DAVIS COMMODITIES LLC

November 2024 Macro Commentary

November was an extremely frustrating month as the markets digested the Trump victory and basically chopped around (except stocks and the dollar). The core thesis has been that a Trump win would allow the 2/10 steepener to finally kick off, however, it has remained rangebound at a slight carry. Despite the lack of follow through, confidence remains high that we will finally see a normalization of the yield curve.

One important development since the election was the appointment of Scott Bessent to be Treasury Secretary. He has been touting his 3-3-3 plan which is 3% GDP growth, 3% budget deficit by 2028, and 3 million barrels per day equivalent of new energy production in the US. As one looks at the pieces, the GDP growth seems like the most achievable goal. With GDP near that level already, it doesn't take much imagination to see the possibility of fewer regulations boosting it to 3+%. Regarding the deficit, getting Congress to actually acknowledge that the "funny money" spending can't continue forever seems a larger ask. While the newly minted Department of Government Efficiency (DOGE) could see some savings, the majority of the expenditures are on the entitlements of Social Security and Medicare. There doesn't appear to be any backbone in Washington to go after those two sacred cows. Finally, regarding the boost to energy production: Washington can make it easier for energy companies to "drill, baby, drill," but they can't make them invest. Absent an economic incentive or massive pushback nationally on green energy policies, it is difficult to project a large increase in new projects that generally take 5 years or more to bring online when the Trump policies could be overturned in 4 short years. While faster permitting of new pipelines and already known sources of energy will be enhanced, few in the oil business want to expand production rapidly and implode the prices. What I saw as his most important comment regards the discussion of the Yellen policy to sell primarily short-term debt at the expense of locking in long-term interest rates. A normalization of debt issuance is the first step to normalizing the yield curve. Combine it with deficit spending near recent levels and it is not hard to imagine the yield curve moving to 2.5% tens over twos.

After gaining 40% on the year, the gold market is stuck in a sideways range. However, as noted above, the odds of truly decreasing the deficit spending remains a long-shot. As long as the US continues with its massive fiscal deficit, it is hard to imagine gold prices going markedly lower. President Trump is certainly pushing for a weaker dollar. One way to achieve that goal would be to revalue the gold in reserve to a new price level. Not only would gold shoot higher, but the dollar would go down sharply in response. In my opinion, that would be last resort type of initiative as a sharply weakening dollar would increase inflation at the same time. With prices already up ~20% in the US since Covid, the US consumer would surely push back on the administration. This leaves a few viable options, but the most logical one is some kind of new Plaza Accord that moves the undervalued currencies of the world to a more level playing field which would weaken the dollar over time without the shock that would spur inflation. While not the sharp move higher in gold that repricing would accomplish, the policy should still underpin the pricing and allow for a continued move higher.

Finally, up until now, I have thrown currencies into the "too hard" pile as the moves have been random. However, with the odds increasing of the Trump administration pushing for countries to stop undervaluing their currencies, the focus is now being centered on the Japanese yen once again. With odds increasing of further hikes in interest rates, the most undervalued major currency is the target. Long positions will be added in the near term.

Sincerely,

Stephen Davis
December 3, 2024

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