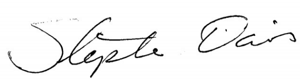
DAVIS COMMODITIES LLC

December 2023 Macro Commentary

The major theme for the past 6 months continues into the new year. The yield curve should continue to revert to a more normal structure with the longer dated debt trading and higher yields than the front end of the curve. There are several reasons why this should happen: gradual slowing of the US economy, and ongoing record deficits (ex-Covid). There has been much prognostication following Fed Chair Powell's comments in December hinting at easing from the Federal Reserve. The reasoning behind the pivot is a bit uncertain. Inflation is slowing, but still well above the stated 2% goal. And, while not even close to running hot, job growth has remained stable. The caveats to those statements are in the ISM data. Manufacturing has been showing contraction for months and the latest data on services turned negative as well. It is possible that the Fed is seeing this data unfold and wants to get in front of it. The other possibility is the expansion of the US debt pile and the ever-growing interest payments on that debt. At the current rate of expansion in deficit spending and accompanying interest rates, the US government debt service will eclipse the available discretionary spending in the budget in the near future. With the ongoing expansion in deficit spending, longer term rates should end their corrective phase in the near future and start moving higher again (barring a recession). With either outcome, it does appear that a normalization to the interest rate curve should happen over the course of the next year.

In addition to the interest rate trade, a long position has been taken in the Japanese yen. The yen has been undervalued for years and the twin deficits in the US should allow for an appreciation in its value. If the US has to cut rates due to a recession, the move could happen swiftly. If the Bank of Japan is forced to abandon yield curve control, the move could happen swiftly. At this low relative value of the yen, it would not take a large change to either to precipitate an outsized move.

Sincerely,



Stephen Davis
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9047 Poplar Ave; Suite 101
Germantown, TN 38138
sdavis@daviscomllc.com
T: 901-766-4446
F: 901-766-4406