

Allview: Market Risk Monitor

Allspring's Investment Analytics team fulfills a crucial role in managing risk across our investment platform, providing oversight on each investment team's process as well as analytics to help teams understand investment risks.

Markets can be affected by many types of risks, and each risk's impact generally varies over time. The Investment Analytics team is responsible for continuously monitoring known risks, anticipating and identifying new risks, and regularly communicating the results of their analyses to all of Allspring's investment teams.

This publication—"Allview: Market Risk Monitor"—is a publicly shared report the Investment Analytics team compiles each month. It names and explains the top 10 current global market risks the team has identified, ranked by each risk's likelihood and potential impact on markets. As events worldwide occur and evolve every month, those changes are considered as the team constructs its next top 10 list. So, risk rankings often shift from one month to the next, and a risk could be removed from the list when a more impactful and/or more likely risk is identified.

In their April update, the Investment Analytics team discusses risk changes made this month and the rationale behind each of them.

April updates

Back on our list again, at #7, is the potential return of bond vigilantes in the U.S. As a refresher, a "bond vigilante" is a bond trader that threatens to sell, actually sells, or refuses to buy debt to protest the issuer's policies. Our concern is specifically focused on the biggest issuer in the world: the U.S. government. U.S. inflation is showing signs of being stickier than previously thought while the U.S. government continues to borrow ever-increasing amounts of money. Past buyers of U.S. Treasuries (the Federal Reserve, China, Japan) have disappeared, raising questions as to who will truly show up at future Treasury auctions to buy the mountain of debt being issued. If enough investors protest, the markets could see a sudden spike higher in longer-term U.S. Treasury interest rates.

Speaking of higher rates, the Bank of Japan (BoJ) has finally moved its short-term interest rates higher, from -0.1% to a new range of 0.0% to +0.1%. This is Japan's first hike in 17 years, officially ending its negative interest rate regime. We've been pointing out the potential for this to happen since July 2022, including past changes made to the BoJ's yield curve controls. At this point, interest rate policy in Japan's bond market appears more predictable, so we've removed the concern about BoJ tightening from our list.

ALLSPRING INVESTMENT
ANALYTICS TEAM

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OVERVIEW

The Allspring Investment Analytics team assembles a top 10 list of market risks that it believes have the potential to influence investment portfolios. The list is not intended to be comprehensive, but rather a short collection of items that answer the question: “As a risk manager, what keeps you up at night?”

ALLVIEW APPROACH

The Allview Market Risk Monitor provides a financial ecosystem that leads to how we invest. Our co-chief investment officers consistently challenge portfolio managers to respond to these views based on their diverse perspectives.

01 DIRECT CONFLICT WITH IRAN

Iran has engaged in a series of brutal proxy wars with other countries, backing Iraqi and Syrian militant groups against the U.S.; rebels in Yemen against Saudi Arabia; and Hamas against Israel. In addition, Iranian naval vessels have seized multiple oil tankers over the past year in the Persian Gulf. These collective actions are increasing the probability of a direct conflict between Iran and another nation. Military actions in the Middle East tend to drive energy prices higher, negatively affecting portfolios underweight the sector—especially if energy infrastructure becomes a target.

PROBABILITY:

Consensus	High	Medium	Low
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GLOBAL IMPACT:

Extreme	High	Medium	Low
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02 CHINESE MILITARY ACTION

China’s desire to expand its influence in the South and East China Seas, especially as it relates to the island of Taiwan, is elevating the probability of a military conflict or a military-led embargo in the region. Portfolios that are overweight Asian equities could experience extreme levels of volatility if a conflict ensues. Portfolios overweight the hardware segment of the information technology (IT) sector could also experience challenges given Taiwan’s status as a major hub for semiconductor manufacturing.

PROBABILITY:

Consensus	High	Medium	Low
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GLOBAL IMPACT:

Extreme	High	Medium	Low
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03 NEW 10% TARIFF ON ALL U.S. IMPORTS

Former President Trump has vowed to introduce a new 10% tariff on all goods imported into the U.S. if he is elected to a new term as president. In addition, he has pledged to revoke China’s “Most Favored Nation” trade status, which would trigger even higher tariffs on Chinese imports. Such actions would have profound effects on global trade and economic growth, potentially pushing inflation higher and global growth lower.

PROBABILITY:

Consensus	High	Medium	Low
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GLOBAL IMPACT:

Extreme	High	Medium	Low
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04 WAVES OF DEFAULTS IN COMMERCIAL REAL ESTATE

Businesses around the world have adopted a “new normal” as it relates to work. Many industries have instituted flexible schedules that allow workers to work from home a portion of the week. Companies have begun to reduce office space footprints to match this new normal. Portfolios exposed to commercial real estate (CRE) or commercial mortgage-backed securities could underperform if a wave of defaults occurs in the space. Regional banks that are heavily exposed to CRE could also underperform or face insolvency.

PROBABILITY:

Consensus	High	Medium	Low
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GLOBAL IMPACT:

Extreme	High	Medium	Low
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05 RUSSIAN MILITARY CONFLICT WITH NATO

Russia’s invasion of Ukraine has the potential to spill over into other Eastern European countries, especially if Russia resorts to the use of nuclear weapons. Military action between Russia and NATO would result in extremely negative price movements for equity securities in all markets.

PROBABILITY:

Consensus	High	Medium	Low
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GLOBAL IMPACT:

Extreme	High	Medium	Low
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06 GLOBAL RECESSION

China; Europe; and, in some cases, the U.S. have begun exhibiting signs of economic contraction. China has already experienced dozens of major defaults within a real estate sector that comprises over 20% of China’s economy. Equity and fixed income portfolios overweight the consumer cyclical, industrials, financials, and IT sectors could underperform if the world enters a recession.

PROBABILITY:

Consensus	High	Medium	Low
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GLOBAL IMPACT:

Extreme	High	Medium	Low
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↑ 07 RETURN OF THE U.S. BOND VIGILANTES

U.S. government debt levels exceeding \$34 trillion, coupled with fears over the U.S. Treasury's ability to roll trillions of dollars of Treasury securities each year, could result in a decline in U.S. credibility that would undermine the reserve currency status of the U.S. dollar. Bond vigilantes could respond to these events by refusing to buy U.S. government debt at current interest rate levels, resulting in a dramatic spike higher in yields. Portfolios overweight U.S. duration could experience significant underperformance relative to their benchmarks.

PROBABILITY:

Consensus	High	Medium	Low
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GLOBAL IMPACT:

Extreme	High	Medium	Low
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08 WAR ON THE KOREAN PENINSULA

A more aggressive stance by North Korea toward South Korea, including frequent missile launches and statements that the two are "belligerent states," has the potential to turn into full-scale war if an errant missile were to hit critical infrastructure. War on the Korean Peninsula would likely result in significant underperformance for any portfolios overweight South Korean equities.

PROBABILITY:

Consensus	High	Medium	Low
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GLOBAL IMPACT:

Extreme	High	Medium	Low
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09 DISRUPTIVE INFRASTRUCTURE ATTACKS

China, Russia, Iran, and North Korea all have offensive cyber capabilities they could use to target essential and particularly vulnerable sectors in the U.S. and Europe, such as energy, utilities, health care, and communications. Assets linked to these industries could experience increased volatility if attacks become more common.

PROBABILITY:

Consensus	High	Medium	Low
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GLOBAL IMPACT:

Extreme	High	Medium	Low
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10 BASEL III ENDGAME LIQUIDITY CRUNCH

In July 2023, U.S. banking regulators proposed changes to bank capital rules to align with Basel III standards. Rules will apply to banks with \$100 billion or more in assets and could result in capital hikes of up to 30% for some large banks. In its current format, the Basel III endgame risks driving up borrowing costs and draining liquidity in financial markets. If the proposal is accepted as is, equity securities of larger U.S. banks could experience material price declines and the U.S. economy could stagnate from reduced lending.

PROBABILITY:

Consensus	High	Medium	Low
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GLOBAL IMPACT:

Extreme	High	Medium	Low
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ARROW LEGEND

↑ **RED UP ARROW:** an event that has moved up the list from the prior month because of an increase in probability or an increase in global impact

↓ **GREEN DOWN ARROW:** an event that has moved down the list from the prior month because of a decrease in probability or a decrease in global impact

PROBABILITY LEGEND:

Consensus	High	Medium	Low
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CONSENSUS: an event that we believe has a 50% to 100% probability of occurring; an event that is widely accepted as the most likely outcome by market participants

HIGH: an event with a 25% to 50% probability of occurring; an event that is not fully priced into markets

MEDIUM: an event with a 10% to 25% probability of occurring; an event that is not priced into markets and that is viewed by most market participants as an unlikely outcome

LOW: an event with a less than 10% probability of occurring; an event that is not priced into markets and in some cases is not on the radar of most analysts

GLOBAL IMPACT LEGEND:

Extreme	High	Medium	Low
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EXTREME: an event for the history books that drives most correlations toward one; global equity markets down more than 20% with some regions down as much as 50%; severe dislocations in fixed-income and currency markets

HIGH: an event that could push global equity markets into a 10% correction, with some regions down 20% or more; fixed-income and currency markets moving similar amounts

MEDIUM: an event that could cause a modest sell-off in global equity markets, with some regions correcting 10% or more; fixed-income and currency markets moving less

LOW: an event that might create acute problems in one sector, region, country, or currency; limited impacts on global equity and fixed-income markets

For further information

We're committed to thoughtful investing, purposeful planning, and the desire to deliver outcomes that expand above and beyond financial gains. Visit our website at www.allspringglobal.com.

Contact details

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