

Research @ Citi Markets Edition: What About the Consumer?

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Host: Scott T Chronert, Head of U.S. Equity Strategy, Citi

Guest: Paul Lejuez, U.S. Department Stores & Specialty Softlines, Broadlines and Food Retailing, Citi

Transcript:

Opening Teaser: (00:00)

Research @ Citi Markets Edition.

Scott Chronert (00:03)

Hi, I'm Scott Chronert, Head of U.S. Equity Strategy here at Citi Research. Welcome to Research @ Citi Markets Edition, covering various topics at work within the U.S. equity markets.

With me today is Paul Lejuez, who heads up our retail work covering department stores, especially softlines, broadlines, and food retailing. I've invited Paul here today to talk about the American consumer. So welcome, Paul. Thanks for taking the time today.

Paul Lejuez (00:27)

Thank you.

Scott Chronert (00:28)

So, the setup for this particular podcast is, when I go into most client meetings these days, one of the most common questions I get is, "What about the consumer?"

And my answer to this is that it's not so much about the consumer — where we think that consumption, generally speaking, is in good shape — but which consumer. When you look at the income distribution across the U.S., there's a lot of dispersion that plays into how we think about the fundamentals for these companies.

So let's get going, Paul, with this notion of how you think about the consumer vs. which consumer framework.

Paul Lejuez (01:15)

Yeah, the consumer is a tricky one and certainly a question that we get pretty much in every one of our meetings. Certainly, I hear the same thing. And I know we all get

into the habit of saying “the consumer” for simplicity, but it really is hard, I would say, to generalize when we think about the consumer outlook.

Some like to use the term “K-shape” to help differentiate between higher-income and lower-income consumers. But I even think that probably oversimplifies it. And the way that I've described it is, if you look at an air-traffic-control map of all the flights in the air from the west coast to the east coast on any given weekday, I think that's probably a little bit more reflective of the different starting points and the directions consumers are traveling. And basically, it's just another way of saying, “it's complicated.”

But I think a common thread, regardless of income level, is that employment is the key across the spectrum. Employment's generally been strong for some time, leading to consumer health ... or at least resilience. And that's something that we're just going to be watching as we move forward to determine the direction of, quote-unquote, the consumer.

Scott Chronert (02:12)

OK, so let's begin to take this down the most direct path. Going into this year, there's been a lot of expectations around various forms of fiscal stimulus, including with this notion of we've got tax refunds coming. I've treated these as somewhat of a passing thing, but maybe there's more durability to them.

So, as you see this setup as we move further into 2026, how would you characterize it looking at the stocks?

Paul Lejuez (02:38)

Yeah, I think it's certainly something that we can't ignore. We do think refunds will provide a boost to spending, and it actually makes it hard to be too negative near-term on some of the stocks that we cover — both the retailers and the brands, because we do think that the high-frequency data that a lot of our clients and investors are looking at will start to look better as a result of more money ending up in the pockets of consumers.

Having said that, we don't know that it's an investable theme as we think about anything long-term. So if there are certain retailers that are facing broader issues — in some cases structural issues — we'd certainly be cautious not to chase stocks higher if they do react well to some of the stimulus in the refunds that we think is coming. Depending on how much the market might drive those stocks higher, it could actually be more of an opportunity to become more cautious on certain names that have a little bit more structural issues that they face.

Scott Chronert (03:41)

OK. So, for the most part, tax refunds, they're a thing, may not be as persistent of a thing as one might expect. Now, shifting over to another topic that's related to your companies — and you and I have spoken about this over the past few months — when

we think about this notion of tariffs, it's essentially importers are paying that bill. And so a lot of your companies are smack dab in the crosshairs of that.

How do you think about the tariff issue fully priced? Is it still a concern in the ability of these companies to pass through to consumers vs. taking the hit at the margin line?

Paul Lejuez (04:15)

Yeah, it's a tricky and dynamic topic. I think most are of the view still that reciprocal tariffs will get shot down. And even if they did, I would say that you'd expect a period of uncertainty in terms of what will the administration do next to fill the hole, maybe using other tariff options. I think it'd probably be a much bigger negative surprise if they were not shot down than a positive surprise if they are.

And it's been tricky. We've seen some companies put through higher prices, try to pass them through to the consumer. And surprisingly, the results have actually been pretty good. The elasticity has not been as extreme as many companies were expecting. Most have had favorable things to say.

Now, having said that, I don't know that we've seen the broad price increases that we might still have coming in the first half of this year. And so even just to connect the dots to the refund and stimulus conversation, those are coming at a pretty good time when the consumer might actually be seeing a little bit more broad price increase across the retail spectrum than they did during the holiday period.

So it's certainly going to be something to watch. But I would say for most companies at this point, for those that have taken a price to try to pass through some of those tariffs to the consumer, their elasticity results have been better than what anyone expected, certainly better than what they expected.

Scott Chronert (05:41)

OK. And then another bigger topic that's coming up is around AI. When I think about areas of the market that should benefit, I would think a lower-margin retail world is a place that you should expect to see some benefit on this.

Now, at the same time, what we're seeing in the market recently is this unusual circumstance where there's a concern about AI disruption such that it, generally speaking, looks to be services companies as opposed to goods companies that are feeling the brunt of that.

So when you step back and look at this AI influence on the retailers, how do you think about that particular circumstance?

Paul Lejuez (06:21)

Yeah, it's certainly a topic of conversation. We've hosted tons of investor meetings, lunches, dinners, and it usually takes up a lot of the time that we have a general conversation, as everybody's really trying to figure it out.

Look, we've got to be thinking about the impact of AI, and specifically agentic commerce is something that comes up a lot in our universe. From our discussions, I would say with investors, it seems that most view the AI and agentic topic and disruption as potentially worse for those that sell third-party brands. And so most, I would say, favor brands over boxes, the boxes that sell the third-party brands.

And I think it's pretty well accepted that Walmart is viewed as a winner in AI, given their low-cost positioning and 5,000 points of distribution, which allows them to get products to customers fast and at the best value. If we think about how we all might be using agentic commerce, you certainly see a lot of the queries, a lot of the searches being based on getting things at a low cost and fast, and Walmart is certainly one of the ones that has that advantage vs. a lot of the retailers in our universe.

But I think people look at brands, specifically on the apparel side, as probably being a little bit less disrupted because they've established a brand identity and there's brand value and consumers do value certain brands within the retail landscape — they're not going to just search for always the lowest-cost alternative or necessarily the fastest way to get something. They want specific brands.

So I think people would tend to think of the brands being more protected in this AI world over boxes and within the boxes, and we certainly would agree with that.

Scott Chronert (08:16)

So we've touched on several topics: broader discussion around the consumer, how tax refunds fit, how tariffs fit, how AI fits. Let's wrap things up to pull this all together. How do you see your most investable trends for this year setting up for '26?

Paul Lejuez (08:32)

When you have such a large retailer gaining consumers, growing sales as they have been for several years, it makes it very difficult for those that go head-to-head with Walmart to compete efficiently, effectively, profitably. It's always something to consider these days. But I think it's probably more of an important dynamic than an investable theme.

A little bit more of a micro theme is that there are some tailwinds in apparel. Fashion has been changing, it's been moving away from tight-to-the-body styles like leggings, let's say, in favor of looser-fitting bottoms like baggy jeans, for example. So many wardrobes are still needing to get updated to stay on trend, and I think that's important.

And I don't think we can ignore the tailwind that GLP-1 provides to the apparel universe. It turns apparel into a little bit more of a need than a want — the only clothes that fit. I think the combination of the change in fashion along with GLP-1s actually provides a nice little tailwind for apparel broadly across the retail spectrum as a theme.

Scott Chronert (09:52)

So we'll have to leave that for a separate discussion. Wasn't quite prepared in our allotted time here to get into GLP-1s, but fascinating in terms of how that can influence the trend!

OK, so high-level takeaway here is that we still think that there are going to be any number of stock-selection opportunities that tie into the way we think this landscape is unfolding. Generally speaking, it feels like the health of the consumer is still in an OK place, if I'm reading you correctly, but you're going to have to be somewhat nimble around picking and choosing spots along these other inputs, whether they be tax refunds, whether they be the state of the underlying economy, AI and even tariffs.

Paul, we've hit our time. I really appreciate your taking the time to speak with us on this. I know we covered a lot of ground in this in a short period of time. We could have talked probably for hours in this topic, but thank you very much. I think this was very insightful for me and for all of our listeners.

In closing, this podcast was recorded on Feb. 17, 2026. Thanks for joining today. Be sure to be on the lookout for our next Markets podcast featuring Dirk Willer, Citi's Head of Global Asset Allocation. And be sure to watch for our other Research @ Citi podcasts, which you can also view on the same channel.

Thanks and have a great day.

Disclaimer (11:05)

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