GLOBAL X INSIGHTS

Inflection Points: Five Risks for 2025 Keeping Us Awake

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Date: January 14, 2024
Topic: Macro, Disruptive Technology, Income

This piece has become an annual tradition for me since returning to finance after working as a professor with the Department of Defense. The goal is not to predict events but to identify risks that financial markets may not be pricing though could unfold, compiled after consultation with colleagues, policymakers, investors, and academics.

Last year (Inflection Points: Five Risks for 2024 Keeping Us Awake), several risks highlighted in these pages played out, to varying degrees. China tested limits of deterrence following Taiwan's election, recently carrying out a military test blockade of Taiwanese ports and potentially cutting an underwater communication line.[1] The Middle East conflict regionalized, with Iran and Israel exchanging attacks.[2] The risk that "neither Trump nor Biden" would make it all the way to the election turned out half right.

Where we missed, the U.S. did not end support for Ukraine, though the Russia-Iran-North Korea-China axis of disruption found new ways to escalate and test limits.[3] Also, misinformation and AI interference in the U.S. election was an issue, but it did not trigger serious unrest.[4]

As we expected, markets were resilient in 2024, and our 2025 Macro Outlook highlights our rationale for continued optimism.[5] Like every year, though, looking below the surface and beyond conventional wisdom to consider different scenarios that could play out is important.

Five Key Risks

- Tariffs, Taxes, and Policy Sequencing
- Global Revisionism Rallies and Status Quo Sells Off
- Orbital Escalation
- China's Stimulus Works (with Commodity Inflation and Trade Escalation)
- An AI Road Paved with Deepfakes

Tariffs, Taxes, and Policy Sequencing

While we remain optimistic about the U.S. economy given the possibility of policies that help support a manufacturing recovery and small-cap business investment, a new policy regime brings important risks to consider. The combination of tariffs that increase goods prices, tax stimulus that fosters demand, and changes to immigration that trigger wage increases are all inflationary. This potent combination would follow the most aggressive Federal Reserve tightening since 2001 to tame the fastest rate of price increases in about 45 years.[6]

At the December 2024 meeting, the Fed cut the interest rate forecast from four in 2025 to two.[7] According to Fed Chair Jerome Powell, some committee members may have taken potential economic policy changes into account, but his statement was quite vague. Markets have remained slightly more optimistic than the Fed on the interest rate path until turning more pessimistic recently, which proved right in 2024, but the Fed and the markets are likely to grapple with increasing uncertainty in 2025.[8]

The rollout of policies and their sequencing could prove critical. For example, adoption of aggressive and rapidly implemented tariffs without progress on taxes could trigger a pullback in consumer spending and corporate investment by the second or third quarter. This scenario is not our base case, but the possibility cannot be dismissed. In this circumstance, haste along with haphazard communication likely makes waste. Cabinet officials with deep ties to the financial markets should understand that risk, and we would expect them to design a strategy that limits unintended damage.

Related Themes: Income-oriented investments theoretically less tied to interest rate volatility like covered calls, master limited partnerships, and preferreds.

Global Revisionism Rallies and Status Quo Sells Off

U.S. President-elect Trump has asserted that the United States should take control of Greenland and the Panama Canal.[9] Meanwhile, Russian President Vladimir Putin has expressed interest in repatriating Alaska.[10] While just talk, for now, comments like these signal a growing possibility of longstanding status quos being questioned or even overturned.

For example, the U.S. has supported the One China policy, which recognizes the Chinese Communist Party as the sole government of China, but rapid escalation in the trade dispute and increased China-Taiwan provocations could shift the U.S. position. Events in the Middle East could trigger a change in the long-held Two State Solution that calls for both Israel and Palestinian governments to coexist. Also, a protectionist approach that sidelines international economic institutions like the D.C.-based International Monetary Fund and the World Bank could mean the end of the Washington Consensus, a set of economic policy principles considered in the 1980s and 90s that champion continued economic liberalization.

Moving into a world where no policy is safe or sacred may prove a challenge for the international community and financial markets. Historically, the U.S. has pushed back on revisionist countries like Russia, Iran, and North Korea, attempting to maintain a good if not perfect status quo. If the U.S. begins asserting interests and claims in other parts of the world, the demands of revisionist states may gain credibility. In our view, the propositions that global leaders are discussing now could usher in the greatest period of global change and political volatility since at least the 1940s.

Related Themes: Domestic-focused businesses like U.S. infrastructure, energy commodities such as uranium, tools tied to future competitiveness like AI, and treasury strategies to reduce volatility.

Orbital Escalation

Historically, conflict in space was the purview of science fiction movies and TV shows. That may change now that space is a rapidly growing industry, and disruptions beyond the atmosphere could spook markets. There are more than 28,000 public and private sector satellites in orbit, up 6% from the prior year.[11] With government and businesses relying on space capabilities more than ever, an escalation of existing disputes in space is increasingly likely.

The use of satellites for targeting and force positioning in Ukraine illustrates the military importance of space capabilities.[12] Satellites are vital to many command and control systems as well as intelligence and reconnaissance activities. As the value of space resources changes, the calculus of escalating conflicts through space is changing and poses new risks.

For example, a satellite could be used to cause a space collision, and countries have tested various anti-satellite weapons.[13] Also, attacking and responding in space could jeopardize collateral assets, as fast-moving space debris could disrupt or destroy other objects. Scenarios like these also beg the question, if an attack is attributable to a specific country, would the response be limited to space or would another operational theater make more sense?

Related Themes: New space risks require defense technology, robotics, and sensors that provide data tied to connectivity.

China's Stimulus Works (with Commodity Inflation and Trade Escalation)

Successful stimulus is usually positive for domestic and global economies, so the stimulus that China announced in late 2024 being a risk does seem contrarian. The initial market reaction was overwhelmingly positive, but that proved short-lived when comments from Beijing pointed to traditional forms of stimulus targeting bank loans and real estate.[14] There was also a vague promise of more stimulus should Trump administration policies threaten China's economy.

Investors have grown increasingly cautious, as successive stimulus attempts seem to get cooler receptions, a trend that dates to the 1990s.[15] This time, the challenges seem more obvious than previous stimulative attempts, even if they are largely the same. China's economy failed to reaccelerate after the pandemic, hindered by slowing exports and insufficient domestic consumption.[16] Rather than announce stimulus that boosts domestic demand, policymakers borrowed from the old playbook focused on stimulus through state-owned enterprises.

Despite some of our misgivings about the plan, consider two hidden dangers should it work. First, if China's economy pulls out of the doldrums, demand for raw materials could increase meaningfully, triggering global inflation. This scenario would be a marked change from decades of China exporting deflation. Second, a stronger domestic economy might reduce Beijing's incentive to seek trade reconciliation with the U.S, potentially leading to higher tariffs for longer and further fueling U.S. inflation.

Related Themes: Industrial commodities like copper and China-focused themes like China consumer discretionary, and lithium and battery technology.

An AI Road Paved with Deepfakes

The potential impact of AI on business profitability and efficiency is an important part of our positive view for market valuations and fundamentals going into next year.[17] At the same time, there are potential risks worth considering. Viral videos and images of unexplained flying objects in the Northeast and chemical fog in the Southeast have been all over social media in recent months.[18] Following the image of a Tesla Cybertruck on fire in front of the Trump International Hotel Las Vegas, we noted social media posts where people still thought the picture could be a fabrication despite validation from multiple news sources. The Information Age and social media platforms revolutionized mass communication. AI has the ability take manipulation of perception a step further.

Last year, we highlighted the use of AI in election misinformation. Election-tied deepfakes circulated the web, but the impact was muted relative to a worst-case scenario.[19] Nonetheless, the use of AI to create and alter information is on the rise. So far, the private sector's reaction is best described as muted, and there is little evidence of a government grand plan.

Misanthropic applications of AI have largely targeted the public sector, but that might not be the case in the future. Financial markets, as forward-looking mechanisms that measure risk and value, are inherently designed to handle uncertainty. In theory, all known information should be reflected in prices, provided the information is vetted and meets certain standards. This principle is a centerpiece of the efficient market and the random walk theories. We believe the growing possibility that seemingly high-quality but blatantly false information can affect companies or even market outcomes could come to present a meaningful risk that investors may need to manage.

Related Themes: Demand for AI hardware such as data centers, solutions like cybersecurity tools, and energy infrastructure tied to electrification.

Footnotes

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