DAVIS COMMODITIES LLC

January 2025 Macro Commentary

The month of January was one of volatility with most markets mainly moving sideways. The dollar traversed about a 3% range and closed mainly unchanged. Stock indices have been trading a band for the past three months. Interest rates are trading in a similar fashion. The exception to that rule has been gold and silver which have both rallied since the end of the year. Gold appears to be breaking out to the upside while silver has a bit more work to do.

The curve steepener is still part of the portfolio. I have been trying to be a bit more proactive, trading around the position instead of simply holding it. The core thesis still remains the same. The Bureau of Labor and Statistics (BLS) is still using an outdated birth/death model for small businesses. That model has been and continues to overstate the strength in the private sector. On January 29, BLS updated the private sector data from Q2 2024. The birth/death model indicated gains of 951k jobs, but the actual revised data shows a loss of 163k. While a loss of 163k is not indicative of massive structural weakness, it sure doesn't support the outlook of an incredibly robust economy either. In addition, the Owners' Equivalent Rent portion of CPI (at ~25% of CPI values) appears poised to fall. Between CPI cooling and revisions to employment, it does not appear likely that the Fed will raise rates in the next 12 months (especially with energy prices mostly steady). With the market currently pricing less than two interest rate cuts through December, odds are looking more likely that the Fed could cut more. Those interest rate cuts would help two of the trades in the portfolio: the aforementioned steepener as well as an outright long in SOFR futures.

In addition to the interest rate trades, a defined risk short has been placed in the S&P 500 index. While I am not abjectly bearish stocks, the market is priced close to perfection at these levels. With the increasing political uncertainty surrounding the new Trump administration, dislocations can (and do) happen. In the first 17 days of the new admin, we have already seen tariffs placed and retracted (or delayed) four times. The only one still in force at this point is on China. The stated purpose for the tariffs on Mexico, Canada, and China has to do with border control and drug enforcement. The delay of 30 days on Mexico and Canada came about after they both promised to do more to secure the border. While it appears that China has very little to do with drugs or borders, seizures in Canada of precursors for fentanyl have happened in the past year. It appears likely that the 10% tariffs will remain in place until measures have been taken to disrupt the flow of chemicals from the country. Throw in a good helping of tariff threats against the EU and the admin is disrupting the vast majority of imports to the US. Right now, the market is discounting any of them obtaining for any length of time. While that is possible, it is far from a certainty. With expanded P/E's, increased AI risk in China, and expanding political risk, a low risk short in the stock market seems prudent.

Sincerely,

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