DAVIS COMMODITIES LLC

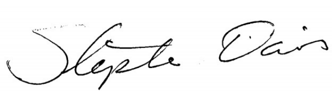
January 2024
Macro Commentary

The core position in the 2/10 steepener continues to be held in the portfolio. While many things can happen, odds continue to point to a normalization of interest rate spreads. Many will point to the levels of unemployment and stock market and say that the Fed can't cut right now. However, there have been many times in history that the Fed has cut under those exact same conditions. The Federal Reserve is first and foremost an inflation fighting institution. While inflation was soaring, it made perfect sense for the Fed to continue raising rates. However, over the past several months, the core PCE has fallen toward the 2% target level that the Fed has been targeting. If the Truflation estimates are correct, inflation could fall under 2% in the near term. With inflation dropping, it is not out of the realm of possibilities to see the Fed lower rates in the May-June timeframe.

In addition to the falling inflation in the US, China has entered a deflationary period. While not 100% true, deflation in China normally allows for deflation in the rest of the world. With crude oil prices stable in the $70-80 per barrel range, it is hard to see that changing. The flip side of the coin would most likely be a recession. It is highly unusual to see an inverted yield curve not followed by one. If that were to happen, the Fed would be even more aggressive in their rate cutting and the trade would work even faster. The biggest risk to the trade would be for inflation to rear its head again. The main driver of that would be energy risk caused, most likely, by an escalation in warfare. While that seems to be mostly contained, it is a risk that is being monitored closely.

The Japanese yen continues to be a trade that has been put on and taken off several times with little success. While it has not worked yet, the time is approaching to take another shot. Conviction remains high that the Bank of Japan will eventually end its yield curve control and the yen will rally dramatically. With the yen being the most undervalued major currency in the world, the revaluation should be quite strong. As you can see in the chart, Japan has endured mostly deflation for the past 30 years. If anything close to this level obtains, look for the BOJ to raise rates which would allow the yen to appreciate.

Sincerely,



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