Research @ Citi, Markets Edition
Title: Unpacking Europe's Equity Rebound
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Guest: David Groman, Global Senior Equity Strategist, Citi

Transcript:

Beata Manthey (0:03):
Welcome to Research at Citi, Markets Edition, where we break down global macro in 10 minutes. I'm your host, Beata Manthei, Citi's Head of European Equity Strategy. Joining me today is our Senior Equity Strategist, David Grohman. Welcome to the show, David.

David Groman (0:18):
Thanks, Beata. Great to be back.

Beata Manthey (0:20) So, David, when we spoke just around a month ago, the markets had turned much more volatile with tech sector in particular coming under pressure. Since then, risk sentiment has been improving steadily, and that means global equities are back to all-time highs. So talk us through where we stand, what's been driving this move higher out of late.

David Groman (0:40):
Yeah, that's right. So equities are climbing once again. And if we look over the past month or so, pretty much every major region is up anywhere from 2% to 4%. And some of the more volatile tech-linked markets like the NASDAQ or Korea's KOSPI have bounced off their lows from late July. That means the global equity benchmark has already delivered very solid returns, around 15% this year. But what's been interesting is that these gains have been very broad-based. So as I said, all regions are doing pretty well. And if we dive into U.S. sectors, the best performance over the past month have been energy, healthcare, and tech. And in Europe, industrials and financials have also seen really strong gains. So this broadening of performance that many investors have been looking for for a long time now has finally shown some evidence of taking hold.

Beata Manthey (1:21):
So yes, it's been encouraging to see the broadening finally in motion. But do we still see that continuing from here?

David Groman (1:30):
That's what our model suggests, but it's nuanced. So we talked about this in our last episode, but a sustained broadening really needs two pillars. So first, you need evidence of a broad cyclical improvement in macro and in corporate earnings. And second, you need a sustained pause in tech outperformance.

Now, in that first pillar, things are going in the right direction, especially when it comes to earnings. So the latest reporting season was incredibly strong, really across geographies. And our proprietary earnings revision index, which measures the ratio of net earnings upgrades versus downgrades globally, just touched its high year-to-date last week. But as we've been arguing, the tech sector continues to look attractive when it comes to some of our favorite fundamental indicators as well. So things like earnings growth, earnings momentum, and valuations, which all look pretty attractive.

So going forward, broadening looks like it can continue, but we see broadening more as an expansion of market participation rather than a pure rotation away from tech or AI. And ultimately, we think that's a setup for more equity market upside to year end. But Beata, that's where I want to turn it to you, because one of the big winners in this market broadening has been Europe. So I want to dig into the case for Europe a little bit more. What has changed of late when it comes to European equities and what has been driving the outperformance there?

Beata Manthey (2:41):
Great question, David. And I would frame a recent strong performance out of Europe around three key drivers all working their way at the same time. So the first one is the domestic growth story and the ongoing fiscal support that is working its way in the background. The second is this broadening dynamics we've been speaking about, which is particularly important for cyclical markets like Europe. And finally, Europe is now perceived as a hedge on the global AI trade. So all three of these things have been aligned in the right direction, really.

David Groman (3:20):
Well, so yeah, let's take each one of those individually. So what are we actually seeing in terms of European fiscal? Is there evidence that this spending on defence is coming through in a pretty meaningful way?

Beata Manthey (3:30):
The answer is a definite yes. So it's important to remember that Europe's fiscal stance was actually a net drag on Eurozone GDP growth as recently as last year, but with the changes

we've seen so far, Citi economists think fiscal will add around 30 basis points to GDP growth this year. And let's not forget the effects of the post-pandemic recovery fund, particularly the Next Generation EU program, which continues to flow through the southern European economies. Germany has also been a notable contributor here with its own domestic fiscal push and the fiscal balance there should widen from around 2.7% of GDP last year to around 4% this year and all the way through 2030. So for us, it still makes sense to follow the spending and the spending is definitely going into Europe.

David Groman (4:27):
Nice. So what about this broadening story? Of course, the ECB has actually already hiked rates and geopolitical risks are still out there. So is there really signs of cyclical improvement when it comes to Europe?

Beata Manthey (4:38):
So there are, of course, plenty of risks to think about. But again, the answer is yes here. On the economic front, growth has been resilient for quite some time. And if you look at Citi economic surprise indices, which measure if economic data is coming in better or worse than the expectations, our measure for Europe has seen the sharpest improvement of anywhere in the world over the past few months. And at the same time, earnings revisions in Europe have been running at uncommonly high and unusually broad levels and significantly better than seasonal norms. And this meant almost no sectors were a net drag on European EPS growth in Q2. That hasn't happened for quite some time. So ultimately, European EPS growth won't be as strong as the US or the EM this year. But we are still talking about a very solid double-digit growth with very strong signs of improvements over the past few months.

David Groman (5:41):
Nice. And yeah, I guess finally to your last point on Europe as an AI hedge, what does this really mean? And couldn't you argue that Europe is just tied into the tech trade in a different way, right? So maybe with AI infrastructure instead of chips, for example.

Beata Manthey (5:56):
So, yes, Europe does have many companies involved in this broader build-out of the AI infrastructure, which, by the way, have done incredibly well. But at the same time, Europe on the whole has a much smaller overall tech exposure and tends to outperform its major peers when AI sentiment wobbles. So the idea here isn't to suggest that AI is going away as a structural driver, but with the AI trade becoming more volatile and evolving, it just makes sense to hold some Europe in that context as a diversifier.

David Groman (6:32):
Thanks, Beata. I think this is a conversation we could continue for much longer, but it's a compelling case for Europe as a diversifier in global equity portfolios going forward.

Beata Manthey (6:40):
Agreed. So to summarize everything we've talked about today, we are still constructive on global equities and we see broadening trade continuing from here. And if it does, indeed, Europe becomes one of many well-performing regions that have or offer this cyclical exposure. And there are many reasons to like Europe in your equity portfolio, including the fiscal story and its role as an AI hedge. David, thanks so much for joining us today.

David Groman (7:12):
My pleasure, Beata.

Beata Manthey (7:14):
Thank you for tuning in. This episode was recorded on the 17th of August, 2026, and I'm your host, Beata Manthei. Our next Research at City Market Edition will be hosted by Derek Willer, City's Global Head of Macro. Thanks for listening. Goodbye for now.

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