Research @ Citi Podcast Markets Edition: Reassessing the Balance of Risks

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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 Head of European and Global Equity Strategy. Joining me today is our Senior Equity Strategist, David Groman. Welcome back to the show, David.

David Groman (0:21)

Thanks, Beata. Great to be here as always.

Beata Manthey (0:24)

David, there's been a lot for markets to digest recently: AI volatility, the U.S. midterms, and potentially improving prospects for peace in the Middle East. So let's start with the backdrop. What has been happening in equity markets over the past few weeks?

David Groman (0:41)

Yes, as you said, quite a lot. I think what's been most interesting to us is that really until last week, global equities looked super calm at the index level, but beneath the surface, there was violent rotation going on. So both in the U.S. and in Europe, defensives had outperformed cyclicals by as much as 15 percentage points over just a month, and equal-weight indices had also outpaced their market-cap-weighted peers.

Beata Manthey (1:05)

And that's unusual?

David Groman (1:07)

Very. So we've found that these types of steady-market violent-rotation events, especially of this size, are incredibly rare, and typically they only show up in major market stress episodes. That's like 2008, 2020, and 2022. We've now seen some volatility in the AI trade spilling into the broader market, and that means that we're getting more questions if this turbulence will turn into something more akin to those past downside examples.

Beata Manthey (1:30)

So how do you see near-term risks?

David Groman (1:34)

The investing environment is really difficult to unpack, but risks still look roughly balanced rather than significantly skewed to the downside.

So let's just look at where things stand versus one month ago. On the positive side, oil prices have fallen pretty meaningfully as geopolitical risks have showed signs of easing. Bond yields and Fed pricing are well off their highs from months ago. And macro data has also stayed relatively resilient over this period.

Beata Manthey (2:00)

And the negatives?

David Groman (2:01)

Credit spreads have certainly risen. Earnings revisions, which had been really strong for the past few months, have decelerated. And obviously, AI sentiment has taken a plunge.

So we've had movement on both the bullish and bearish sides of the ledger here. But I think with equity valuations ultimately resetting lower, while 2027 EPS forecasts have stayed basically the same, we still see reasons to stay constructive on a medium-term horizon, at least for now.

Beata Manthey (2:28)

So the balance of risks looks OK, but with a lot of uncertainty. But let's talk for a few minutes about the events of last week, the U.S. midterm elections, and how they play in there. Can you quickly talk us through the results first?

David Groman (2:44)

Sure. To summarize, this really was a blue wave for Democrats, who took control of both the House and the Senate. And there were also some key wins for Democrats at the governor level, most notably in Texas.

I think for markets, there was some hope that the midterms would ultimately be a clearing event, as historically equities are pretty volatile heading into midterms but you see some seasonal improvement afterwards. But the scale of the Democratic victory has helped trigger a further deterioration in sentiment around AI, as there's some worry that policymakers can ultimately push for a slowdown in data-center capex and AI buildout more broadly.

And of course, it's hard to say exactly how this will play out from here, but consensus analyst forecasts currently see AI capex rising from around $1 trillion this year to $1.5 trillion next year, and potentially well beyond that out through 2030. So it's the capex growth in those out years, which flows directly into the cash flow of chip makers, for example, that's very much in focus now.

Beata Manthey (3:41)

Interesting. Anything else that investors should be watching?

David Groman (3:45)

So many things to be watching, but healthcare is another one I would point out. So our U.S. strategy colleagues had expected a blue sweep to set up for improved sentiment on healthcare spending, and calls to reinstate Medicaid spending cuts have already started to unfold. So this could be one of the sectors that is seen as a relative beneficiary coming out of this election.

But, Beata, obviously a lot has happened recently. So, what does it actually mean? And how are we allocating across global equities?

Beata Manthey (4:12)

We believe the events of the past weeks, together with the potential for energy prices falling further, would have an impact on global equity allocation. We have made some changes over the weekend ourselves. We've tactically downgraded the U.S. from Overweight to Neutral, and we've also neutralized our growth exposure.

David Groman (4:43)

And the upgrades?

Beata Manthey (4:45)

Continental Europe moves to Overweight from Neutral. The market is less sensitive to AI and more levered to falling oil prices than peers. Japan remains an Overweight. So overall, we argue that the setup is starting to look more favorable towards the rest of the world's equities, at least for now. Globally, our sector strategy is now a barbell of cyclicals and defensives.

David Groman (5:06)

Yep, so it all makes sense. But obviously, our market targets for next year are still fairly constructive. So what's behind that? And what should investors watch out for that might change this?

Beata Manthey (5:16)

Lower rates, still-resilient economic data, and potential easing in geopolitical risks — all to watch out for. But global EPS growth is expected to slow by about 20 percentage points in 2027. We find that in positive but decelerating years like that, global stocks have risen only by about 4 percentage points on average, but with a rotation towards defensives and quality.

Concentration is also another concern, because Tech's share of global EPS growth is rising in 2027, not falling. So a lot to think about into the next year.

But I'm afraid we have to wrap it up for now, David. Thank you very much.

David Groman (5:59)

Of course. Happy to be here.

Beata Manthey (6:00)

Thank you for tuning in. This episode was recorded on the 9th of November, 2026. 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 listening. Goodbye for now.

Disclaimer (6:17)

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