

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

May updates

We have two new items for May. Back on our list is the risk of another global pandemic, this time caused by the H5N1 strain of the influenza virus. The virus recently spread from birds to additional mammalian species, including dairy cattle herds in the U.S. While additional mutations would be needed for the virus to spread from person to person, it's concerning to see the virus still expanding its reach in animal species. If the virus does take hold in humans, markets would likely react in a similar manner as they did during the COVID-19 pandemic.

Also new to the list is school closure risk within the postsecondary education space that could result in a spike higher in defaults as enrollment levels are pressured by numerous factors across the country. For context, our internal analysis shows there have been 56 closures or mergers of U.S. colleges and universities since 2020, but 21 of those (nearly 38%) were recently announced closures for the coming academic year. In general, financial pressures are worse for smaller, private institutions as state support provides larger, public institutions with greater financial flexibility. We think there's a high probability of a spike in defaults this summer as schools reassess their financial situation between semesters. Postsecondary education exposure is most prevalent in the tax-exempt (municipal bond) segment of the market.

ALLSPRING INVESTMENT
ANALYTICS TEAM

Allview: Market Risk Monitor

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 Red Sea shipping traffic, and Hamas against Israel. In addition, the recent Iranian attack against Israel, involving over 300 drones and missiles, has sent tensions between the two nations to the brink of war. 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:

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|---------|------|--------|-----|
| 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:

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| 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:

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|-----------|------|--------|-----|
| Consensus | High | Medium | Low |
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GLOBAL IMPACT:

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| 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:

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|-----------|------|--------|-----|
| Consensus | High | Medium | Low |
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GLOBAL IMPACT:

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| 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:

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|-----------|------|--------|-----|
| Consensus | High | Medium | Low |
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GLOBAL IMPACT:

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| 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:

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|-----------|------|--------|-----|
| Consensus | High | Medium | Low |
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GLOBAL IMPACT:

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| 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:

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|-----------|------|--------|-----|
| Consensus | High | Medium | Low |
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GLOBAL IMPACT:

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| Extreme | High | Medium | Low |
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↑ 08 HUMAN BIRD FLU PANDEMIC

The World Health Organization recently called the H5N1 "bird flu" strain of the influenza virus an "enormous concern" as the virus has effectively caused a global zoonotic (animal) pandemic with its recent spread to mammals, including dairy and beef cattle. While only a small number of humans have contracted the virus, the possibility exists for it to mutate into a form that's transferable from human to human. Such a mutation could lead to an exponential increase in the transmission rate with the potential to cause another worldwide pandemic. Equity markets around the world could experience sharp corrections, with leisure and travel names encountering the most significant declines.

PROBABILITY:

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|-----------|------|--------|-----|
| Consensus | High | Medium | Low |
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GLOBAL IMPACT:

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| Extreme | High | Medium | Low |
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↑ 09 SPIKE IN DEFAULTS IN POSTSECONDARY EDUCATION

U.S. colleges and universities are under increasing financial pressure as long-term demographic trends and COVID-19 have meaningfully reduced enrollment. Making matters worse, the federal government's recent botched rollout of the new Free Application for Federal Student Aid (FAFSA) application has the potential to plunge near-term enrollment even further, potentially forcing financially distressed institutions into default later this year.

PROBABILITY:

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|-----------|------|--------|-----|
| Consensus | High | Medium | Low |
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GLOBAL IMPACT:

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| Extreme | High | Medium | Low |
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10 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:

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|-----------|------|--------|-----|
| Consensus | High | Medium | Low |
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GLOBAL IMPACT:

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| 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:

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|-----------|------|--------|-----|
| 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 |
|---------|------|--------|-----|

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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