Research @ Citi Markets Edition: Lessons and Views Post-Davos

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Opening Teaser: (00:00)

Research @ Citi Markets Edition.

Dirk Willer (00:04)

Welcome to Research at 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 (00:15)

Thank you so much for having me, Dirk.

Dirk Willer (00:17)

We are recording this podcast at 9 a.m. on Monday, Jan. 26, 2026.

Coming back from Davos, there's much to discuss. The two big themes were geopolitics as well as AI. Both are very market-relevant. So what did you think we learned?

Let's start with geopolitics. Going into Davos, the key question was how the Greenland crisis would play out. In the end, it appears that the maximalist demands by the U.S. administration for Greenland were once more part of the Art of the Deal, even though some European resistance and a weaker equity market may also have contributed to the U.S. administration paring down its demands.

Still, to some extent the damage was done, as Canadian Prime Minister Carney summarized in his speech, where he suggested that middle powers like Canada, but also like Europe, should stop relying on the old rules-based global system for protection, and instead should cooperate strategically rather than relying on old alliances.

Now, the interesting market aspect of all this was that at the height of the crisis, we saw a fall of the S&P combined with a weaker dollar, somewhat reminiscent of the April 2025 behavior. This correlation used to be unusual, but it's now more common when U.S. exceptionalism is questioned.

Even more importantly, as the Greenland crisis faded, the S&P recovered but the dollar did not. On the contrary, the euro kept moving stronger. This is interesting and may well set us up for more dollar weakness. Adam will discuss the issue more in depth.

The other big topic in Davos was AI. Many of the large AI companies and some of the star researchers were in Davos and opined on the geopolitical aspect of AI, the path to monetization and the time it would take to reach AGI, Artificial General Intelligence. We think for equity markets, the AI debate is more important than geopolitics as it impacts the earnings power of the corporate sector much more directly and faster.

In particular, strong earnings this earnings season would go a long way to calm investor sentiment. Furthermore, if AI is fast in impacting the labor market, it has important implications for the Federal Reserve. Only if AI is going to meaningfully contribute to a weak labor market can cuts be easily justified, no matter who the new FOMC chair should be. Such cuts are part of the bullish equity narrative, too. We at Citi still see cuts, even though not this week.

Given that the AI story seems on track, and as we do expect some Fed cuts, we stay the course long equity markets, even though we would also note that some of our more tactical signals suggest short-term caution.

Adam, the team has done a lot of work on the dollar and diversification flows. How do you see this in the light of the latest developments?

Adam Pickett (02:57)

Thanks Dirk. Our immediate-term view that we put out last year was that the U.S. exorbitant privilege is increasingly an equity trade, not a treasury trade, which is to say that the traditional relationship between equities down and dollar up, we were calling into question. And so it's not too surprising to us that we've had another example of that, but it does make us want to dust off our post-Liberation Day playbook.

Now, that's a good narrative. You know, we had dollar down on the tariffs. We didn't really have it recover when the tariffs got taken off and then dollar down again quite broadly across G10 with the risk rally to the end of the week. So that's one tick.

The other tick in that box would be more obvious examples of real flow rotation rather than just the dollar weakening. And some of these metrics are longer-term, hedging flow indicators from the Scandinavians, bigger-picture equity flow and allocation data.

One thing we can track a little bit by frequency using ETF flow data is a proxy for cross-border equity flows. Those have started to move in favor of Europe. So Americans buying more Europe and Europe buying less America in equity space. And ultimately, we think the bar for diversifying has been lowered last year simply by returns. In ‘25, diversifying slightly away from the U.S. was a brave decision. The U.S. performance the year before had been very strong relative. Now we're coming off one of the worst years the U.S. has ever had in terms of local price performance vs. the rest of the world. And that was even worse when you took FX into account.

So, you know, we're not for one minute saying you shouldn't be overweight the U.S., it's just that there are some rest-of-world opportunities now to be buying into and so that's the way that we're allocated — we're overweight the U.S., but we also have China and Japan. But in FX, I think they're a tentative sign that some of this policy uncertainty and some of these equity fragilities can also be dollar-negative. So we're long euro targeting a move toward 121.

Dirk, elsewhere in FX land, the yen move has been pretty stark. How are you thinking about all things Japan?

Dirk Willer (5:00)

Yeah, that's the other key story that coincided really with the whole Greenland issue. The last leg of the Japan story was, of course, the rising likelihood of snap elections. And indeed, they're now going to take place on Feb. 8.

Going into the election, a two-year holiday for VAT on food items has been suggested by the prime minister. This added to fiscal fears that led to higher rates in the context of a steeper curve, to higher equity markets, and to higher dollar-yen, which was driven really by term premia.

Now, we had actually taken off our long-lasting JGB underweight last week as a likelihood of intervention in both dollar-yen and JGB was clearly rising. Since then, JGB has rallied as did the yen, partly because the Fed has been checking rates on dollar-yen.

Now, this could be because the Fed acts as an agent for the Japanese Ministry of Finance or because joint intervention has become more likely. We do not know yet how that will play out, but I have a few thoughts that I want to share.

First, bilateral intervention is a lot more effective than unilateral. So that will be important to watch. Second, intervention usually just builds a bridge to a situation when fundamentals change too. So if fundamentals don't change, the impact of intervention is usually somewhat short-lived and can be measured in days or weeks, rather than months.

So what could change fundamentals, or what could make sure that dollar-yen keeps going lower? One, again, would be bilateral intervention that would be really quite powerful potentially. Second would be better fiscal. If it turns out that the fiscal concerns are somewhat overdone post-election, that would clearly help. Or third, a more hawkish BOJ that could control term premium. It might not necessarily lead to lower rates in JGBs, but certainly to lower term premium, and that might also help.

So a lot of uncertainty whether any of those three factors can be achieved or not. For now, I think the market is correct in trading a bit more carefully and unbinding some of these stretch positions.

But Adam, overall I would say it's not just Japan. Rates have become more difficult to trade. There's no clear-cut easing cycle anymore ongoing in many countries, which is usually the easy money. And so, the team has focused much more on relative value in rates. Walk us through your thoughts on that side, please?

Adam Pickett (07:15)

So it seemed to us like last year when some front-end curves repriced from cuts to hikes, it dragged a lot of other G10 curves with it, and we thought maybe that was a little bit overexuberant. So firstly, we looked at historical precedents for hikes, and actually in the ‘90s, the gap between last cut and first hike was measured in single-digit months for a lot of DM, and we think that we're probably closer to that type of backdrop with inflation and shorter growth cycles than before.

So can we get hikes this year? Yes. Can we get hikes broadly? We don't think so. In Australia, yes. In Japan, yes. So we're paid Aussie vs. CAD. We have been since mid-December out to Z6. We think that still makes sense given all the strong overmarket data out of Australia plus the additional threat of tariffs in response to Carney's speech. And elsewhere in Norway and Sweden, again, looking at relative inflation profiles, you've got inflation in Norway that's typically consistent historically with the start of hikes and in Sweden, that's nowhere near. We've got negative inflation deltas. So within the G10 space there's plenty of opportunities to fade this idea of synchronized hiking cycles.

Dirk Willer (08:35)

Thank you, Adam.

So overall, we believe that the fact that the Greenland issue has quieted down does not necessarily mean that the dollar weakness is behind us. For equities, the AI story is more important than geopolitics, and we stay strategically positive, even though some of our short-term tactical indicators are somewhat less constructive.

Thank you for joining us for today. The episode was recorded on Jan. 26, 2026, and I'm your host, Dirk Willer. For more details, Citi clients can check out our report on the Citi Velocity portal.

Next week's Research @ Citi Markets Edition will be hosted by Beata Manthey, Citi's Head of Global Equity Strategy. And be sure to watch our Research @ Citi podcast, which you can view on the same channels.

Disclaimer (09:18)