Research @ Citi Markets Edition: From Penalty Kicks to Macro Risks

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Transcript:

Opening Teaser: (00:00)

Research @ Citi Markets Edition.

Alex Saunders (00:03)

Welcome to Citi @ Research Markets Edition, where we break down global macro in 10 minutes or less. I'm your host this week, Adam Pickett, Citi's Macro Head in London. We are recording live at 9.30 Eastern on Monday, July 27, 2026.

I am here with my esteemed colleague, Alex Saunders, Head of Quant Macro Strategy. Hello, Alex.

Alex Saunders (00:27)

Hi, thanks for having me, Adam.

Adam Pickett (00:29)

So we put out the House Views theme. In essence, the Middle East conflict has re-escalated the surge in oil prices, and that's clawed back a decent amount of June's losses.

And so, when we start with equities, for example, despite the shift in geopolitics, are we still staying risk-on in equities, Alex? Or are we trimming? What's the story there?

Alex Saunders (00:51)

I think, as the title suggests, we've gone from an era of easy, sort of low-risk, high-conviction trades — the penalty kicks — to much more macro risks. As you said, we've got these geopolitical cross-currents, also have inflationary concerns with the oil price, and AI-related concerns in terms of the investment.

So that has changed the outlook somewhat, but we're still staying risk-on. We maintain an overweight equities standpoint.

I'll make a couple of points. The first one is that these cross-currents have led us to tactically reduce some equity risk. So earlier in July, we reduced our EM Asia overweight. But the fundamental backdrop is OK. Earnings revisions are strong, albeit those expectations are high, judging by the price reactions post announcements. But when we look at positioning, it's come in quite a bit, actually. And if we look at sentiment, it's not overly bullish.

AI, as I mentioned, is front and center. And to recap some of the prior work of you and the team, Adam, which uses shale as an analogy, capex spending by itself is not necessarily a reason for the market to peak. The market peaks when the fundamentals weaken. Fundamentals, in that case, were the oil price.

Here, the concerns have been around open-source models. The big picture: We still think that Jevons paradox applies and that there'll be an increase in demand as prices fall. But having said that, the risk is two-way.

The closed-source models are responsible for a decent amount of the order backlog, so profitability risks there could reduce some of the demand for chips and some of the underlying components. And then there's also regulatory risks.

Adam Pickett (02:33)

Super-interesting — and so where does that leave us on the geography split overall?

Alex Saunders (02:38)

Yeah, overweight U.S. We maintain that still that's the best place to gain AI exposure, but then we're neutral the rest of the world at the moment.

Adam Pickett (02:47)

Interesting. If you had to drill down into sectors, what do you like, Alex?

Alex Saunders (02:52)

Sectors are similar, so keep that tech overweight as well, but also somewhat diversified again into cyclical exposure. So we're trying to stay away from some of the oil-price theme where it's very much two-way risk. So we have an industrials position on as well.

Adam Pickett (03:07)

And any risks that we're watching in the big picture?

Alex Saunders (03:11)

That's a great question, Adam. I would highlight that we do have this Generals trigger, which really tracks all bubbly concerns or concentration risks around bubbles. Technical-based signal, it's flirting with trigger levels.

So the risk-on stance is somewhat fragile. Obviously, we have these geopolitical cross-currents. We also have the Fed later this week. So there are caveats, I think, to our view.

Adam Pickett (03:38)

Interesting, that's great. And you know, as a reminder for the audience, it's tracking the breadth of the top seven market-cap names in the S&P. How many of them are above or below their 200-day? We started to trigger late last week. And, interestingly, if it continues to stay in a negative stance, it would trigger for good the day of the Fed, or the day before the Fed, so an interesting setup.

In light of the Fed discussion, I'll turn over to sovereigns. We still keep a neutral stance. What we've kept is our underrated U.S. rates. I would say that really comes from an RV angle, in the sense that in the moment we still think across G10 one of the places that still has domestic, endogenous inflation and growth risks is the U.S. And to some degree, if we are to take away the Iran risk or move beyond peak Iran risk — which some of the headlines over the weekend maybe suggest we're getting close to — we think the rally or the reprieve in ex-U.S. duration could be stronger, given most of the inflation concerns there are external.

And we've mostly been playing that in European duration. We were previously overweight Gilts, but we decided to change that up and move Gilts back to neutral and go overweight Bunds instead. And ultimately, we think Gilts are more sensitive to global energy spikes. We see that from our analysis, as well as some local fiscal vulnerabilities rearing their head again as well.

Alex Saunders (05:05)

On that Adam, [new UK Prime Minister] Burnham has given some interviews. We now have a cabinet out there as well. What's your initial take on the political backdrop?

Adam Pickett (05:12)

It's still pretty light on detail, I must say. There's obviously the intent to work within the fiscal rules, although I think the key push on the idea of trying to find as much flexibility as possible within those rules maybe slightly spooked the market on the margin. We've seen a little bit of cross-market curve steepening in the back end 1030s in the UK relative to European peers, which maybe suggests just a hint of the fiscal worry, but for now we're still in wait-and-see mode.

But ultimately we just think Bunds are a cleaner, safer haven to capture maybe some of those Iran risks eventually coming away.

Alex Saunders (05:47)

And then JGBs have been selling off. We were underweight, but that was brought back to neutral. Can you talk about that a little bit?

Adam Pickett (05:55)

Absolutely. We cut our underweight in JGBs more on the sentiment around some of these announcements, hinting about shifts in flows, both from the GPIF and NISA accounts, trying to sort of push money back into JGBs. In our discretionary portfolio, we moved the underweight back to neutral and in effect targeted the front-end pricing more.

So our view is that there's just more juice in playing for a hawkish BoJ rather than to be outright underweight duration. So we're neutral in the asset allocation just because we think the long end's got a bit more noise around it. But ultimately, from a sort of existential view, we still think the BoJ is slightly underpriced.

You know, I think we've done a good job of covering fixed income in the sovereign space, but Alex, what about credit? And how are we thinking about credit in the context of our asset allocation?

Alex Saunders (06:44)

We're underweight in the U.S. and in Europe investment grade. And it's been a relatively long-standing view, to have this underweight, and we've been tactical around it on and off. But the basic premise is really that in risk-off environments, on a risk-adjusted basis, credit typically underperforms.

And therefore, the credit underweight is not really a view on the asset class per se, it's much more of a hedge for, I would say, the portfolio’s active risk. Spreads are not particularly wide, as well. So in terms of the cheapness or expensiveness of that hedge call, it's not that unattractive.

I would say that my regime work also shows that financial conditions tightening almost always proceeds or is at least contemporaneous with some of the less-benign macro backdrops that you have for risk assets — so, stagflation. We see, periodically, concerns pop up. That nearly always happens with the financial conditions tightening. Credit spreads are a pretty important element of that tightening.

And then the final point, I would say at the moment, is the supply pressure. So from a fundamental perspective, we've seen a decent volume of new IG issuance that has weighed on spreads a little bit. It has increased the weighting of AI-related risk in some of the credit indices, and our credit team has done a great job in terms of quantifying that. And in terms of that AI, we think that the risk-reward basis for AI accrues much more to equities than it will do to the credit. So we think of the view as a technical basis; we think the underweight has this technical basis from the supply overhang, but also acts as a decent risk hedge.

So if we finish off the portfolio run with our commodities and our dollar view, we're overweight commodities, are neutral on oil. Can you comment on that?

Adam Pickett (08:38)

Yeah, absolutely. Energy, I think, is really just far too up in the air right now, just given the negotiations between the U.S. and Iran and even structural OPEC dynamics beyond that.

Instead, our higher conviction is in base metals. We still see this as a reasonably strong cyclical global backdrop. And in particular, copper has been incredibly resilient to the backdrop in geopolitical tensions, which we see as a net positive. You know, there are some structural EV-transition and AI tailwinds for that space as well, so we like it there.

Neutral gold, just because pretty large pullbacks but a real rates picture that is still looking quite perky. So not clear to us that it's still clear there on gold.

And in FX, we moved neutral on the dollar in the middle of July, right after the soft CPI print. And ultimately when we look at our EUReka framework — our model for eurodollar relative rates, relative equities, relative terms of trade and relative data momentum — it's really only relative equities that are in favor of euro. So, it's a mild dollar-bullish signal from the model.

But a lot of those crossovers or signals are super close to being flipped. And so obviously with U.S.-Iran and with the Fed ahead being such big catalysts, that model is liable to jump about a bit, which I think is a good way of wrapping up a lot of investor sentiment around FX at the moment. A lot of the signals are sort of balancing on a knife edge, and it's difficult to take too strong a stance.

Instead we're hiding out in FX carry but in currencies that also benefit from higher energy prices within that carry basket.

So that wraps it all up. As a quick, high-speed summary: We're overweight equities primarily out of the U.S., and we like tech and industrials and sectors. Within commods, we like base metals but are neutral everywhere else. We're underweight IG credit. Neutral on rates with a bias towards underweight treasuries versus Bunds.

Citi clients can access the full report on Velocity. Reach out if you'd like to see more of it.

The macro team will be back in two weeks, and we look forward to speaking to you.

Disclaimer (10:38)