Research @ Citi Podcast Markets Edition: The Bull-Bear Debate for Global Equities

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Transcript:

Opening Teaser: (0:00)

Research @ Citi Markets Edition.

Beata Manthey (0:07)

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 Global European Equity Strategy.

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

David Groman (0:21)

Thanks, Beata — always great to be here.

Beata Manthey (0:24)

David, markets have had quite a run. Equities are near all-time highs, we've had a blowout earnings season in the U.S., and sentiment has recovered sharply from the lows we saw around the end of March. But at the same time, there are still plenty of things to worry about — the Strait of Hormuz, interest rates, the narrowness of market leadership. So today, I thought we'd do something a little different and have a proper debate: the bull vs. the bear case for global markets. I'll let you pick the side — optimist or pessimist?

David Groman (0:55)

Ha — I'll take the optimist side, though I'll admit it's not the cleanest call. I think there'll be a good debate to be had here.

Beata Manthey (1:01)

Perfect. So make the case: Why should investors feel good right now?

David Groman (1:06)

So I guess I'd start with earnings, because I think that's really at the foundation of everything bullish this year. We've had a genuinely strong 1Q reporting season — particularly in the U.S., where — as you said — it's been a blowout quarter. And it's not just the U.S. — we've actually been seeing global earnings upgrades basically wherever you look. Initially these were very concentrated into a few areas, like Tech and Commodities — which made sense given the tailwinds from AI and oil prices. But over the past month, we've actually seen more EPS upgrades than downgrades in all but two global sectors. And that has left analysts pencilling in a pretty astounding 25% global earnings growth this year, which would be one of the best years ever to not come off of a recession.

Beata Manthey (1:43)

Fair enough, but what about the macro set-up, which underpins these types of earnings numbers?

David Groman (1:50)

Yeah, I think that's a fair question. But our base case is still that the Strait of Hormuz reopens sometime in July and that oil prices settle back in at around $90 a barrel by the end of this year. That's obviously still way above what we were forecasting coming into 2026, but it's also the type of environment where our economists aren't particularly worried about big downside risks to growth or big upside risks to inflation.

And if anything, I'd say that recent press reportings and comments from political officials has lifted hopes that a cease-fire could be coming sooner rather than later when it comes to Iran.

And then on top of all of that, our house view is also that U.S. rates are going to come down pretty meaningfully by the end of this year, with 10ys settling in around at 3.75%. And that compares to around 4.5% where we are right now.

So what I would say is that if we get all of these three things playing out — so that's solid earnings growth, geopolitical de-escalation, and lower interest rates on top of it — you've got a constructive setup for global equities to the end of this year.

Beata Manthey (2:47)

OK. So that's a reasonable bull case, I have to say. But let me push back, because I think there are some real reasons to be cautious here. The first one I'd flag is the narrowness of what's driving the markets. Yes, earnings are strong, but Tech and Commodities are still doing the heavy lifting, while consumer sectors in particular are being driven by downgrades. That means solid global EPS growth, but it's still going to be propelled by a small set of sectors. And historically, narrow markets tend to come with more volatile trading conditions.

David Groman (3:23)

Yeah, that's fair — and it's obviously something we've been watching closely. But don't valuations already reflect this gap, or this narrowing in the earnings trends?

Beata Manthey (3:30)

Well, not necessarily. Value sectors are still trading at some of their highest multiples over the past few decades, and that means there's very little margin for error if earnings do disappoint. But at the same time, the macro risks are still skewed to the downside if the Strait of Hormuz stays closed longer than expected. Our commodity strategists still see a 30% chance of oil prices averaging $130 per barrel in the second half of this year. And that could be a world where global growth falls below 2% and inflation stays elevated — which would be a very difficult environment for equities.

David Groman (4:13)

Yeah, makes sense. So what about rates here? Because that's another headwind that a lot of investors have been talking about lately.

Beata Manthey (4:19)

Well, we've seen some relief lately: Interest rates have been rising again this year. There are some idiosyncratic drivers, like the UK, but this has been a coordinated rise in bond yields across the world. I don't want to overplay this because the relationship between bonds and equities is nuanced. But what I will say is that our work in the past has shown that equities can do well when bond yields are rising — but usually that's because higher yields are reflecting solid macro conditions. The worry this time is that rising yields reflect worries around inflation or policy — and again, that would typically be a trickier environment for equities.

Beata Manthey (4:58)

David, let me bring up one more thing which sits between the bull and the bear case, and that's sentiment. How bullish is market sentiment right now? And can we put that it into historical perspective at all?

David Groman (5:10)

Sure. So after the sharp recovery that we've seen in the markets just over the past few weeks and months, some of the sentiment indicators that we watch have moved into what I'd call frothy territory. Our favorite tool for this is our proprietary Bear Market Checklist, and in the BMC, what we do is monitor 18 different factors to see if the conditions are in place for a long and sustained equity-market drawdown. This is particularly helpful because we can compare this to the past, right? We can look at what the BMC was telling us heading into the Tech bubble or into the GFC. And just for context here, we like to say that when we have fewer than 10 factors flagging red, buying dips in equities still makes sense. And when more than 10 flags are up, it might be a little more worrying.

So as of our latest update, our global BMC had about 8.5 out of 18 factors flagging red. Those flags are primarily coming from high valuations more than anything, which look very similar to the past. But what's more worrying to us is that many factors that aren't flagging red yet are just right on the cusp of reaching frothy territory. So that includes things like equity fund flows, for example. And IPO activity, which has been pretty subdued, could be another thing to watch as we go on to later this year.

Beata Manthey (6:18)

Interesting — so maybe we are still narrowly in dip-buying territory for now, but the market is getting seriously frothy. It will definitely be something to watch very closely going forward.

David Groman (6:32)

Exactly. But Beata, let me turn it back to you really quickly before we wrap up — just given everything that we've discussed, the bull and the bear case here, how are we actually positioned in our global equity allocation? How are we thinking about the markets to the end of this year?

Beata Manthey (6:43)

Since the start of the war, our message has been consistent: Favor quality, and with some defensive hedges. And we still see reasons to stay invested, even if gains look narrower in the months ahead. So that means we still like the U.S. market in the global context, paired with an overweight on the UK market. The resilience of earnings going forward will be key to watch — and of course, geopolitical developments around the Strait of Hormuz remain the single biggest swing factor for markets.

Plenty to watch out for, and I have a feeling that our bull-bear debate will continue — but let's wrap up there. David, thanks for being here today.

David Groman (7:23)

My pleasure!

Beata Manthey (7:25)

Thank you for joining us today. This episode was recorded on the 26th of May. And I'm your host, Beata Manthey. Our next Research @ Citi Markets Edition will be hosted by Dirk Willer, Citi's Global Head of Macro. Thanks for tuning in — goodbye for now.

Disclaimer (7:41)