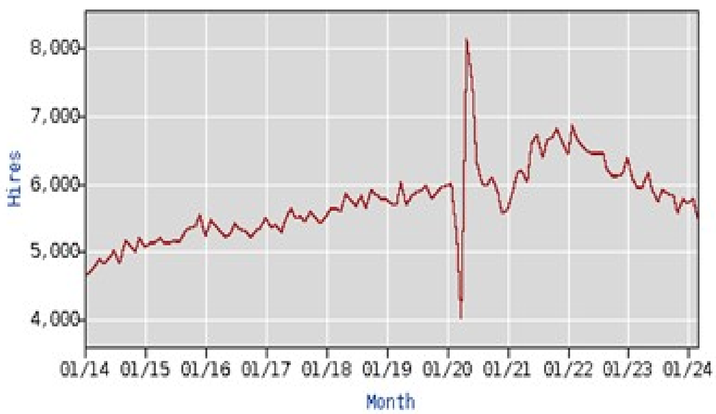
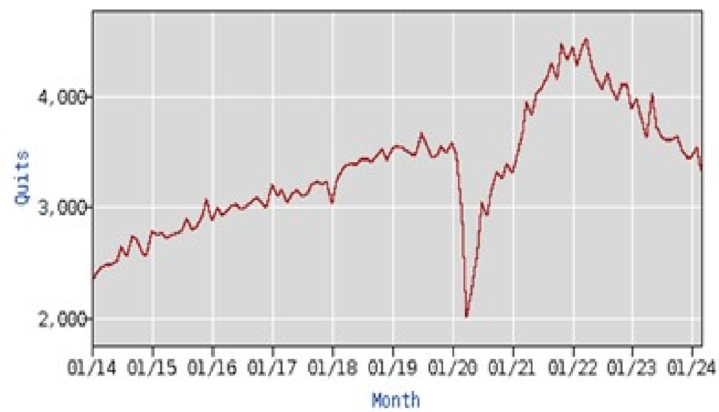
DAVIS COMMODITIES LLC

April 2024
Macro Commentary

After a frustrating start to the year, April was a positive month and some of the pieces discussed in prior reports are starting to fall into place. During the winter, the market was reversing the majority of the rate cut projections for calendar year 2024 as GDP was strong and inflation was stubbornly high. After showing growth of 4.9% QoQ for the quarter ended September 30, growth slowed to 3.4% in Q4 2023 and Q1 2024 showed growth of only 1.6%. On the flip side, after showing only 2% inflation in the previous two quarters, the Fed's preferred measure (PCE) showed a surprise acceleration to 3.7%. This is obviously well above the stated goal of 2% inflation. With inflation high and growth decelerating, the market is in a dilemma as to what comes next. The two charts below shed a lot of light on the slowing economy and what should lead the Fed to eventually cut rates. Both charts are from the Job Openings and Labor Turnover Survey (JOLTS). The hires index is the chart on the left. As you can see, hiring has now fallen below the pre-Covid meltdown. The chart on the right is the quits index. In times of booming hiring, people quit more often to find a better job. It also has now fallen under the pre-Covid level.





With both hires and quits dropping, odds are increasing that the unemployment rate will tick higher. Higher unemployment will weigh on wage growth and help to lower the rate of inflation closer to the Fed's goal of 2%. With the program involved in the yield curve steepening trade, any further data that proves the Fed can cut interest rates later this year should allow that spread to have another leg higher. With that spread consolidating for the past two months, any breakout should be large in magnitude.

The other main theme in the portfolio is a long position in the Japanese yen. That has obviously been wrong for quite some time as the yen has done very little but get weaker for the past several months. Recently, however, the Bank of Japan has intervened to support the yen from falling further. While the jury is still out as to whether or not they will be successful, if they are the ramifications are large. While hard to define, the interest rate differentials between Japan and the rest of the world are massive. It is a safe assumption that there is a large amount of borrowing being done in Japan to buy interest rate securities in higher yielding areas of the world. A strengthening yen would force quite a few of those yen shorts to cover and lead to an unwinding of those spread trades. With the front end of the yield curve controlled by the Fed, the ensuing selling of the longer dated maturities would push yields higher. This would create another reason for the yield curve in the US to steepen. Between these two inputs, confidence is growing that both trades could pay off.

Sincerely,

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