DAVIS COMMODITIES LLC

September 2024 Macro Commentary

The macro inputs over the past month have been nothing short of jaw-dropping. Between the escalation of the war in the Middle East, easing by the Federal Reserve, and Chinese easing/stimulus, there have been a plethora of inputs to consider. As the market (and I) have tried to digest all of the moving pieces, the moves in the underlying assets have been marked.

Let's start out by talking about the core holding of the yield curve steepening trade. While it has recently pulled back from its recent high, the base theory still appears to be correct. The markets over time will move to a more normal curve with the 10-year and 30-year debt holding a premium to the shorter term 2yr notes. The sheer weight of record deficit spending out of the federal government should, over time, push the longer duration yields higher. The absolute level of the 10 year yield, for example, got extremely cheap. In mid-September, the yield got down to about 3.6%. Assuming that the Fed is able to get their preferred measure of inflation (core PCE) to 2%, that would indicate a CPI of ~2.5%. With a normal curve, the 2yr yield would need to be running about 3.5%. Again, assuming a normal curve, the 10yr yield would need to be at least 4.5% and more likely something over 5%. I will be the first to admit that "normal" has not entered the conversation as of late. However, as treasury issuance normalizes across the curve, the odds of moving back into a normal yield curve increase markedly. While the 10yr yield is only 4 basis points over the 2yr at time of this writing, one must remember that the low in the curve was -100. The market has moved a long way, but still has even further to go. This will continue to be a core holding.

As stated earlier, the 10yr yield was inordinately low, thus, an outright short position was initiated. The timing has been fortuitous as stronger than expected services ISM and non-farm payrolls have pushed those yields higher. While yields have strengthened from 3.6% to 4%, I believe that there is still more to go. This is a tactical trade that will come and go, but, overall, the trend in the 10yr yield should be higher over time.

Regarding precious metals, the overall trend continues to be higher. For now, having the core position in silver instead of gold appears to be a bit of a mistake. However, we are continually reminded that as gold pushes into new highs that silver is still ~40% under its all-time high at $50 per ounce. If things get squirrely in precious metals, silver will be the one to own. With ongoing currency debasement in every major country, the odds of a significant rally grow by the day. Until we see G7 governments truly contain deficit spending, precious will continue to see a bid.

Last, regarding currencies, I have put them mostly into the "too hard" pile for now. All of the major currencies are undergoing some kind of structural issue. For the US, the twin deficits and political uncertainty with the looming election make a strong stance on the fate of the dollar difficult. For the EU, their ongoing high cost of energy and the slowing economy (especially in the growth engine of Germany) is difficult to own. While the yen is structurally undervalued, the uncertainty surrounding their new government makes it tough to own. As for the UK, a Labour government is rarely friendly to the currency, but their interest rates have remained pretty sticky. For a market that is mostly eyeing interest rate differentials, selling a high interest rate is tough. To reiterate what was said earlier, there are a lot of moving pieces right now and no sense in trying to be a hero (just yet).

Sincerely,

Stephen Davis
October 7, 2024

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