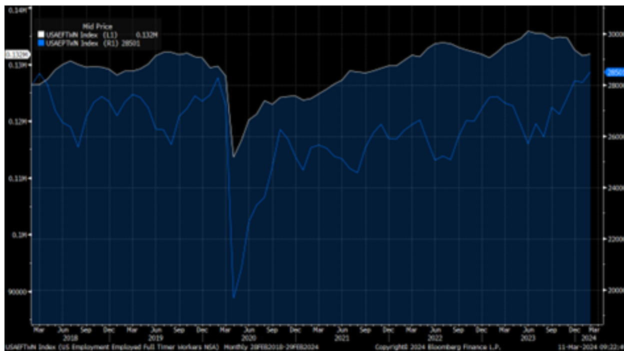
DAVIS COMMODITIES LLC

February 2024 Macro Commentary

Performance the first two months of the year has certainly been disappointing. As the data is analyzed on an ongoing basis, a very similar bias emerges. What is obvious at this point is that the timing of the trades has certainly been early.

Regarding the long-term yield trade for the program, the bias is still that the large twin deficits being run by the US will eventually overwhelm the longer end of the curve and allow for a normalization of the curve. On March 8, the US released its non-farm payrolls report. At first blush, the report was deemed strong based on the number of new jobs exceeding expectations by 75k. The report was tempered by two headline numbers: the previous two months were lowered by a total of 167k jobs, and the unemployment rate ticked higher to 3.9% from 3.7%. Digging further into the data reveals that full-time jobs were lost while part-time jobs were gained. The main takeaway is the data would suggest that more people took on part-time jobs to make ends meet as full-time jobs were lost, thus the uptick in the unemployment rate. The chart below shows this very clearly as the blue line shows the increase in part-time jobs since June, 2023 vs. the loss of full-time jobs during the same period.



With full-time jobs decreasing, odds are high that the Federal Reserve (Fed) will cut interest rates before the election. The timing is still a bit of a toss-up due to the relative strength in inflation over the past few months. The next Consumer Price Index (CPI) report comes out on March 12 and will give the market a better look at how inflation is progressing. As you can see in the chart below, the price of unleaded gasoline (white line) correlates well with CPI (blue line). With the recent price rise during February, odds are high that CPI will come in a bit hotter.

The combination of weaker job growth with hotter inflation makes for an interesting conundrum at the Fed. Do they fight inflation first or support job growth? My bias is that they try to support job growth. The ever-widening deficits for the US government require close to full employment in order to keep them from blowing out even wider. In addition, more unemployment should lead to lower wage inflation which would allow the Fed to focus more on the unemployment rate. The slower growth in the US should allow the Fed to ease short-term rates slightly. However, the large ongoing debt issuance by

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the US government should continue to put pressure on the longer-term bond prices and force the back end of the curve back toward the 5% level that we saw last in October, 2023. For these reasons, the yield curve trade remains in place, however, an option position has been added to take advantage of the likelihood that the 10-year treasury note yield will rise.

In addition to the yield curve strategy, a short position in eurocurrency has been added via options. The primary driver for the short position is the ongoing slowdown in industrial activity, especially in Germany. The initial pulse to slow the industrial sector was high energy costs stemming from the banning of natural gas import from Russia and exacerbated by the destruction of the Nordstream pipelines. While energy prices have eased sharply from the highs, quite a bit of damage has already been done. In addition, SE Asia has been a big driver of demand for German products. With China facing a slowing economy and deflation, that demand has lagged. In addition, cheap Chinese cars are now competing with German products further pressuring their industrial based economy. As Germany continues to lag, it should pull the rest of the EU lower. This economic weakness coupled with declining inflation should allow the European Central Bank (ECB) to ease rates. This action will most likely happen before the Fed lowers US rates which should allow the euro to weaken as we get closer to summer.

Thank you for your continued support during the current drawdown. The positions in place and further opportunities throughout the year should allow for the program to return to expectations.

Sincerely,

Stephen Davis
March 11, 2024

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