Research @ Citi Markets Edition: Back to the Broadening Debate

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Transcript:

Opening Teaser (0:00)

Research @ Citi Markets Edition.

Beata Manthey (0:06)

Welcome to Research @ Citi Markets Edition, where we break down global macro in 10 minutes. I'm your host, Beata Manthey, Citi's Head of European Equity Strategy.

Joining me today is our Senior Equity Strategist, David Groman. Welcome to the show, David.

David Groman (0:20)

Thanks, Beata. Great to be back.

Beata Manthey (0:22)

So David, the markets have turned more volatile recently, driven by tech-related jitters and, of course, the renewed geopolitical risks out of Iran. But to put this in context, global equities have had a great run in the past few months and are up around 10% year to date. But the ride has been anything but smooth. So we've had the Iran conflict, AI volatility, the sharp sector rotation. How would you characterize this first half of the year?

David Groman (0:51)

Yeah, as you'd say, I'd call it a bumpy climb. The pattern this year has actually been remarkably similar to 2025: solid index-level gains, but with a lot happening beneath the surface.

We've seen really three distinct phases this year. In the run-up to the Iran conflict, ex-U.S. equities outperformed, and tech was actually a laggard. Then from late February onwards, U.S. and tech leadership really reasserted itself in the market. And then more recently, we've started to see signs of rotation again. Some of the crowded trades, like semis and Korea, have come under pressure.

So it's a tricky moment, but despite short-term volatilities, we still think equities look interesting on a 6–12-month horizon.

Beata Manthey (1:26)

OK, so let's try to put the current market volatility aside for a moment and have a discussion about the outlook for the second half of the year — and of course the central debate, which is the theme of our latest global equity quarterly as well: Will we see a sustained broadening of market leadership beyond tech going forward?

David Groman (1:50)

So we've had a taste of this broadening in the past few weeks. And I guess the big question now is, Can it last? And our answer is partly yes, but maybe not a full broadening. We actually like to call it “narrow broadening.”

There are really two conditions you need to meet for a sustained broadening trade to take hold. First, you need evidence of a broad cyclical recovery, both in macro and earnings. I think we are starting to see that. Economic data globally is improving and more frequently surprising to the upside. And at the same time, our earnings revision indices have improved significantly. So actually, over 60% of global sectors are now in net earnings upgrade territory, which has historically been supportive for cyclical market outperformance.

The second condition is a sustained pause in tech outperformance, and that's less certain. Tech has been under a lot of pressure lately, but the sector continues to screen very highly on our fundamentals-based models, with standout earnings growth and notably valuations that are actually a lot less stretched than many other sectors right now.

So one of the two conditions for broadening is met, which gives you some broadening, but tech could also remain a key pillar from here.

Beata Manthey (2:52)

That's really interesting on tech valuations, because I think a lot of investors assume tech is still the most expensive part of the market. But indeed, it's actually one of the cheaper global sectors on traditional price-to-earnings ratio. But I think increasingly the debate is turning towards the earnings. The sector, and especially semis, have seen huge EPS upgrades over the past year. So could we be in something like an earnings bubble for many of these names?

David Groman (3:19)

That’s a great question. And for us, I think much of the debate comes back to the underlying AI buildout, which has knock-ons for everything else down the AI value chain. When speaking to our analysts covering all of these names in depth, what they tell us is that there is still solid enough return on this AI investment to keep global AI capex growing at a steady pace out over the next few years.

And while there is now focus on some of the zero-sum aspects of the AI buildout — more expensive memory ultimately weighing on free cash flow of hyperscalers, for example — the underlying profit pool for tech and tech-adjacent sectors should remain strong on the whole.

But Beata, let's talk a little bit about what we're actually recommending here. What are some of the meaningful changes that we've made in our last global quarterly? And could you walk us through some of these key shifts?

Beata Manthey (4:05)

Absolutely. I think the biggest change is Japan. We've upgraded it all the way to overweight. And as the market leadership broadens and cyclical conditions hopefully continue to improve, Japan stands out as one of the best-placed beneficiaries. It also has meaningful exposure to the AI investment cycle through its tech and semiconductor supply chain, which gives it a nice combination of cyclical and structural growth exposure.

On the other side, we've downgraded the UK to underweight. The market's defensive and commodity-heavy composition is less appealing if the geopolitical tensions ease. However, for those worried they could continue, it does look like the most effective geopolitical hedge.

We also remain underweight Australia, and the U.S. and continental Europe stay at overweight and neutral respectively.

David Groman (4:54)

Nice, and while I've got you, I'd be remiss not to ask about your views on Europe. So we're staying neutral on continental Europe in our global allocation. But do you think the case for European equities is improving? What are some of the things that you're watching there?

Beata Manthey (5:07)

Absolutely. So Japan rates higher on our model as a whole, but Europe is looking more interesting in quite a few ways.

For one, economic surprises — or Citi Economic Surprise Indices — are improving more rapidly than anywhere else. And at the same time, we've seen some really interesting dynamics in European earnings revisions, which we would characterize as uncommonly high, unusually broad, and unseasonally strong. And these types of dynamics tend to point to more earnings upgrades from here, which should be constructive for market performance going forward as well.

It's also worth noting that Europe increasingly serves as a very effective anti-AI hedge because of its lower tech weight. So it could be an effective diversifier too for those worried about AI-induced market volatility. European banks are a very good global cyclical diversifier.

David Groman (6:04)

That's a great summary, Beata. Thanks.

Beata Manthey (6:06)

Yep, so much more to discuss, but I think we'll pause our conversation there for now.

So to summarize to our listeners: We are still constructive on equities through to the end of 2026. We are seeing through the current market volatility, but we are positioning for selective broadening. We prefer growth and cyclicals over defensives, with the U.S. and Japan as our top regional picks. And we are very closely monitoring the earnings season, geopolitical developments, and any shifts really in AI sentiment going forward.

David, thanks so much for joining us today.

David Groman (6:44)

My pleasure, Beata.

Beata Manthey (6:45)

Thank you for tuning in. This episode was recorded on the 17th of July 2026. And I'm your host, Beata Manthey. Our next episode of Citi Markets Edition will be hosted by Dirk Willer, Citi's Global Head of Macro. Thanks for listening. Goodbye for now.

Disclaimer (7:03)

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