DAVIS COMMODITIES LLC

February 2025 Macro Commentary

Despite headlines coming at the market in a flurry over the past month, most of the markets were relatively quiet. Stocks moved in a sideways fashion for most of the month as did precious metals. The dollar index did dip by ~2% toward month end as interest rates fell and are now back to levels when the election was held. The end of the month and start of March has been marked by much sharper moves, as the markets digest the meaning of the current administration's plans.

It is my belief that the effectiveness of DOGE and the desire of the Trump administration to cut expenses/staff had been woefully underappreciated. The algos being utilized by Musk and his staff are quickly finding spending largesse and outright fraud in some cases. Those savings by the US government will effectively reduce the deficit. When you add in a smaller federal workforce, the deficit shrinks even more. Those newly unemployed federal workers will most likely end up adding to the overall unemployment statistics showing a slowing of the economy. While it is my opinion that most of those workers will eventually be able to find jobs in the private sector, it will take some time for the economy to adjust. Treasury Secretary Bessent basically said something similar in a recent interview on CNBC. Simply put, the shift from public spending to private will take an adjustment period which could cause a temporary slowdown in the overall economy. With a smaller (albeit still massive deficit) and higher unemployment, the economy should slow. A slowing economy will allow the Fed to cut short-term interest rates which will filter back into our 2/10 spread. The market is coming around to my way of thinking. Looking back at the beginning of this year, the market was pricing 1.5 rate cuts by the end of the year. It is now pricing three cuts. A brief recession or near recession should move the spread sharply over the next year.

In addition to the interest rate effect, slower US growth should be overall bearish the dollar as well which I have chosen to express through the eurocurrency. The main initial reason for utilizing the euro is simply because there are no liquid options available on the dollar index. However, euro options have been fortuitous. While I did expect that the US position of pulling away from NATO would lead to fiscal stimulus in Europe in the form of defense spending, I did not expect Germany to pull out a Howitzer. With pledges now of ~800 billion euros and the EU weakening rules on debt, public spending will be ramping appreciably. The increased spending will help boost their overall lackluster GDP and strengthen the euro. The other piece helping the euro appreciate is the interest rate differential. Lower US interest rates and higher EU interest rates will also help to push the euro higher against the dollar.

The final position in the portfolio is short the S&P 500. A combination of factors is now working against the stock market in general. First and foremost is the slowing economy as noted above. The second has been a rejection of TINA (there is no alternative). Several stock markets have been outpacing the US over the past several months. There has been a revival in Chinese and European stocks. In addition to an actual alternative to US growth stocks, there has been a dent in the theory of American exceptionalism. While I have many doubts about the DeepSeek inroads, there is at least a doubt that the AI build-out will be as lopsided in favor of the US as many had thought. With a likely slowing economy, alternative assets outperforming the US, and a weak dollar, the rotation out of US stocks into the rest of the world could continue for some time. In the end, I do believe that the US stock market will come roaring back. In the meantime, we will try to take advantage of the current uncertainty.

Sincerely,

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