fall as the market begins to price recession, but the front end of the curve falls faster than the back end. While the timing is certainly unknown at this point, confidence remains high that the trend back to a normal yield curve is currently underway.

The relative strength in the US dollar should continue for the near term. As stated earlier, the energy independence of the US means that high oil prices move money from New York and California to Texas, but dollars do not leave the US. For importing countries, that is simply not the case. Europe has to buy oil in dollars and those dollars get exported to the producing countries. When you take the dollars needed to buy energy and throw in the current recession in Germany and slowing in other EU countries, the dollar strength makes a lot of sense. Currently the program is trading Eurocurrency from the short side on a tactical basis. Until we see the US slowing into recession, that trade should remain in place.

Last, but certainly far from unimportant, the unfolding war between Israel and Hamas is adding risk to the marketplace. We are not experts in war to say the least. At this time, it appears that what the world knows today is small compared to the unknowns. The length of the war and all of its participants have not yet been defined. When you add in the fact that the US is supporting war on two fronts, the risks get magnified. Will the stretched US military capabilities allow for mischief on another front? Do the Hamas actions embolden others to act? There are simply too many questions at this point in time. One thing we know, the world just got a lot riskier.

Sincerely,

Stephen Davis
October 9, 2023

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9047 Poplar Ave; Suite 101
Germantown, TN 38138

sdavis@daviscomllc.com

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