Research @ Citi Markets Edition: Hawks vs. Bulls — Into the Knockout Stages?

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Transcript:

Opening Teaser: (00:00)

Research @ Citi Markets Edition.

Alex Saunders (00:03)

Welcome to Research @Citi Markets Edition, where we break down global macro in 10 minutes or less.

I am your host today, Alex Saunders, Head of Quant Macro Research, and I'm joined by Alice Zheng of our Global Macro Strategy Team. Welcome to the show, Alice.

Alice Zheng (00:18)

Thanks, Alex. Happy to be here.

Alex Saunders (00:21)

We're recording this podcast at 10 a.m. on Monday, June 29, 2026.

First, let's talk about Kevin. We saw a hawkish debut from the new FOMC chair, which fit with the historical pattern of rates markets selling off on the first meeting of a new chair.

Why was that? Firstly, we got a hawkish dot plot from the other FOMC members, but we got very little in terms of forward guidance beyond an emphasis on price stability from the chair himself. We did get a plethora of task forces, one of which will cover communications — which we expect, like the statement, to be more terse than under previous chairs. This probably means more volatility around data releases.

The other large change in markets has been oil prices, which have fallen in anticipation of de-escalation and the memorandum of understanding between the U.S. and Iran. We have made the point before and elsewhere, that rate hikes tend to be oily and it is very difficult for fixed-income markets to look beyond oil-price shocks, even if they're thought to be temporary in nature.

Now, however, oil prices are back to pre-war levels, which means that central banks that reacted to higher oil prices and whose front ends are more sensitive to oil price moves, namely UK, EU and Sweden, stand to benefit more.

The potential hawkish turn on the FOMC committee, plus the fact the U.S., as well as some other countries in EM Asia, are the primary beneficiaries of the AI capex booms, suggests relative value opportunities in fixed income.

That covers the rates section, but what do these themes mean for the dollar and FX markets, Alice?

Alice Zheng (02:07)

Thanks Alex. We have moved more bullishly on the dollar. As you mentioned, oil prices have dropped with the de-escalation and G10 rates have generally followed the path of oil, both higher and lower. But the U.S. front end stands out here because rates have stayed elevated even with lower oil.

Other than Chair Warsh being more hawkish than expected, domestic factors, with inflation from AI and improvements in the labor market, have kept front-end rates elevated. The sustained divergence in central-bank policy, where front-end policy in the U.S. is decoupled from Brent oil prices, unlike other G10 central banks, has solidified the case for a stronger dollar.

From the more quantitative side, our Fed policy-stance proxy, which is based on forward rates, break-evens, and S&P performance, indicates that current Fed pricing is tight relative to economic conditions. We find that periods with tight Fed policy stances are typically correlated with stronger dollar returns.

From the flows perspective, we've definitely seen this play out. Citi flows data shows that net inflows into dollar from both leveraged and real-money accounts have increased. And CFTC data also shows the largest net bullish USD positioning in over a year.

In our asset allocator blocks, we also saw large asset managers reduce their dollar short significantly over the past month. The AI trade and U.S. exceptionalism will also be key to the dollar trade. Alex, what are we thinking on that?

Alex Saunders (03:29)

Thanks Alice. I mean, the final point to make there is that we're calling for extra time on the AI trade, or at least on the equity trade. The first point to make is earnings revisions have been very strong, which is typically a good backdrop for equities. We have another earning season starting in just a couple of weeks, and we'll get a lot of new information, but earnings revisions don't tend to act as a contra indicator, so it seems too early to fade. Our U.S. equity strategist also recently upgraded his year-end estimates on stronger earnings fundamentals.

That same too-early-to-fade point can be made on the Fed. The bear markets in 2007-2008, and post the dot-com bust, came against the backdrop of the Fed actually delivering interest-rate hikes.

For all that hawkish Fed-speak that Alice had mentioned, we have not seen a hike yet. Central-bank liquidity also remains accommodative. Now, this may change — there's a task force for that. But at present, there's no reason for concern.

The caveats to that positive backdrop are technical and worth monitoring. If we see several of the leaders or the so-called generals breaking down, that would be cause for reassessment. Finally, we think having credit underweights is a good hedge for equity risk, as we think a scenario of an equity sell-off without financial-condition tightening is unlikely.

So overall, a potentially hawkish Fed coupled with declining oil prices gives rise to relative value opportunities in rate space and in trading the dollar, while not yet giving us concern on equity risk.

Thank you for joining us today. This episode was recorded on June 29, 2026. I am your host, Alex Saunders, standing in for Dirk Willer. For more details, Citi clients can check out our report on the Citi Velocity portal.

And next week's Research @ Citi Markets edition will be hosted by Scott Chronert, Citi's Head of U.S. Equity Strategy.

Be sure to watch for our Research @ Citi podcasts, which you can view on the same channel. The macro strategy team will be back in two weeks. Stay sharp!

Disclaimer (05:42)