# THE SHORT AND LONG

**Weekly Bulletin**

# Overheating signals call for resilient portfolio positioning

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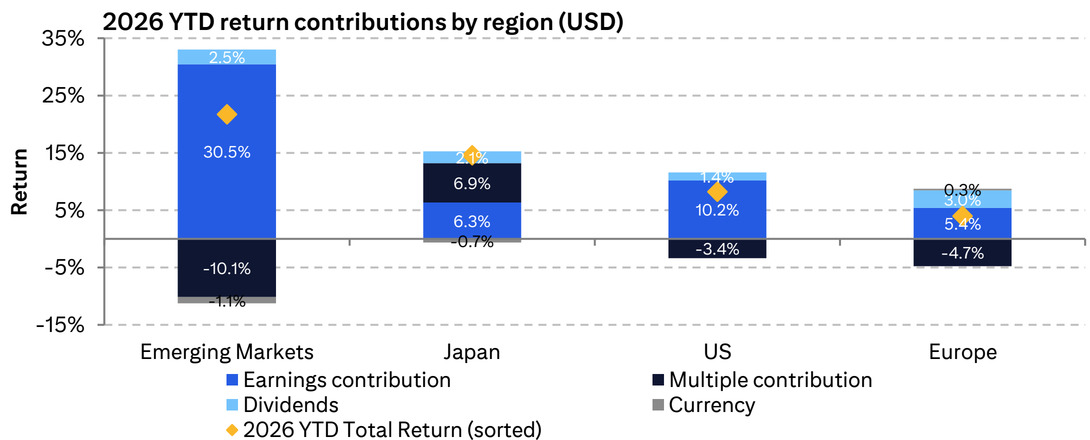
**TAKEAWAYS**

- In our view, earnings strength in the U.S. remains a sustainable driver of equity returns today. We continue to monitor Tech earnings as a broader bellwether for AI-linked equity momentum, as results could carry implications for the broader technology and semiconductor complex.
- Inflation pressure is broadening and above pre-COVID[1] norms across both Consumer Price Index (CPI) and Personal Consumption Expenditure (PCE) measures. Combined with strong activity data, we believe the high growth and high inflation environment suggests we are in an overheating regime, which continues to support real asset exposure in portfolios.
- We continue to favor gold and natural resources as portfolio diversifiers suited to the current overheating regime. We view both as long-term allocations rather than near-term trades and expect them to remain relevant as long as inflation stays elevated.

**This week in charts**

**FIGURE 1: Earnings, not multiple expansion, are driving year-to-date returns.**




Source: Factset as of May 15, 2026. MSCI regional indices used as proxy. 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**

Across regions, earnings and fundamental strength are driving performance this year. Multiples are contracting in most markets, a distinct difference from last year where Europe outperformance was led by valuation re-rating. This fundamental-driven return is more durable for investors.

[1] The COVID-19 pandemic started in 2020 when the World Health Organization declared a public health emergency and ended in May 2023 when the declaration was ended.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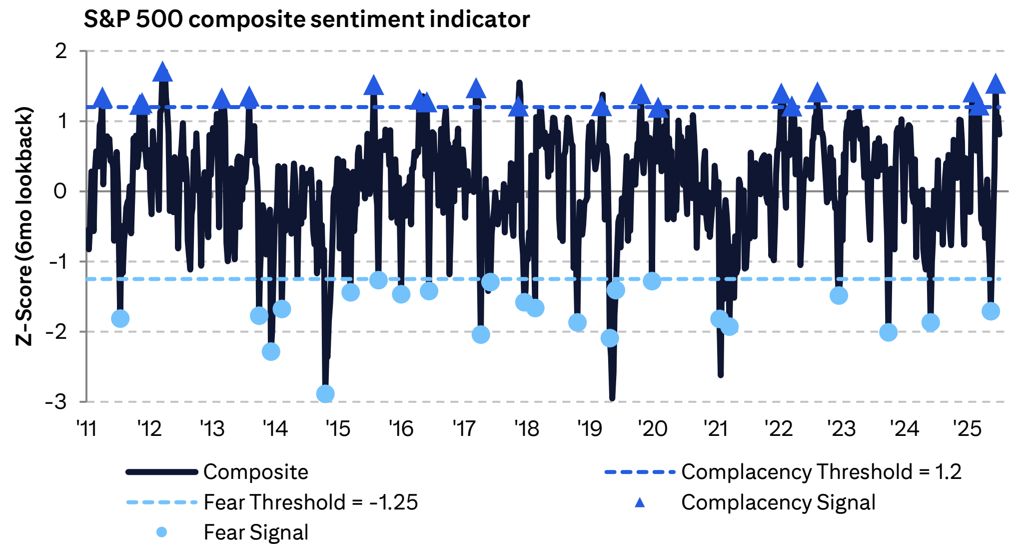
**Earnings drive returns as sentiment and positioning reaches "complacent" levels**

A U.S. equity sentiment and positioning indicator we utilize recently reached a "complacency" reading. What does this imply for markets? Historically, when sentiment and positioning indicators reach a fear reading, this has been a statistically significant contrarian buy signal, with prior instances going back to 2011 producing strong forward returns (Figure 2).

Complacency readings, by contrast, have not been a statistically significant sell signal. Historically, the complacency reading has instead been followed by rangebound returns, with a bias towards lower-than-normal returns. Given that long positioning has grown over the past two months, near-term return potential for equities may be more limited from current levels.

**FIGURE 2**: Market sentiment hit complacency signal, historically predicts some weakness




*This chart shows the z-score of the S&P 500 composite sentiment indicator since 2011.*
Source: Bloomberg as of May 12, 2026. 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.

Importantly, earnings growth, not multiple expansion, is driving U.S. equity returns. Roughly 10% of year-to-date U.S. equity gains have come from earnings growth, which we view as a more durable foundation than valuation re-rating alone (Figure 1).

This contrasts with Europe, where 85% of last year's equity return came from multiple expansion rather than earnings growth, and earnings are growing by only 5.4% so far this year. European economic growth continues to struggle, and as a net energy importer, we believe the region faces structural headwinds that peers have largely avoided.

Emerging markets (EM) have benefited from the AI buildout. South Korea recently overtook China in EM Exchange-Traded Fund (ETF) market
cap share, with Taiwan also gaining as two critical nodes in the semiconductor supply chain. Japan has also seen multiple expansion alongside defense spending tailwinds, distinguishing it from most other developed markets this year.

**Bottom line**: Earnings strength in the U.S. remains the most sustainable driver of equity returns today, but positioning and sentiment indicators suggest that we could see some slowdown in forward momentum.

## Inflation stays broad and sticky as the overheating regime holds

The U.S. economy entered an overheating regime last October, defined by growth and inflation rising above historical trends. This is distinct from stagflation, which requires growth deterioration alongside elevated price pressures, and we do not currently see evidence of stagnation in the U.S. economy.

Inflation breadth tells a more complete story than headline readings alone. Currently, 45% of CPI components are rising at a 5% or higher annualized pace, compared to the pre-COVID average of 25%[2]. In PCE, the Fed's preferred measure of inflation, the latest figure stands at 34%, also well above the pre-COVID baseline[3]. Looking abroad, outside of COVID, Japan PPI in April rose at the fastest pace in almost eighteen years.

The geopolitical conflict has added pressure to energy prices even as inflation in most major economies was above target. But growth has remained strong: US same-store sales growth averaged 6.6% year-over-year in January and February and moved even higher after the Middle East conflict began, reflecting a consumer that continues to absorb costs with resilience.

Business pricing expectations offer an important forward signal. Following the COVID shutdown, businesses largely predicted the inflation surge that followed. Today, business pricing expectations are moving sideways, which suggests a more nuanced view of price pressure than the surge experienced in 2021.

Recent U.S. inflation data printed on the high side, and we will be closely watching readings for the U.K. and Japan this week.

**Bottom line**: Inflation remains sticky, and above pre-COVID breadth norms across both CPI and PCE measures. We continue to position portfolios defensively against persistent and potentially widening price pressure.

## Real assets continue to deliver in an overheating environment

Historically, overheating regimes have favored real assets over fixed income, and the current cycle is tracking that pattern closely. Gold has outperformed fixed income on a one-year basis and is outperforming year to date, consistent with its historical behavior during periods of elevated inflation.

Reviewing gold returns across different inflation regimes going back to 1990, gold has outperformed in virtually all inflationary environments. We treat gold as a long-term portfolio holding and a substitute for duration, not a short-term tactical position.

Natural resources have delivered strong returns since we initiated a tactical long position in December. The Morningstar Global Natural Resources Index has returned approximately 23% since the inception of that call on December 9, 2025, outperforming the S&P 500 by roughly 14.5% percentage points over that period. Real assets as a category have historically outperformed during environments of rising growth and rising inflation, which describes the current regime.

Longer duration Treasuries have historically underperformed
in an overheating environment, consistent with our underweight duration. This reinforces the case for real asset substitutes that can absorb inflation pressure rather than erode under it.

**Bottom line:** We continue to favor gold and natural resources as portfolio diversifiers suited to the current overheating regime. We view both as longer-term allocations rather than near-term trades and expect them to remain relevant as long as inflation stays elevated.

[2] Bloomberg as of May 15, 2026
[3] Bureau of Labor Statistics (BLS) as of May 12, 2026.

| | What happened | What's ahead |
|---|---|---|
| ECONOMIC DATA | **U.S.**<br>• CPI and PPI both hotter than expected (3.8% headline, 2.8% core. 6.0% PPI) behind broad-based consumer components<br>• Retail sales beat estimates and saw upward revisions to prior months. | **U.S.**<br>• Conference Board Leading Economic Index for April set to release.<br>• May flash PMIs set to release. |
| | **Global**<br>• Eurozone industrial production +0.2% for March.<br>• China CPI +1.2% and PPI +2.8%. | **Global**<br>• UK retail sales for April set to release.<br>• UK and Japan CPI for April set to release.<br>• Eurozone, UK, Japan, Australia flash PMIs for May set to release. |
| POLICY | **U.S.**<br>• Warsh confirmed by Senate as the new Fed Chair.<br>• After Trump called the ceasefire "on life support," he is more seriously considering resuming combat operations. | **U.S.**<br>• FOMC minutes expected on Wednesday.<br>• USTR & White House tariffs announcement expected this week. |
| | **Global**<br>• Positive but largely symbolic U.S.-China headlines Xi pledging no military equipment to Iran, opposing Hormuz tolling.<br>• China to purchase U.S. aircraft, increase U.S. oil purchases. | **Global**<br>• U.S.-China, U.S.-EU trade and tariff developments expected.<br>• European Central Bank monetary policy meeting accounts set to convene.<br>• Andy Burnham's bid to begin for UK PM. |
| MARKETS | **U.S.**<br>• S&P 500 extended six-week winning streak before wobbling midweek on hotter CPI and Iran ceasefire concerns. | **U.S.**<br>• 11% of S&P 500 market cap reporting this week. |
| | **Global**<br>• Oil-driven inflation pulse showing up across global CPI and PPI; global bonds sold off as a result. | **Global**<br>• Extent markets continue to look past geopolitical tensions and focus on growth drivers.<br>• Equity sentiment sharply reversed higher, triggering "complacency" signal in sentiment indicator. |

Source: Bloomberg as of May 19, 2026. 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.

## RELATED READING

**May 12, 2026 | Capex Broadens as Labor Holds and Themes Converge**

In last week's CIO Bulletin, we looked at how strong U.S. payroll data and broadening global PMIs reinforce a constructive macro backdrop. We also analyzed two structural themes gaining earnings confirmation: physical AI is driving exponentially higher memory and compute requirements, and energy infrastructure investment is accelerating globally as grid hardening becomes a national security priority.

**April 20, 2026 | The Short and Long Podcast**

Hosted by Kate Moore, Chief Investment Officer of Citi Wealth, the inaugural episode "AI Through an Investor's Lens: Looking Beyond the Hype" addresses AI – the most transformative technology of our lifetime. Watch on YouTube, Apple, or Spotify, and subscribe for future episodes.

**April 8, 2026 | The Short and Long: Q2 Macro Investment View**

Citi Wealth's quarterly report is designed to offer global, data-driven guidance to help investors navigate increasingly complex markets with confidence and clarity. The latest report states global shocks to markets are driving higher volatility and rapid risk repricing, while the U.S. economy remains relatively resilient.

**April 2, 2026 | Global Investment Council**

The Citi Wealth Global Investment Council met April 2, 2026, and reallocated equity exposure from Europe to the U.S. The move maintains equity allocation while shifting risk toward more resilient markets. European fundamentals were already weakening prior to the Middle East conflict, and the U.S. offers more durable earnings with less geopolitical vulnerability.

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|---|---|---|---|
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| **Investment Grade** | | | |
| Highest quality | Aaa | AAA | AAA |
| High quality (very strong) | Aa | AA | AA |
| Upper medium grade (Strong) | A | A | A |
| Medium grade | Baa | BBB | BBB |
| **Not Investment Grade** | | | |
| 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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# THE SHORT AND LONG

Weekly Bulletin