

# THE SHORT AND LONG

Weekly Bulletin

## Bonds offer income as rates and equities churn

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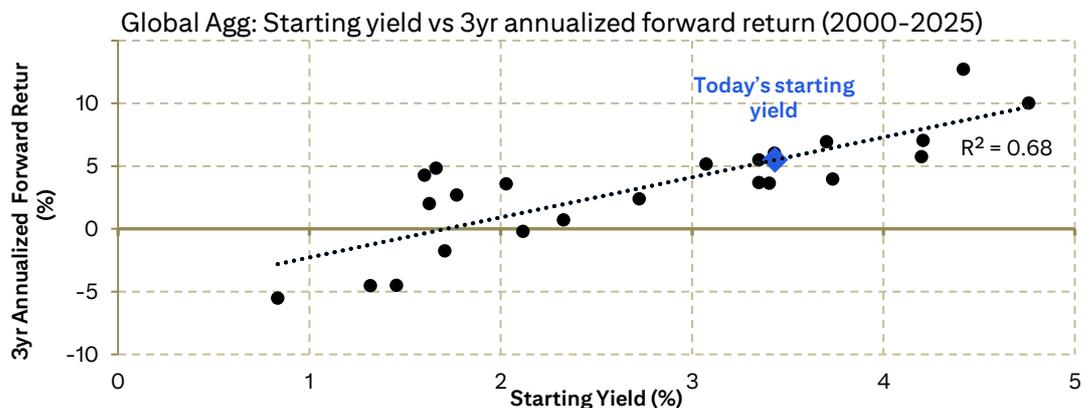
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### TAKEAWAYS

- High-quality, low-duration fixed income remains attractive in this environment. Elevated yields provide a strong starting point, but macro conditions argue for patience on duration and discipline on credit.
- Global earnings trends remain supportive for the market backdrop. Secular winners continue to impress with strong earnings growth, while above-trend growth in cyclical regions and industries provides a near-term foundation for the rotational market.

### This week in charts

**FIGURE 1: Starting yield levels are a good predictor of forward returns.**



Source: Bloomberg as of February 17, 2026.  $R^2$  measures how closely the movement of a dependent variable (3yr annualized forward returns) can be explained by an independent variable (starting yield). In this chart, it shows how strongly starting bond yields have historically been linked to the total return investors earned over the following three years. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Index returns do not include any expenses, fees, or sales charges, which would lower performance. Past performance is no guarantee of future results. Real results may vary.

### Looking closer

High quality yields are on the upper end of their 15-year historical range. This presents an attractive entry point for a fixed income portfolio given the strong relationship between starting yield and forward three-year total returns.

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**High-quality, low-duration fixed income remains attractive in today's environment**

Today's fixed income environment challenges investors to balance attractive absolute yields with headwinds from higher-biased rates and limited portfolio ballasts to equity risk. We believe investors should consider a high-quality, low-duration portfolio until the macro environment shifts.

Recent economic data trends align with our start-of-year outlook: easier monetary and fiscal policy, resilient corporate profits, and strong balance sheets support cyclically strong nominal growth. We expect the Fed to remain on hold for the first half of this year, which should keep front-end yields at an elevated level as investors price out near-term rate cuts.

Meanwhile, recently strong economic data as seen in the Citi U.S. Economic Surprise Index, along with secular factors around fiscal balances and foreign entities diversifying U.S. assets, has created a steepening bias in the curve as backend rates adjust higher. We remain underweight duration as longer-end rates remain biased higher within their recent range. At the lower end of Treasuries' recent trading range of 3.5-4.5%, bonds have shown limited hedging potential during equity declines. The equity-rate correlation between equities and rates typically turns negative only when the 10-year yield moves above 4.5%. At that level, we would consider adding duration given more attractive yields and improved portfolio construction. Globally, the higher rate path appears even more pronounced for non-U.S. developed markets where we maintain our largest duration underweight. Pockets of emerging markets sovereign bonds offer attractive risk-adjusted yield until developed markets rates inflect.

Moving down in credit quality presents challenges as well given historically tight spreads. To note, the difference between High Yield (below investment grade rated) and Investment Grade corporate bond spreads (difference between the bond yield and Treasury yield at given maturity) is also near all-time tights. Said another way, investors are not being properly compensated for taking on excessive credit risk. While we do not believe the macro backdrop supports an increase in default risk and therefore significant credit underperformance, we believe the rich valuations in credit present limited total return upside in High Yield bonds. For more total return upside in a portfolio, we prefer adding cyclical equities in this macro environment given the high directional correlation of high yield bonds and equities.

Overall, high-quality bond indices remain at the upper end of their 15-year yield percentiles. This presents an attractive starting point for building a fixed income portfolio given the tight relationship ( $R^2$ ) of your starting yield and forward three-year total return (Figure 1). While staying up-in-quality reduces unnecessary credit risk without proper compensation, focusing on shorter-duration products also limits return downside if rates backup further and bond prices fall.

**Bottom Line:** We remain underweight duration because the global macro backdrop may limit meaningful declines in rates. Treasuries currently provide reduced capacity for hedging equity risk. Extra yield compensation for moving down in credit quality is also at all-time-lows, supporting our up-in-quality bias. We prefer to focus on high-quality, low-duration fixed income in today's environment.

**Broadening earnings growth continues to underpin market strength**

Ahead of the 4Q25 reporting season, consensus expected S&P 500 earnings to rise about 7% year-over-year. With nearly 80% of market cap reported, growth is tracking closer to 12%, marking the fifth straight quarter of double-digit, year-over-year gains. Technology remains the primary driver, delivering roughly 26% earnings growth. The rest of the index is growing closer to 6%. While less impressive, this is still above-trend for the cohort. Despite ongoing concerns around U.S. concentration, the durability of Tech leadership, and capex pressures, the fundamental earnings backdrop remains robust from both secular and cyclical industries. We see this as evidence of holding on to the former despite recent volatility and capturing upside in the latter with complementary exposure.

Earnings revisions have also broadened meaningfully across regions in early 2026 as most regions are exhibiting higher 12-month forward earnings expectations now than at the start of the year. This follows last year's ex-U.S. multiple expansion, suggesting the fundamental support for those higher valuations is starting to take shape. While this underpins the year-to-date rally in international markets, we continue to emphasize the structural advantages the U.S. maintains in profitability, innovation, and sector composition – factors that may limit the longevity of a full-scale rotation abroad.

Beneath the global surface, earnings revisions remain uneven. Japan shows the strongest and most broad-based momentum, with upgrades across Industrials, Financials, Information Technology (IT), and Communication Services. China is also seeing sizeable upward revisions, though concentrated in Communication Services, Financials, and Industrials. Europe is improving but still mixed: Communication Services and Health Care lead, while Consumer Discretionary remains a persistent drag.

**Bottom line:** Rare pockets of fundamental strength can be found outside of Technology-related companies in this macro backdrop, supporting complementary exposure outside of the U.S. and across sectors such as Materials and Energy. Despite recent volatility, U.S. Technology companies continue to drive the bulk of earnings growth, and we continue to view them as a core long-term holding within client portfolios.

	What happened	What's ahead
<b>ECONOMIC DATA</b>	<p><b>U.S.</b></p> <p>Nonfarm payrolls of +130K and unemployment rate of 4.3% better than expected, but seasonality make January's report difficult to project.</p> <p>January inflation a bit softer, rising just 2.4% (headline) and 2.5% (core)</p> <p>December retail sales were flat month-over-month with weakness relatively broad-based</p> <p><b>Global</b></p> <p>Japan labor earnings fell for fourth straight year.</p>	<p><b>U.S.</b></p> <p>Q4 GDP, Personal Consumption Expenditures (PCE) income/spending, flash Purchasing Managers Indices (PMI) for February</p> <p><b>Global</b></p> <p>Eurozone flash PMIs for February</p> <p>UK employment data, retail sales</p> <p>German ZEW survey</p>
	<b>POLICY</b>	<p><b>U.S.</b></p> <p>U.S., Taiwan finalize trade deal that lowers tariff rate from 20% to 15%; U.S. working on plan to reduce steel/aluminum tariffs.</p> <p>U.S. immigration crackdown de-escalation</p> <p><b>Global</b></p> <p>Bank of Japan (BoJ) official says central bank could say inflation target has been achieved, signaling further tightening ahead.</p>
<b>MARKETS</b>	<p><b>U.S.</b></p> <p>Market's rotation from growth/tech and into cyclical sectors has been joined by "AI disruption" trades.</p> <p>Small caps, megacap tech, software struggling. Defensive sectors, gold outperforming.</p> <p><b>Global</b></p> <p>Quick swings last week underscore how much AI sentiment can ripple beyond just AI names.</p> <p>Chinese shares fell as market trims risk ahead of holiday.</p>	<p><b>U.S.</b></p> <p>Notable Tech and Retail earnings</p> <p>With about 75% of S&amp;P constituents reporting, earnings per share (EPS) surprises are highest in Industrials, Materials, and Tech. Firms with more international exposure are reporting higher EPS growth.</p> <p><b>Global</b></p> <p>Global yields are lower this week amid uncertainty in equity markets.</p>

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## RELATED READING

### [The Short and Long: Q1 Macro Investment View](#)

Citi Wealth's new quarterly report offers investors data-driven guidance to help navigate complex markets. The report projects a constructive macroeconomic environment for early 2026, with corporate profitability and global growth encouraged by favorable money and fiscal policy.

### [February 10, 2026 | CIO Bulletin: Jobs noise masks resilient labor market](#)

In last week's Bulletin, we looked at how AI spending continues to accelerate, with S&P 500 capex expectations rising and hyperscalers pushing investment higher even as investors debate how quickly those dollars will translate into returns. At the same time, resilient labor data, sticky inflation, and persistent U.S. dollar dominance reinforce the case for focusing on AI beneficiaries and maintaining core exposure to U.S. assets.

### [Global Investment Committee](#)

The Citi Wealth Global Investment Committee met December 8, 2025, and added to U.S. Large Cap Equities and Gold. Emerging Markets Asia ex-China equities and Developed Markets High Yield were trimmed to fund the moves. These tilts seek to capture a seemingly stronger macro backdrop while being selective on risk and maintaining diversification.

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<b>Investment Grade</b>			
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High quality (very strong)	Aa	AA	AA
Upper medium grade (Strong)	A	A	A
Medium grade	Baa	BBB	BBB
<b>Not Investment Grade</b>			
Lower medium grade (somewhat speculative)	Ba	BB	BB
Low grade (speculative)	B	B	B
Poor quality (may default)	Caa	CCC	CCC
Most speculative	Ca	CC	CC
No interest being paid or bankruptcy petition filed	C	D	C
In default	C	D	D

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- volatility of returns;
- restrictions on transferring interests in the Fund;
- potential lack of diversification and resulting higher risk due to concentration of trading authority when a single advisor is utilized;
- absence of information regarding valuations and pricing;
- complex tax structures and delays in tax reporting;
- less regulation and higher fees than mutual funds; and
- manager risk.

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