



GLOBAL X INSIGHTS

# Inflection Points: Five Risks for 2026 Keeping Us Awake

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*Note: The original draft of this was written December 29 and revised on January 8 after the military operation in Venezuela and before the Federal Reserve subpoena.*

*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, several of the Five Risks for 2025 played out to varying degrees.<sup>1</sup> The sequencing of U.S. tariffs and tax changes fueled volatility amid inflation risk and Federal Reserve caution, but much of that concern receded by mid-April, when worst-case tariffs were dialed back, and further in July when Congress passed tax cuts. Global revisionist powers continued challenging the status quo in multiple theaters, but most of the conflicts remained contained, even if interconnected. Finally, concerns that the possibility of Chinese stimulus would drive further trade escalation and commodity inflation proved partially correct.*

*Where we missed, there was no meaningful escalation in space, though there was an increase in anti-satellite activity.<sup>2</sup> Also, AI deepfakes, while increasingly prevalent, did not produce meaningful social or market unrest.*

*As we expected, strong fundamentals drove markets in 2025, and our 2026 Macro Outlook identifies reasons for continued optimism.<sup>3</sup> Like every year, though, it's important to look below the surface and beyond conventional wisdom to consider different scenarios that could play out.*

## Five Key Risks

- The Fed's Independence–Credibility–Growth Dilemma
- U.S. Trade Negotiations with the Big Three
- Venezuela Aftermath and the Monroe Doctrine
- Partisan Policy, Brinkmanship, Shutdowns, and Fiscal Credibility
- AI Supply Chain Hiccup

### The Fed's Independence–Credibility–Growth Dilemma

Economic expansions do not die of old age, or so the saying goes. They end because of policy errors and exogenous shocks. Because exogenous shocks are typically hard to predict, the first two risks are tied to potential challenges in monetary policy and trade.

The Fed will have a new chair starting in June 2026, and with the White House publicly calling for lower rates, the administration is likely to nominate someone who is ready and willing to cut rates.<sup>4</sup>

This dynamic creates an unusual set of challenges that could complicate the Fed's dual mandate of full employment and stable prices.<sup>5</sup> Three Fed objectives that are often aligned—Independence, credibility, and growth—may fall out of equilibrium, potentially forcing the Fed to sacrifice one to deliver on the other two. It could be an Arrow's Impossibility Theorem of sorts, where no single policy choice can satisfy all constraints.<sup>6</sup>

In an ideal scenario, the Fed would want to signal its independence, maintain credibility in long-term inflation fighting, and stimulate short-term growth, but it may only be able to deliver on two of three. Sacrificing any one of those objectives could trigger market volatility.

We continue to believe that 2–3 rate cuts are likely warranted to keep real rates near 100 basis points, given inflation's progress towards the target and based on comments by Fed Chair Jerome Powell.<sup>7</sup> The combination of a new appointee and dovish rate policy, however, could call into question the Fed's independence and credibility.

One way the Fed can maintain its independence is by resisting White House pressure and keeping rates higher. Another is by shrinking its balance sheet to separate the bank from the financial system.<sup>8</sup> The balance sheet is currently about \$6.5 trillion, below the peak of



almost \$9 trillion during the pandemic, but still above pre-pandemic levels of around \$4.5 trillion. As a percent of GDP, the current 22% is a little above the post-2000 average of 18%.<sup>9</sup> As a percent of the S&P 500's market cap, the current 11% is below the average of 17%. Prior to the Global Financial Crisis, the balance sheet was about 6% of GDP and 7% of the S&P 500 market cap.

The challenge is that higher rates and balance-sheet reduction could drain liquidity, with different consequences. Higher rates generally increase the cost of capital, dampening borrowing and investment activity. Balance-sheet reduction by selling government securities risks creating a supply-demand imbalance that drives rates higher. Either path is restrictive, likely to slow growth and weigh on the labor market.

The Fed could lower rates to stimulate growth and reduce the balance sheet to offset concerns about independence, but the resulting flood of debt supply could undermine confidence in the Fed's ability to keep rates contained. Alternatively, the Fed could cut rates, hold the balance sheet steady, and focus on maintaining the inflation target to signal credibility, but in that scenario the perception of its independence could take a hit. A third option would be to deemphasize growth and focus on maintaining credibility and independence by ignoring calls for lower rates. Two out of three usually ain't bad, but in this case, it might not be enough.

*Related Themes: Presuming the risk is to the pro-growth/pro-inflation side, cyclicals such as energy and infrastructure; precious metals (gold and silver); and real assets like master limited partnership (MLP) pipelines.*

## U.S. Trade Negotiations with the Big Three

Upcoming trade negotiations with Canada, Mexico, China, the United States' three largest trading partners, come at a time when global trade tensions remain elevated. While no material tariff changes have been made to the United States-Mexico-Canada Agreement (USMCA) framework to date, the mandatory USMCA review in 2026 could prove challenging. U.S.-China trade negotiations are ongoing, with the moratorium on escalation on hold until November 2026, but any deterioration could quickly reintroduce market volatility.

Markets have become less reactive to trade headlines following the April 2, 2025 "Liberation Day" tariff announcement, but the USMCA review and U.S.-China trade relations could represent more material and sustained sources of risk. On April 2nd and the four trading days that followed, the S&P 500 fell 11.5% and the 10-Year U.S. Treasury yield rose 1.42%. On April 8th, the VIX spiked above 50.<sup>10</sup>

Given the deep integration of North American supply chains, a prolonged renegotiation could have broad economic consequences across multiple industries. Automakers, for example, have already delayed more than \$20 billion in investment amid the uncertainty, and potential changes to rules of origin could raise production and logistics costs.<sup>11</sup> Labor and energy policy disputes could further elevate risks, as more than 14 million jobs are tied to trilateral trade.<sup>12</sup>

In October 2025, President Trump and Chinese leader Xi Jinping agreed to a temporary trade truce that included lowering tariff rates and suspending Chinese export controls on rare earths for one year. While this truce eases pressures, agreements like this one are fragile. China remains one of the largest export markets for U.S. goods and services, second to Mexico, and the United States is China's largest export destination.<sup>13</sup> Tensions between the world's two largest economies could disrupt critical sectors including agriculture, technology, and energy. Any significant change to the current truce could impact global supply chains, consumer prices, and investment decisions.

With nearly 40% of U.S. trade subject to negotiation in the year ahead, modest disruptions could dent investor sentiment.<sup>14</sup> While markets may appear less sensitive to trade headlines, history shows that sudden policy shifts can quickly reintroduce volatility.

*Related Themes: U.S.-domiciled companies with domestic revenue spanning sectors such as infrastructure and electrification, as well as robotics that supports reshoring.*

## Venezuela Aftermath and the Monroe Doctrine

At first glance, U.S. military escalation in Venezuela may feel a little out of place on the list, as the country has largely been closed off from the global economy for more than a decade. Over that span, it has been characterized by minimal energy output and persistent inflation. That said, there are potentially larger considerations. The 2025 U.S. National Security released in December marked a change in focus, essentially shifting emphasis away from Europe and towards the Western Hemisphere in a way slightly reminiscent of the Monroe Doctrine issued in 1823 warning foreign powers from intervening in the U.S. sphere. This logic may have driven the recent operation in Venezuela as well as bringing discussions about Cuba and Greenland to the fore. While these issues may remain top of mind for the White House in the coming months, the likelihood of additional military action seems low for now. Venezuela was a unique case, and we identify two reasons why the aftermath of removing Nicolas Maduro from power may pose underappreciated market risks.

First, it seems the Trump administration believes that the path to negotiating an end to the Ukraine-Russia war involves reestablishing deterrence, and the recent military action in South America may have been an attempt to signal U.S. resolve. Whether Moscow and its supporters ultimately interpret the U.S. operation as an attempt at regional stabilization rather than a provocation remains to be seen.<sup>15</sup>

When the new administration entered the White House last January, there was a sense that oil prices were a path to ending the Ukraine-Russia war, with the theory being that lower prices through higher OPEC quotas and U.S. drilling would starve the Russian economy and make continued military action untenable.<sup>16</sup> Instead, Russia's supporters have helped prop up its military campaign. Getting Russia to the negotiating table on reasonable terms has proven more difficult than the administration expected.

The U.S. military has deployed a sizable force to South America and the Caribbean, with one carrier strike group and one amphibious ready group amounting to roughly nine naval vessels and 105 aircraft.<sup>17</sup> Since September 2025, the military has conducted at least 10



strikes against suspected drug cartel boats and intercepted two oil tankers. The operation to remove Maduro marked a clear escalation, and one that leaves open a range of possible outcomes for the region.

The second reason is that military operations are almost always more complicated than leaders expect, as evidenced by interventions in Lebanon (1982–1984), Somalia (1992–1994), Afghanistan (2001–2021), and Iraq (2003–2011, 2014–2021). Most major deployments deemed long and dangerous are never approved in the first place, creating a bias toward underestimating the intensity, resources, and even feasibility of success.<sup>18</sup>

In the case of Venezuela, the United States may be able to force regime change through kinetic means, but that does not guarantee a friendly regime comes in after. Multiple armed actors use Venezuela as an operational base, including narco cartels and Iranian-supported Hezbollah.<sup>19</sup> Any new government is unlikely to monopolize violence, leaving multiple armed groups with different interests and loyalties competing for influence. And that scenario has the makings of a quagmire.

*Related themes: Defense tech on increased demand; cybersecurity given the range of sub-state players' use of asymmetric tactics; and energy assets amid reduced supply supporting multiple industries, including energy infrastructure MLPs and natural gas.*

## Partisan Policy, Brinkmanship, Shutdowns, and Fiscal Credibility

A government shutdown is unlikely to derail markets or materially alter the economic outlook in isolation, but partisan politics beyond the budget could lead to brinkmanship that creates a larger and persistent challenge this year. With growing policy schisms across a wide range of issues, policy makers may choose whatever options available to stymy or steamroll opponents, especially with mid-term elections in November. The combination of ideological differences and debates over government authorities could drive even more aggressive political posturing that flows into concerns about continuity of government and expenditure.

When a shutdown coincides with elevated issuance, data opacity, and fragile liquidity conditions, the challenge becomes more complex. The risk is less about duration and more about repetition. If the tactic of fiscal brinkmanship continues to replace durable budget solutions, markets may increasingly price a persistent political risk premium, reflecting growing concerns around fiscal credibility.

The risk of another government shutdown is rising as political negotiations deteriorate and bipartisan alignment remains elusive. Midterm elections loom in November 2026, potentially creating a perception that brinkmanship may be rewarded. The most recent shutdown from October 1 to November 12, 2025, the longest on record at 43 days, reinforced how fiscal standoffs have shifted from episodic events to recurring features of the policy landscape. With narrow congressional margins and entrenched partisan positions, the likelihood that Congress continues to rely on temporary funding extensions remains elevated.<sup>20</sup>

Historically, markets are resilient to government shutdowns because economic fundamentals tend to dominate pricing. Equity markets and credit spreads generally absorb shutdown-related uncertainty and normalize once funding resumes.<sup>21</sup> Fixed income markets, however, are more sensitive to uncertainty around policy, liquidity, and data availability, factors that are increasingly important in the current environment.

In the early weeks of 2025, U.S. Treasuries experienced one of the largest selloffs of the past decade, with the 10-year yield rising more than 100 basis points from late-2024 lows and long-duration bonds posting sharp declines. The move reflected persistent inflation pressures and shifting expectations for Fed policy that coincided with mounting concern around fiscal deficits.<sup>22</sup> Importantly, markets stabilized after repricing higher, suggesting volatility driven by uncertainty rather than systemic stress.

The second episode followed the Liberation Day in April and ran through late May. Treasuries initially rallied as a safe haven amid the renewed trade and tariff uncertainty before reversing sharply, with long-end yields posting some of the steepest multi-day increases in decades. The move reflected a mix of inflation risk, forced selling, and a temporary erosion of confidence in Treasuries as a volatility hedge.<sup>23</sup> Yields ultimately normalized as positioning adjusted and policy clarity improved.

These episodes highlight that policy uncertainty, rather than economic deterioration, has been a dominant driver of debt market volatility. Policy uncertainty has been elevated and possibly remains so. Government shutdowns can amplify this dynamic by disrupting key economic data releases, including employment, inflation, and GDP. During recent shutdowns, bond investors were forced to rely more heavily on private indicators, increasing dispersion in rate expectations and volatility in a market that remains highly data dependent.<sup>24</sup>

*Related Themes: Precious metals like gold and silver potentially running higher amid government funding uncertainty; utilities tied to electrification and covered call strategies for portfolio ballast.*

## AI Supply Chain Hiccup

The AI ecosystem is in a period where small disturbances can have outsized effects on expectations. Enthusiasm around AI adoption has driven markets higher, but recent market volatility indicates that current valuations rely on the assumption that compute capacity scales rapidly and without interruption. Even temporary disruptions could challenge that assumption and introduce meaningful uncertainty. Nowhere is this sensitivity more apparent than in the semiconductor supply chain.

Semiconductors remain the bedrock of AI progress, yet the manufacturing base for advanced chips is remarkably narrow. Taiwan accounts for more than 70% of global foundry revenue and up to 92% of the most advanced chips.<sup>25</sup> While supply-chain discussions often focus on the possibility of a military conflict in the Taiwan Strait, lesser measures, such as sanctions, airspace restrictions, or a military exercise blockade, could disrupt supply chains or delay equipment servicing. Taiwan's geography adds another layer of vulnerability, as the Pacific Ring of Fire exposes production to earthquakes, tsunamis, and severe weather events.



Compounding these risks is the singular role of ASML in the semiconductor ecosystem. The Dutch company is the sole supplier of extreme ultraviolet (EUV) lithography systems required for the most advanced semiconductor nodes.<sup>26</sup> These machines depend on highly specialized optics and subsystems produced by a small group of partners, creating a tightly coupled network with few substitutes.

Beyond semiconductors, scaling AI workloads also depends on physical infrastructure, introducing additional constraints. While developed economies don't face aggregate power shortages, local politics and regulatory scrutiny increasingly shape the approval of new data centers. Rising utility bills, land-use debates, and concerns about energy-intensive industries could slow interconnection approvals or result in outright moratoriums.<sup>27</sup> Northern Virginia, one of the world's largest data-center hubs, has already signaled constraints on future development.<sup>28</sup>

At the input level, copper—critical to both data-center construction and electrification—faces structural supply challenges. Chile, Peru, and the Democratic Republic of Congo account for nearly half of global mined supply, leaving the market sensitive to political instability, labor disputes, and climate-driven disruptions.<sup>29</sup> These pressures could delay grid upgrades or data-center expansion. Other inputs are subject to similar constraints. Water availability shapes cooling strategies in data-center-dense regions, while rare earths, gallium, and industrial gases, all essential to chipmaking and lithography, remain geographically concentrated with limited substitutes. Although efforts are underway to diversify supply, progress is likely to be gradual.

*Related Themes: Copper miners positioned for the AI buildout, despite potential disruption; uranium and energy, with demand expanding alongside the data-center buildout; short-term Treasuries potentially offering downside protection if disruptions adversely affect corporate investment.*

**Jason Anderlik, Jack Kiernan, and Dylan Quigley contributed to this piece.**

## Footnotes

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