

Research @ Citi Markets Edition: VAR – Volatility Also Rises

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Opening Teaser: (00:00)

Research @ Citi Markets Edition

Dirk Willer (00:03)

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 Head of Macro in London. Welcome to the show, Adam.

Adam Pickett (00:15)

It's great to be here, Dirk.

Dirk Willer (00:17)

So we're recording this podcast at 8.30 a.m. on Monday, Oct. 5, 2026.

Rates have been rising and risky assets have not cared very much. Why is that? And can it continue? We think there are a few ways to look at that.

First, and we made that case for a while, the level of the 10-year Treasury yields is just not very predictive for what risky assets do, and how equities behave. The level of the MOVE index, meaning the volatility of the Treasuries, is much more predictive. And that, of course, has been really a no-show for a long time, but recently has started to move higher. So this is raising the risk that equities will eventually be impacted by rates.

Now, the good news is that these MOVE spikes tend to be quite short-lived. And we also found a pattern where the MOVE tends to go up around the first hike — actually, somewhat interestingly, slightly after the first hike — but then comes down once it's better understood what the Fed has in mind in terms of the hiking cycle and then the speed of it.

Now, that is reassuring, but of course one issue is that the back end has recently developed a little bit of a life of its own, and there seems to be somewhat of a buyers' strike going on. For example, if you look just in 2026, auction weeks have meaningfully

worse performance for bonds than non-auction weeks. And that is much more the case than it used to be in previous years.

So it's not that clear what breaks this buyer strike in Treasuries. It could be a combination of a more dovish Fed, maybe skipping October. It could be the refinancing announcements in November where fewer coupon bonds could be sold. But it's really uncertain — and to the extent that the move in the volatility index is less driven by the Fed cycle and maybe more by a buyer strike, that raises certainly the risks for equities.

But we also think it's wrong to say that the market has ignored rates, because under the hood a lot has happened. So first of all, valuation has come off with rising rates. And of course, the way to think about rates, it should be much more about valuation than about the level of the equity index that has been really strongly held up by very impressive earnings growth performance. So it's not true that nothing has happened.

And then secondly, of course, on a sector level and also on a small-cap level, there have been pullbacks. And if you are a rate-sensitive sector, you have pulled back meaningfully. And so it's really the large-cap growth names that are keeping the S&P from pulling back.

And so net-net, I would say we stay invested in equities, partly also because better seasonals will kick in soon. The recent data flows address that the MOVE index could become a problem, but it also could come back soon — and some of it is already priced. So we stay constructive on equities here.

But Adam, the MOVE index is also impactful for other asset markets, like for FX in particular. What are you seeing on that side?

Adam Pickett (03:08)

The MOVE index features within our cross-asset volatility indicator. We regularly use it as a cutout signal for our EMFX carry trades. And it recently went above the two-sigma level that we find really improves your Sharpe ratios by cutting out of. We did get out of our recent EMFX carry trade there, and we'd really prefer to see cross-asset volatility come lower to re-enter a trade like that.

Outside of the MOVE index specifically, I would also flag that at least some of the move in global rates has been triggered by a move in global commodities. Initially, it was mostly oil, but increasingly it's become product prices, with a heavy focus on diesel.

If we borrow from our commodity-strategy colleagues' work on diesel exposure, in particular, we find the countries with large net shorts in terms of consumption vs. production of diesel. A lot of APAC, but also Mexico and Brazil in LATAM are vulnerable. But interestingly, when we look at the FX impact, we've actually found significantly more sensitivity in places like the Mexican peso and the Chilean peso.

Dirk Willer (04:18)

And let's shift to France. I think we all expected some volatility going into the election, but what was surprising is that the markets started to trade so poorly so far in advance of the election. What's your view on that developing story?

Adam Pickett (04:31)

So it doesn't look like there's really any appetite or frankly much avenue for a French fiscal consolidation, which clearly leaves OAT Bund spreads quite vulnerable. And certainly when we look ahead, we struggle to see much in the way of an election outcome that actually provides an avenue for the necessary consolidation.

But in terms of the overall setup, it's really been a perfect storm, whereby we've known that France's fiscal position is bad and arguably unsustainable. But adding into this mix a very aggressive ECB hiking cycle and especially a very aggressive meeting in September, OATs were part of a popular carry trade. You also added into that mix the energy-price dynamic as well, which is not great for European fixed income. And it seems to have conspired to give us quite gappy, almost stop-out type price action.

I think going forwards, it's clear that French government bonds and arguably French assets overall would probably like the idea of the ECB moving slower. And certainly, the market has started to price out hikes from 2027. It's not obvious that the OATs have massively loved that just yet. They've responded slightly positively. I suspect also OATs would really like energy prices coming down as well. And so, interesting to see where the European diesel release dynamic goes as well.

So certainly less stress than 2011, probably more avenues out of the bad situation in 2011, not seeing much contagion either. And I think initial first steps would probably be for the ECB to message that they're going more slowly. So overall, it arguably makes probably euro FX the more vulnerable asset to all of these dynamics, where even the good scenario still suggests a little bit of rate compression between the ECB and others.

Dirk Willer (06:17)

Interesting. Yes, it could be more of an FX story.

But it's also interesting from the rate side, where just as the market really was getting ready or was getting paid in a lot of markets, we got the France story really slowing things down, maybe for the ECB potentially. And we got also, of course, a quite weak NFP print here in the U.S., which also maybe takes away the urgency of payers a little bit.

But we went through an exercise thinking through where payers could still make sense, maybe on a pullback. And if you just look at the CPIs at the start of hiking cycles, it is

probably the single most important variable to look at, to figure out how far above neutral these hiking cycles will have to go.

And the somewhat reassuring message is actually that for all the G10, where we ran this exercise, the markets seem to price enough. However, the other finding really from that study is that it's really very rare that market rates peak at the front end even before the first hike has even happened. And that is true for all the cycles where at least 100 basis points of hikes happened throughout that cycle.

Adam Pickett (07:26)

That's pretty interesting, Dirk. I mean, where would that leave you in terms of mispricings, or places where there's vulnerability to repricing?

Dirk Willer (07:36)

G10 central banks that haven't even started yet and where the market is pricing that type of hiking cycle or more is, of course, BOC, BOE, Riksbank and SNB. I think every case has to be discussed on a case-by-case basis. For example, BOE, we are positioning that probably go in November, but probably not go twice in a row.

So you have to really go case by case. But I do think this rule that it is unlikely that the selloff is over before the first hike has happened applies to those four central banks.

Great. Just in summary, rising fixed-income volatility is raising the risk that equities and other risky assets will start to queue a bit more into these rising rates and take that more seriously. However, keep in mind that volatility spikes are really short-lived and they tend to calm down after the first hike. And also, under the hood the equity market has actually done some work to price that volatility.

We therefore stay positive. High-carry EMFX is more vulnerable to this continued high fixed-income volatility, and therefore, a few weeks ago, we reduced the positioning there.

So thank you for joining us today. This episode was recorded Oct. 5, 2026, and I'm your host, Dirk Willer.

For more details, clients can check out our reports on Citi Velocity, and next week's Research @ Citi Markets Edition will be hosted by Beata Manthey, Citi's Global Head of Equity Strategy. Also, check out our Research @ Citi podcast, which you can view on the same channel.

The Macro Strategy team will be back in two weeks. Stay sharp!

Disclaimer (09:05)

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