Research @ Citi Markets Edition: A Jobless Recovery

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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 (00:16)

Thanks, Dirk. It's a pleasure to be here as always.

Dirk Willer (00:18)

We are recording this podcast at 9 a.m. on Monday, Nov. 3, 2025.

It's either the best of times for investors focused on equity markets and productivity, or the worst of times for college grads trying to find a job. We have lived through a jobless recovery in the '90s. Now we are living through a jobless boom. What's going on?

Let me start setting the scene a bit. So the Atlanta Fed GDPNow Q3 estimate is running at extremely strong numbers in the high threes. Productivity is booming and sales per head for the S&P companies is strongly rising. Equity markets are up 16% year to date in the U.S. and 35% since the April lows.

On the other hand, the last published NFP from August was only 22k and the three-month moving average was as low at around 29k. We have a negative ADP print for September. Since then, we got weekly ADP prints, which are also quite low.

The next NFP print should be out shortly, mid-November, and consensus for September is actually not so bad, but the October number is meant to be weak again. Anecdotally, grads are having a hard time landing an entry-level job. This is really quite rare. Last time we built a big equity bubble in 1999, which also had strong productivity

numbers, NFPs were on average printing 250k numbers. The Fed was hiking. So clearly something is different this time around.

Adam, talk us through the various hypotheses of what explains this disconnect.

Adam Pickett (01:46)

Thanks, Dirk. We get leveled with four: labor hoarding, tariff impacts, AI, and rate sensitivity. We tried to dig into all four recently.

So, on labor hoarding, the theory is that firms hired a lot during the COVID rebound. They were uncertain about the future state of the economy, so they held on to them. And now we're seeing the giveback of some of that hoarding.

Now, if that were true, we would expect to see an inverse relationship between some of the positive hiring trends in '21 and '22, vs. some of the more negative hiring trends this year vs. the long-term trend. And we don't. We see a barely flat relationship on the scatter plot. So we don't give that answer too much credence.

On tariffs, our economists have done some good work breaking up the jobs report into tariff-adjacent goods, tariff-adjacent services. And we did see a decent hit in June and July, but actually since August, there hasn't really been a marked expansion in some of those tariff dynamics. And if anything, with some of the deals that have recently been signed, we would expect some of those headwinds to become tailwinds next year.

On rates, we look at the interest-rate sensitivity or the beta to the two-year of the GIX equity-level sectors, relative to the S&P. And then we map that to the JOLTs hiring numbers. And we look at the '25 trend vs. pre-COVID. And we do find a decent relationship there whereby the sectors with the higher rate sensitivity have also experienced slightly weaker hiring trends this year vs. the longer-term average.

So, we do think that rate sensitivity is a decent angle to map this on. And as the Fed cuts, we would expect to see some tailwinds going forward into next year.

AI is a trickier topic. On a macro level, we use firm AI sensitivity and map that to recent hiring trends vs. average. We actually don't find the inverse relationships that technological unemployment or productivity would suggest, i.e. the firms with a higher AI sensitivity do not have weaker hiring trends. They have strong hiring trends.

So, on a macro level, it's not quite there yet. On a more micro level, we do see evidence. So, when you look at recent work from Harvard and Stanford researchers, when they dig into subsectors or micro subsectors that do have stronger AI sensitivity, places like computer coding, places like customer services, there's a really marked dispersion in head count normalized over time between early-career workers and late-career workers, whereby mid and above basically continued to see head-count expansion. and the more junior sectors are seeing quite a marked downturn.

So, we think we could be at the beginning of this trend. It's not fundamentally what's driving the market just yet, but ultimately raises the risk that we have this sort of AI flywheel whereby the Fed cut into a boom.

Dirk, more broadly, given everything that's going on, how do you think the markets are going to react to it?

Willer (04:46)

It's a two-part question, right? I mean, first, "How will the market take it if employment improves?" And that is interesting because the Fed is, of course, cutting only because of the employment mandate.

And it's not clear just how much employment you need to keep the unemployment rate steady. So there was a Dallas Fed paper that argued with slightly negative net immigration, you only need 30,000 jobs a month. And with small positive net immigration, you need 60,000 jobs.

You don't need these 150K type of NFPs in the current labor market, given the supply side. And from that point of view, yes, if NFP recovers, then the Fed will have to become less dovish. And of course, a big part of the narrative for the equity-market rally is that the Fed is cutting into a bubble, is cutting into at least a very strong bull market. And that has never happened before. But that is really part of the bullish narrative.

So, if we have to give up on a dovish Fed, there will clearly be a hiccup in the equity market. We don't think it would be that huge, and we think it would be temporary. The reason is twofold. First, as the drop market recovers, the recession risk would of course go to zero. And we have a model that tries to suss out whether good economic news is good news for the equity market or not. Currently, the model is saying good news is good news, which is actually the normal behavior during easing cycles. So, the market likes good data. That can change, of course.

But the other big argument is that we will get a new Fed chair and from May onwards next year will potentially be a Fed led by someone much more focused on supply-side economics and therefore probably somewhat more dovish, and less focused on inflation, at least in the short term. And from that point of view, we think that the selloff will be somewhat contained, if the Fed turns more hawkish under Powell.

The second question, though, is "What happens if the AI job cuts come?" And eventually they will. And then — you hinted at it already, Adam — we see this flywheel kicking in, where job cuts may happen due to AI; as a result, the Fed cuts; the market goes up more; you get more capex; CEOs feel better about it; you get more job cuts as a result of that capex into AI; and so it continues.

So that would be really quite bullish equities, of course. And so, we are really very positive into the end. We had originally upgraded U.S. equities overweight back in April, but last week we increased our overweight.

Adam Pickett (07:20)

Dirk, that's all well and good, but equities are at the highs. It seems like there's already a bunch of optimism placed in. Do you really think pushing and adding length at these levels makes sense?

Dirk Willer (07:30)

Yes, very good question, Adam. And we have two studies. First of all, you cannot find any proof that buying a market at the highs is necessarily a negative for the outcome. That's, of course, in the context of a long bull market that the S&P has had, so on average, it has not hurt you.

But maybe much more importantly, we did a lot of work on the seasonals, and especially what we call conditional seasonals, meaning the returns for November and December dependent on what the returns were from January to October. And it's really quite interesting, but if you get this strong January to October performance that we had this year, you have a 94% hit ratio for a positive combined November/December return and a sort of point estimate is actually a return of 5% combined over those two months.

So that is of course very strong and the negative outcomes are really quite small and very few. Now to believe in the seasons, I think you have to ask the question of why they happen and that gives you more confidence in them. And I think there are three reasons.

One is that investors suffer from recency bias: If recently things were going well, they expect the next year to go well and they want to pre-position for '26. And certainly I think people are bullish for '26, when they expect probably still some fat cuts, a bit of a fiscal boost, tariffs sort of fading away, and some deregulations overall. I think people want to be long going into 2026.

The second reason is that the investors who missed the trade have still time to catch up and to beat their benchmarks. And we see some of that behavior late in the year as well.

And then the last one is that you get reduced tax-loss selling, right? Because there are fewer losses around if the tape was strong. And that also is helpful for the market. So, all that suggests to us that into year end, yes, the market is obviously not cheap, but you still want to be long.

So, summing up the discussion, our best guess is that the weak labor market is so far mostly about high rates and maybe a little bit about lag tariffs. Eventually it will kick it in, but so far, the evidence is still really quite weak. But when that happens, the equity

market could really benefit from both the productivity, of course, but also from renewed Fed dovishness. And that keeps us bullish equity capital.

Thank you for joining us today. This episode was recorded on Nov. 3, 2025, and I'm your host, Dirk Willer.

For more details, Citi clients can check out our report on the Citi Velocity portal. If you enjoyed the podcast, please leave us a review on your favorite podcast platform.

Next week's Research at Citi Markets Edition will be hosted by Beata Manthey, Citi's Head of Global Equity Strategy. And be sure to watch our Research @ Citi podcasts, which you can view on the same channel. The macro strategy team will be back in two weeks. Stay sharp.