THE SHORT AND LONG

Weekly Bulletin

Strong payrolls support rate hike expectations amid AI-earnings boom

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TAKEAWAYS

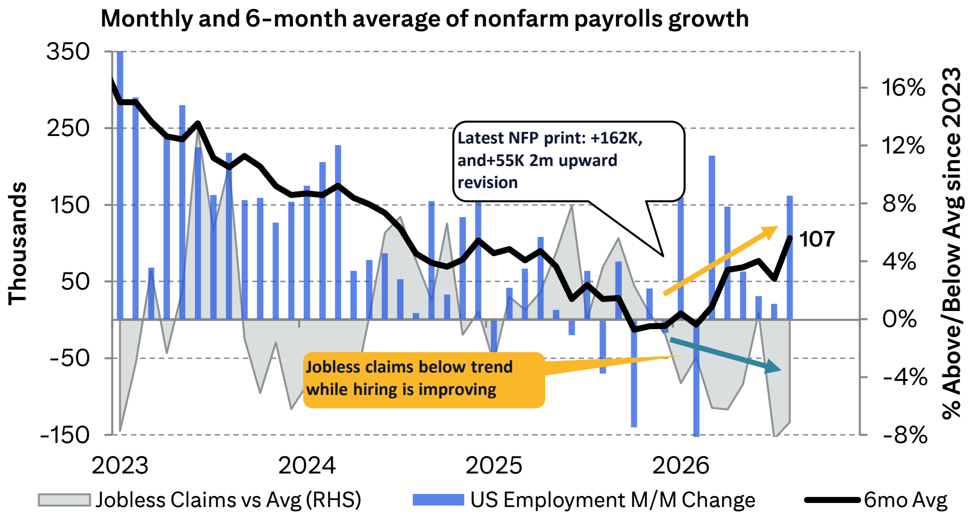
The U.S. labor market remains strong, with August non-farm payrolls at 162,000 - nearly triple the consensus estimate - and real wage incomes rising. Markets have repriced hikes sharply, making a September policy move highly defensible. Strong economic growth, sticky inflation, and higher rates may present a challenging environment for fixed income returns.

September historically represents a challenging month for equities, and midterm election years amplify that volatility. Yet earnings per share (EPS) have grown more than 20% over each of the trailing four quarters, as Q2 earnings were particularly strong. We view any seasonal weakness as a potential opportunity to add exposure to risk assets amid what we see as outstanding fundamentals.

Attempts to diversify away from technology prove challenging. A look-through of the Russell 1000 shows 70% of companies have direct gearing to artificial intelligence (AI). Rather than rotating into weaker fundamentals, we prefer commodities and precious metals as potential diversifiers that complement core equity exposure.

THIS WEEK IN CHARTS

FIGURE 1: Friday's NFP print confirms strong and stable labor market



Source: Haver Analytics as of September 4, 2026.

LOOKING CLOSER

This combination of accelerating employment growth and falling jobless claims confirms the underlying resilience of the U.S. labor market, supporting our view that the macroeconomic backdrop remains highly robust.

THE ECONOMY IS RUNNING AHEAD OF POLICY

Investors entered the year expecting the Federal Reserve to cut rates twice in 2026, according to the consensus estimate in January. Nine months later, the economic reality is a stark contrast to that forecast.

Friday's August payrolls report showed the U.S. economy added 162,000 jobs, nearly triple the 55,000 estimate. Upward revisions to the prior two months pushed the three-month average to 71,000 per month, a notable gain given stagnant labor force growth. The unemployment rate held at 4.1%, a level that remains stable and toward the low end of recent trends. More importantly, wage income growth is now outpacing inflation, which means real wage incomes are rising. Jobs gains were also the broadest across industries in two and a half years.

The Federal Reserve's policy rate, currently at 3.5–3.75%, sits more than 200 basis points below where each variation of the Taylor Rule (a formula for estimating the appropriate policy setting given deviations from the Fed’s inflation and employment goals) suggests it should be. That gap is a representation of the currently easy policy stance and has consequences over time. Markets have caught on and have moved to price in the adjustment, and now lean toward a rate hike for the next Federal Reserve meeting on September 16th.

In our view, the Fed’s most prudent decision is to raise policy rates in accordance with the data. Failing to act risks the central bank’s credibility given the duration of above-target inflation and against an economic backdrop this strong. The 10-year yield has risen 60 basis points Year-to-Date, and the 30-year is up 40 bps, mostly due to higher real yields.

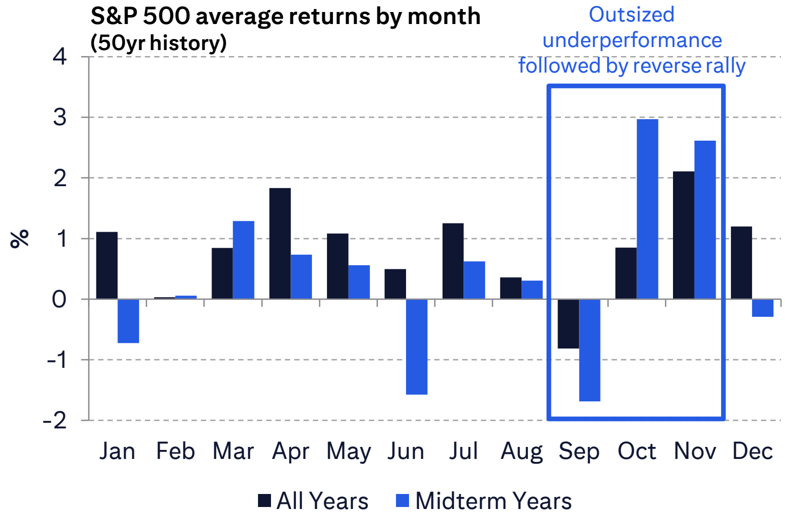
Bottom line: The macroeconomic data does not give the U.S. Federal Reserve room to ease. Higher growth alongside higher rates is a difficult environment for fixed income, and we maintain our underweight to duration, particularly on the longer end.

STRONG EARNINGS MEET A SEASONALLY DIFFICULT STRETCH

The equity market faces a familiar balancing act this fall: strong fundamentals, set against a seasonally weak backdrop that has historically been the most volatile period of the year. Add in U.S. midterm elections and there are many potential market catalysts.

September is historically the single worst month for equities over long periods of market history, and October compounds that volatility with the highest average VIX reading for a month. In U.S. mid-term election years (with 35 Senate seats and all 435 House seats on the ballot in early November), that seasonal softness has tended to be more pronounced, as political uncertainty adds a layer of noise that markets must work through before recalibrating (Figure 2).

FIGURE 2: Midterms may exacerbate seasonality, but also present potential opportunity



Source: Factset as of September 3, 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.

The fundamental picture, however, argues for perspective over caution. EPS growth over the trailing four quarters has exceeded 20%. Q2 2026 earnings were remarkably strong - the strongest quarter on record outside of post-recessionary rebounds - with technology accounting for more than half of that earnings expansion.

That does not mean markets are immune to a pullback, as the seasonal data remains real and worth respecting. However, we see sentiment rather than a deterioration in the underlying business environment as the likely driver of potential pullbacks this fall. Any shallow dips amid this fundamental backdrop remain opportunities to add to risk, in our view.

Bottom line: We expect volatility to pick up through September and October and view any weakness as a potential opportunity given the fundamental backdrop. Waiting for perfect conditions risks missing the entry point, as dips in an environment this strong tend to be short and difficult to time.

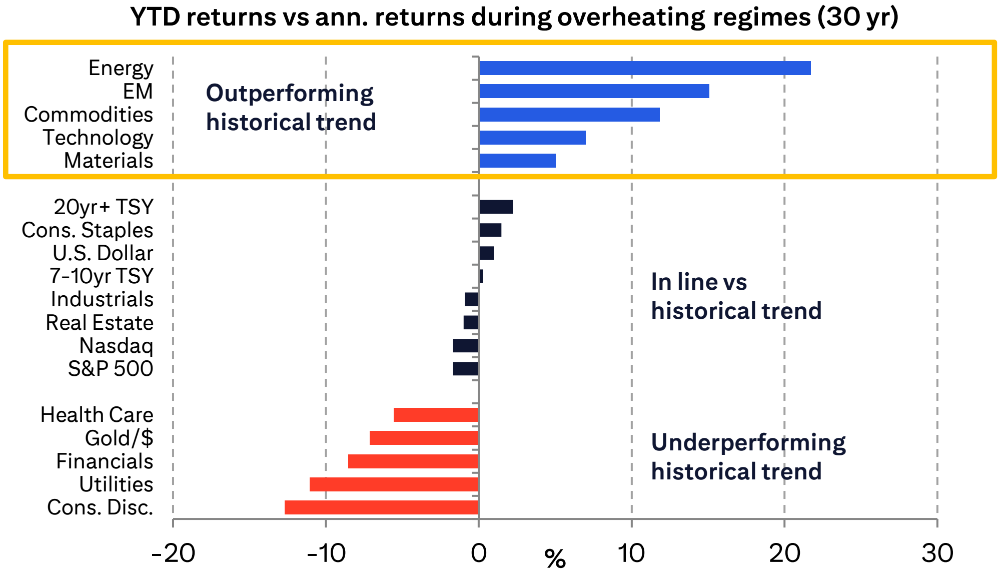
EVERYTHING IS AI - AND DIVERSIFYING AWAY FROM IT MAY COST INVESTORS

One of the most common conversations in wealth management today centers around concentration risk, specifically that too much of a portfolio is exposed to technology and that a rotation into less correlated sectors would reduce that risk. The data suggests that approach may be both flawed and costly.

A look-through of the Russell 1000 found that 70% of companies have direct gearing to AI. That figure spans not just semiconductor manufacturers and cloud platforms, but healthcare, industrials, financials, and consumer companies - all of which are deploying AI across drug discovery, logistics optimization, fraud detection, and customer engagement. Healthcare, which investors often cite as a natural defensive diversifier when technology wobbles, shows a higher correlation to tech than many appreciate in part because technology enables a large share of modern healthcare's potential growth. For example, investors increasingly cite healthcare companies as some of the best positioned beneficiaries of AI-efficiency gains.

As such, rotating into sectors with weaker fundamentals (e.g. earnings growth) to reduce technology exposure may not reduce risk; instead, it trades one risk for another. We suggest a different approach to building portfolio ballast: commodities, industrial metals, and precious metals may offer lower correlation to equity markets and can potentially provide a hedge against the inflation and geopolitical pressures that remain present in the macroeconomic backdrop (Figure 3). Gold, in particular, may serve as a diversifier in a period when the traditional stock-bond relationship has been less reliable.

FIGURE 3: Growth and inflation backdrop still supportive of risk taking and commodity exposure



Source: Bloomberg as of September 3, 2026. Regional indices are using their respective MSCI indices as proxy. Sector indices are using their respective S&P indices as proxy. Fixed income indices are using their respective Bloomberg indices 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.

Bottom line: You cannot mitigate the correlation to AI by simple rotation. We prefer commodities and precious metals as potential diversifiers to complement core equity exposure, which should remain geared towards earnings growth rather than rotating into areas where fundamentals look less compelling.

	What happened	What's ahead
ECONOMIC DATA	**U.S.**	**U.S.**
	Employment jumped 162K in Aug and Jul was revised by +44K. UR held at 4.1%. Wage growth picked up but still remains below pace of inflation. ISM Manufacturing (Mfg) and Services (Srv) both showed resilient growth with activity and orders both strong. Srv prices surged to four-year high. Job openings per unemployed job seeker ticked higher and has been since fall 2025	CPI and PPI for Aug Fed consumer expectations survey for Aug Consumer credit for Jul Inventory/trade sales for Jul
	Global	**Global**
	Eurozone retail sales fell unexpectedly by the most in over a year as energy prices crowd out discretionary spend.	China, Taiwan trade data South Korea, Japan Q2 GDP
POLICY	**U.S.**	**U.S.**
	US forces guided oil through the Strait of Hormuz, reaching 85% of pre-war flow last week. After the blowout jobs report, the probability of a Fed hike in September jumped to 70%.	Federal budget figures for Aug Iran conflict at a stalemate with US refusing to return to MOU.
	Global	**Global**
	BoJ suggesting its leaning toward a rate hike this month and open to picking up the pace later as inflation risks skew higher. Fiscal spend in focus as both UK and France unlikely to reduce deficit/curb spending.	ECB September meeting Strait of Hormuz oil flow improving but refined products in short supply.
MARKETS	**U.S.**	**U.S.**
		With 97% of companies reported for Q2, Y/Y EPS growth stands at 50% with all but two sectors (HC, RE) up double digits.
	Global	**Global**
	Yields rise around the globe amid fiscal worries and inflation flare-ups in energy prices. JPYUSD rallied to one-month high with BoJ more hawkish, carry trade unwinds.	September is historically the weakest month for equities with an avg return of -0.8% for the S&P 500; positive returns are a coin toss.

Source: Bloomberg as of September 4, 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

[August 25, 2026 | Volatile Markets, Strong Fundamentals, and the Role of Growth]

In last week's Bulletin, we looked at how markets have absorbed a recurring cycle of worries in 2026, high intraday volatility, and short pullbacks. We also focused on the role each asset can play in portfolios as clients pull away from the traditional efficient frontier.

[July 20, 2026 | The Short and Long Podcast]

In the third episode, "AI, Quantum, and Cybersecurity; From Breach to Resilience," host and Chief Investment Officer of Citi Wealth Kate Moore speaks with Fatima Boolani, Co-Head of U.S. Software Equity Research, Citi Research, and Anneka Gupta, Chief Product Officer at Rubrik, on how today's cybersecurity threats require continuous adaptation in prevention and resilience and covers questions every investors should be asking right now around cybersecurity in the age of AI. Watch on YouTube, Apple, or Spotify and subscribe for future episodes.

[July 14, 2026 | The Short and Long: Q3 Macro Investment View]

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[April 2, 2026 | Global Investment Council]

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High quality (very strong)	Aa	AA	AA
Upper medium grade (Strong)	A	A	A
Medium grade	Baa	BBB	BBB
Not Investment Grade			
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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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