

Research @ Citi Markets Edition: How to Navigate 2026

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Opening Teaser: (00:00)

Research @ Citi Markets Edition.

Dirk Willer (00:04)

Welcome to Research @ Citi Markets Edition, where we break down global macro in 10 minutes or less. I'm your host Dirk Willer, Citi's Global Head of Macro, and with me today is Adam Pickett, our London Macro Head. Welcome to the show, Adam.

Adam Pickett (00:15)

Pleasure to be here as always, Dirk.

Dirk Willer (00:18)

We are recording this podcast at 9 a.m. on Monday, Dec. 8, 2025.

2025 was an eventful macro year, but what assets will work in 2026? Let me start laying the scene a little bit. Our economists are calling for Goldilocks for 2026, which means growth that is more or less in line with this year, so relatively strong, where inflation is maybe slightly elevated on the services side, but broadly in line with where it should be.

This means that central banks will probably cut less than they did this year. So the breadth of the cutting will narrow, but we don't expect a lot of central banks hiking. So monetary stimulus will still improve from here.

And this environment is, of course, a good one for risky assets. And as a result, we are still overweight equities. Of course, as you know, we are believing that valuation is this fly in the ointment for risky assets. And we do believe that the U.S. equity market is in a bubble. We also have seen cracks in the AI story a little bit, especially surrounding OpenAI. The worries have increased both around the tense competition in the field and the huge funding needs that have to be met somehow.

But we don't believe that the bubble has peaked yet, and that's for two reasons. One is we haven't seen this optimism and very heavy positioning that you typically see when the bubble peaks, and that we certainly saw in 2000. And second, liquidity is also not tightening and bubbles need liquidity. And the reason I think why 2000 peaked when it did was partially because the Fed had increased liquidity tremendously going into Y2K

because of the Y2K bug and then removed that liquidity again early in 2000. And that was very important for the timing of the end of the bubble.

And this time around, of course, we see liquidity fairly benign, both because the Fed is cutting, which is actually very rare in a bubble period; and secondly, also because liquidity in terms of the Fed balance sheet is likely to be benign and possibly improve going forward.

One issue for next year is, of course, that it's midterm election year, which is a period where typically the S&P does not do all that well. Though we would say the real risk around the midterms is typically more a Q3 type of event rather than a Q1 or Q2 type of event. So, we stay quite positive here into next year.

Adam Pickett (02:29)

Dirk, overweight in the U.S., I'm sure, is reasonably consensus. Do we have any diversifiers?

Dirk Willer (02:35)

Good question. Diversifying should happen both across countries, and across sectors potentially. On the country side, we think China offers a good way to diversify, which is not that obvious because it's, of course, also partially an AI story. However, it is the index, the global market that's least correlated with the U.S. And also, the AI story is least correlated with the U.S. AI value chain.

Because if you buy Korea or if you buy Japan or if you buy Taiwan, you're essentially still on the U.S. AI value chain. While if you buy China, it's a completely separate AI value chain and a very high-quality one. It also has, of course, cheaper AI assets. The cheap power is a big advantage for China as well. And then the liquidity situation is still quite good because deposits are still flowing into the brokerage sector. So we quite like that as a diversifier.

On the sector level, it's also an interesting question. What is important to realize is that in past bubbles that were tech-driven, the tech sector peaked on the day when the bubble peaked. So if you don't think the bubble has peaked, you should still keep tech.

The big, big sector rotation happens after the bubble blows, or it's coincident with the bubble peaking — not before. Now, one thing that we do see is that cyclicals over defensives do also quite well during the bubble, but that peaks one month before. So that would actually be a warning sign to look out for. But also, it means that right now we should still be positive on cyclicals where we have picked financials. And we recently also upgraded healthcare — which is relatively cheap, regulatory risk has been priced, and which could be a beneficiary from the AI story.

But Adam, bubbles don't just need diversification. They also need hedges. What do you think are interesting hedges?

Adam Pickett (04:18)

It's a great question, Dirk. And I think you've already laid out why in equity land hedges are difficult — because in a slightly broader world, one is just that other sectors don't do poorly, but also in a bubble your leadership rarely rotates, and so you don't get much opportunity for big sectors to help you out.

We still like credit when we've looked at IG credit underweights both in Europe and the U.S. in risk scenarios, so big market shocks. On a risk-adjusted basis in spread terms, credit shorts or underweights outperform long JGBs unhedged, long gold or short the S&P 500.

So from that perspective we think they are favorable, but also from a hedging perspective you tend to pay away performance, you tend to get strike drift with hedges, but credit has been materially underperforming equities on a risk-adjusted or beta basis in the U.S. all year. And you know that comes by construction; there's still not that much AI, or less AI, in credit indices and equity indices. And the only way that really changes is if the AI names do an enormous amount of issuance, which we wouldn't see as too credit-positive anyway. And so net-net, we like credit underweights as a way to ballast our equity overweights in the portfolio.

Dirk Willer (05:35)

What about fixed income? I mean, a normal hedge for equity downside is treasuries, right? What are your thoughts there?

Adam Pickett (05:42)

It's a tricky one outright for treasuries. We still have a relatively reflationary backdrop for next year. Economic surprises globally posted their third-longest consecutive streak of positive surprises on record for the index. The Hasset risk looks for a full-26 basis reasonably well-priced. Citi has two cuts for next year but mostly centered at the beginning of the year, and we think there's a risk of a rebound in the U.S. economy in the middle of the year.

We have a steepening bias. And so for those that can do it, steepeners probably represent a decent macro hedge. But outright on treasuries, we're neutral. We're overweight gilts. We think that the BOE still looks underpriced: The issuance profile coming out of the budget, skewing heavily towards shorts, vs. history means that issuance profile is particularly healthy.

For gilts, with the lowest DV01 issuance profile potentially in five years. And while there is some risk around the May local elections, we think it can still have a very good start to the year.

France, we're underweight, not enough political risk premia, nearly 50% of the net cash requirement is coming in the first quarter of next year. Plus, you still have some

lingering upside risk to yields in Europe coming from an ECB being done, from pension fund reform in Holland, as well as potential defense-spending risks longer-term.

And lastly, on Japan we stay underweight. It's been one that we've had for a while. We may be close to the back end of that trade rather than early in the trade, but certainly the structural story in the Japanese labor market still means that the BOJ probably stays the course and can hike a bit quicker than is expected from here, or at least the market can chase that theme.

If they don't, it's probably because you've had political pressure and more fiscal — in which case, again, we think that the back end probably still stays under pressure. So neutral overall in fixed income, but still, we think plenty of long, short opportunities.

Dirk, one of the other places we're still overweight is EM Sovereign. Amazing year for EM last year. Do you think the party's still going to continue?

Dirk Willer (07:47)

Yeah, EM Local, not necessarily EM Credit, right? But yes, it was a great year, benefited both from aggressive easing cycles and from the strong currencies. And of course, next year will not be quite the same.

Some central banks have reached where neutral rates are roughly and are therefore pausing because growth is not falling off a cliff in most places. So you will not get the same tailwind from the local central banks. However, we also don't think you will see hikes. I mean, growth is broadly speaking still below potential and we never really overcut anywhere.

So, the rates part will be more neutral, but the EMFX part will do more of the heavy lifting. And that is because I think for EM local FX unhatched, you really just need relatively stable U.S. rates and a stable big dollar. And that's good enough for carry to perform, especially if volatility remains low.

Now on volatility, very, very hard to forecast, but our best indicator is actually to just look at the implied volatilities of the various cross-macro assets. And our indicator is telling us that we still stay in a fairly benign environment for EM carry, so we stay overweight EM local. And we do think EMFX will have to do more of the heavy lifting, but it still seems an attractive position in relative terms.

OK. So we still like high-yielding EMFX, but what about your G10 FX, Adam — and then what about commodities?

Adam Pickett (08:50)

It's always tempting to say next year is going to be a year of two halves. Especially for the dollar, I'm going to go one further and say maybe it's going to be a year of three thirds.

At the beginning of the year, Citi still has the Powell Fed as being slightly more dovish than what is priced. So, we still have December, January and March penciled in for cuts, which I think could probably still see some dollar downsides as we start the year, potentially trending back towards the recent lows. Into the middle of the year, once we're past peak U.S. cyclical weakness, peak local Fed dovishness, the dollar can probably rebound as we see the economy rebound, as well as the AI bubble still attracting capital inflows.

And I think there's a risk at the end of the year from coupon issuance — our great strategists think that issuance is going to skew longer-dated toward the end of the year. We could see some term-premia issues towards the back end of the year, which from our work has typically been dollar-negative.

On commodities, we are slightly at a consensus. Neutral on gold, rather than overweight. In global cyclical recoveries, we find that gold tends to do less well, and we're not big buyers of the structural-debasement Fed independence risks. Slightly dovish risks, but not debasement risks, which have been supportive for gold. So we think that that debasement risk is fading into next year.

Rather, we are quite positive on base metals, both copper and aluminum — big parts of the index have strong cyclical upside being in cyclical recoveries for the world. Copper has supply risks from mining dynamics, has positive demand risks from the energy transition and EVs.

Aluminum is very energy-intensive and effectively competes with data centers on the supply side now. And that features heavily in some of the weaker supply backdrop for aluminum from our commodities strategists next year. So, both of those perspectives were bullish. Oil still bearish, mostly see that the supply picture is quite robust next year and structurally the world has become less and less oil-intensive per unit of growth.

Dirk Willer (11:10)

Great. Thank you, Adam.

So in summary, our economics team believes in Goldilocks for next year, which is generally risk-friendly. We overweight equities but given that we do think we're in a bubble in the U.S., hedges are needed. So we are negative on credit, neutral fixed-income. Long EM and gilts, but on the negative side it's France and Japan. And we're long commodities, but we prefer base metals over precious.

Thank you for joining us today. This episode was recorded on Dec. 8, 2025, and I'm your host, Dirk Willer. For more details, Citi clients can check out our report on Citi Velocity. Next week we will have Beata Manthey, our head of European Equity Strategy. And be sure to watch our Research @Citi podcast, which you can find on the same channels.

The macro strategy team will be back in the new year, and we wish our listeners a happy holiday season and a great start to 2026. Stay sharp!

Disclaimer (12:03)

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