Geopolitics Is No Longer a Tail Risk

Investors often ask which geopolitical tail risks keep us awake at night. Increasingly, the honest answer is: they are no longer tail risks. The conflict in the Middle East is disrupting major shipping routes and global energy markets, the war in Ukraine has rewritten Europe's investment priorities, and the US-China technology race is accelerating by the month. These are not low-probability events lurking on the horizon. They are the new baseline. The challenge for markets is not identifying the shocks. It is understanding how long they remain embedded in the economic landscape.

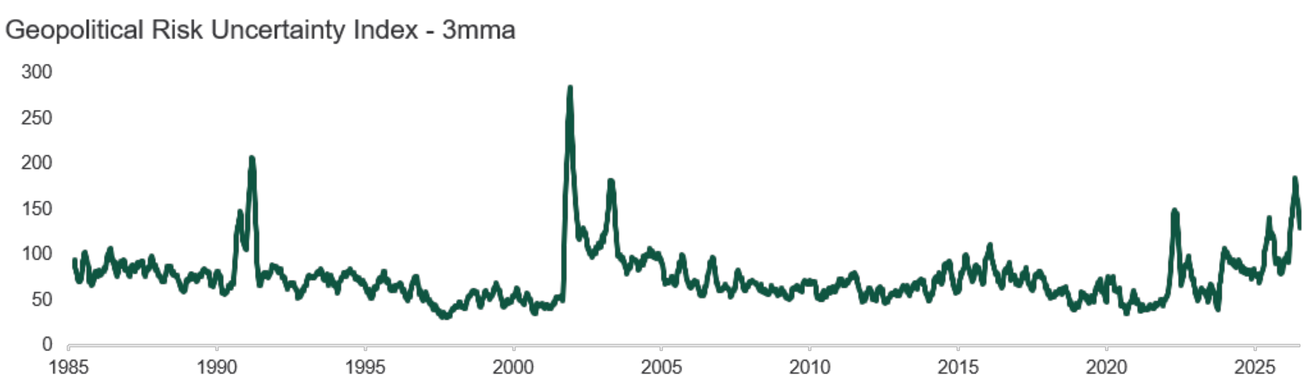
First, the Middle East. The re-escalation of the Iran-US conflict is once again threatening the world's most important energy and shipping corridors. Iran continues to exert pressure over traffic through the Strait of Hormuz, while Yemen's Houthis have announced actions targeting Saudi shipping through the Bab al-Mandab Strait, the critical gateway to the Red Sea. Gulf states remain divided over how the conflict should be resolved, reducing the likelihood of a coordinated regional solution. Investors should therefore prepare for intermittent disruptions rather than a quick diplomatic breakthrough.

Second, Ukraine. Russia has intensified ballistic missile and drone attacks on Kyiv despite making little meaningful territorial progress in eastern Ukraine. Meanwhile, improved Ukrainian strike capabilities have increasingly targeted Russian supply lines, fuel depots, and oil infrastructure, including routes supporting Crimea. The result is a war that is shifting from territory to economic attrition. Energy markets are already feeling the effects. Diesel and refined-product markets remain unusually tight, helping keep distillate prices elevated even when crude prices appear relatively stable.

Third, technology. Moonshot AI's latest Kimi model is a reminder that the AI race between China and the US is accelerating rather than slowing. What began as a commercial competition has evolved into a strategic contest involving intellectual property, national security, and technological leadership. Some US policymakers have openly questioned whether American technological advantages are adequately protected. Investors should remember that AI is no longer merely an earnings story. It has become a geopolitical one.

The common thread is that the world's most important growth drivers, energy systems, and technological platforms are all becoming more politically contested. Markets continue to celebrate AI-driven productivity gains and resilient economic growth. Yet the same forces supporting growth are also intensifying geopolitical rivalry. The lesson for investors is uncomfortable but clear: geopolitics is no longer an occasional source of volatility. Increasingly, it is becoming the macroeconomic backdrop itself. The question is not whether these risks will disappear. It is whether investors have fully appreciated a world in which disrupted shipping lanes, persistent energy insecurity, and technological competition are no longer exceptions to the rule, but are priced as routinely as inflation prints or earnings season.

A MORE CONTESTED WORLD – GEOPOLITICAL UNCERTAINTY REMAINS ELEVATED



Source: Northern Trust Asset Management, Bloomberg. Three-month moving average in Caldara Iacoviello Geopolitical Risk (GPR) Uncertainty Index using weekly data from 1/6/1985 until 7/13/2026. Historical trends are not predictive of future results.

POSITIONING SCENARIOS

Productivity Upside (25% probability)

Tax cuts, deregulation and AI adoption more than offset supply restraints. Strong productivity gains continue, allowing for robust economic growth without sparking higher inflation.

Two-Speed Expansion (50% probability)

Soft labor force dynamics and a bifurcated economy govern what would otherwise be a stronger growth environment, resulting in a trend-like expansion and disinflation.

Economic Fault Lines Broaden (25% probability)

The economic expansion is cut short by persistent supply-side restraints, energy headwinds, or AI-related disruption that weakens activity and/or tightens financial conditions.

Note: Probabilities are assumed from proprietary research and are subject to change.

Additional Index Definitions:

Bloomberg Treasury Bills 1-3 Months: The Bloomberg U.S. Treasury Bills: 1-3 Months Index tracks the market for treasury bills issued by the U.S. government with time to maturity between 1 and 3 months. US Treasury bills are issued in fixed maturity terms of 4, 8, 13, 17, 26 and 52 weeks.
Bloomberg U.S. Treasury: The Bloomberg US Treasury Index measures US dollar-denominated, fixed-rate, nominal debt issued by the US Treasury. Treasury bills are excluded by the maturity constraint but are part of a separate Short Treasury Index. STRIPS are excluded from the index because their inclusion would result in double-counting. The US Treasury Index is a component of the US Aggregate, US Universal, Global Aggregate and Global Treasury Indices. The index includes securities with remaining maturity of at least one year.
Bloomberg Global Treasury: The Bloomberg Global Treasury Index tracks fixed-rate, local currency government debt of investment grade countries, including both developed and emerging markets. The index represents the treasury sector of the Global Aggregate Index.
Bloomberg Municipal: The Bloomberg Municipal Bond: Index is a flagship measure of the US municipal tax-exempt investment grade bond market. Included in the index are securities from all 50 US States and four other qualifying regions (Washington DC, Puerto Rico, Guam, and the Virgin Islands). The index includes state and local general obligation bonds and revenue bonds. All bonds in the Municipal Bond Index are tax exempt and hence are not eligible for other indices that include taxable bonds, such as the Bloomberg U.S. Aggregate.
Bloomberg U.S. TIPS: The Bloomberg US Treasury Inflation-Linked Bond Index (Series-L) measures the performance of the US Treasury Inflation Protected Securities (TIPS) market. Federal Reserve holdings of US TIPS are not index eligible and are excluded from the face amount outstanding of each bond in the index.
Bloomberg Global Inflation-linked: The Bloomberg Global Inflation Linked Index (Series-L) measures the investment-grade, government inflation-linked debt from 12 different developed market countries. Investability is a key criterion for inclusion of markets in this index, and it is designed to include only those markets in which a global government linker fund is likely and able to invest.
Bloomberg U.S. Aggregate: The Bloomberg US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, fixed-rate agency MBS, ABS and CMBS (agency and non-agency). Provided the necessary inclusion rules are met, US Aggregate-eligible securities also contribute to the multi-currency Global Aggregate Index and the US Universal Index.
Bloomberg Global Aggregate: The Bloomberg Global Aggregate Index is a flagship measure of global investment grade debt from twenty-seven local currency markets. This multi-currency benchmark includes treasury, government-related, corporate and securitized fixed-rate bonds from both developed and emerging markets issuers.
JP Morgan GBI – EM Global Diversified Composite Index: The J.P. Morgan Emerging Markets Bond Index Global Diversified tracks total returns for U.S. dollar-denominated debt instruments issued by emerging market sovereign and quasi-sovereign entities.
Bloomberg U.S. High Yield: The Bloomberg US Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on the indices' EM country definition, are excluded. The US Corporate High Yield Index is a component of the US Universal and Global High Yield Indices.
Bloomberg Global High Yield: The Bloomberg Global High Yield Index is a multi-currency flagship measure of the global high yield debt market. The index represents the union of the US High Yield, the Pan-European High Yield, and Emerging Markets (EM) Hard Currency High Yield Indices. The high yield and emerging markets sub-components are mutually exclusive.
MSCI AC World: The MSCI ACWI captures large and mid cap representation across 23 Developed Markets (DM) and 24 Emerging Markets (EM) countries.
MSCI USA: The MSCI USA Index is designed to measure the performance of the large and mid cap segments of the US market.
S&P 500: The index, a gauge of the large-cap U.S. equity market, includes 500 companies that represent approximately 80% of the market capitalization of publicly traded U.S. equities.
Russell 2000: The Russell 2000® Index measures the performance of the small-cap segment of the US equity universe.
Russell 1000 Growth: The Russell 1000® Growth Index measures the performance of the largecap growth segment of the US equity universe. It includes those Russell 1000 companies with relatively higher price-to-book ratios, higher I/B/E/S forecast medium term (2 year) growth and higher sales per share historical growth (5 years). The Russell 1000® Growth Index is constructed to provide a comprehensive and unbiased barometer for the large-cap growth segment. The index is completely reconstituted annually to ensure new and growing equities are included and that the represented companies continue to reflect growth characteristics.
Russell 1000 Value: The Russell 1000® Value Index measures the performance of the largecap value segment of the US equity universe. It includes those Russell 1000 companies with relatively lower price-to-book ratios, lower I/B/E/S forecast medium term (2 year) growth and lower sales per share historical growth (5 years). The Russell 1000® Value Index is constructed to provide a comprehensive and unbiased barometer for the large-cap value segment. The index is completely reconstituted annually to ensure new and growing equities are included and that the represented companies continue to reflect value characteristics.
MSCI World: The MSCI World Index captures large and mid cap representation across Developed Markets countries.
MSCI World ex US: The MSCI World ex USA Index captures large and mid cap representation across 22 of 23 Developed Markets (DM) countries*--excluding the United States. With 778 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.
MSCI Europe: The MSCI Europe Index captures large and mid cap representation across Developed Markets (DM) countries in Europe. The index covers approximately 85% of the free float-adjusted market capitalization across the European Developed Markets equity universe.
MSCI Japan: The MSCI Japan Index is designed to measure the performance of the large and mid cap segments of the Japanese market. The index covers approximately 85% of the free float-adjusted market capitalization in Japan.
MSCI Emerging Markets: The MSCI EM (Emerging Markets) Index is a free-float weighted equity index that captures large and mid cap representation across Emerging Markets (EM) countries. The index covers approximately 85% of the free float-adjusted market capitalization in each country.
MSCI China: The MSCI China Index captures large and mid cap representation across China A shares, H shares, B shares, Red chips, P chips and foreign listings (e.g. ADRs). The index covers about 85% of this China equity universe. Currently, the index includes Large Cap A and Mid Cap A shares represented at 20% of their free float adjusted market capitalization.
S&P Global Natural Resources: The index includes 90 of the largest publicly-traded companies in natural resources and commodities businesses that meet specific investability requirements, offering investors diversified and investable equity exposure across 3 primary commodity-related sectors: agribusiness, energy, and metals & mining.
S&P Global Infrastructure: The S&P Global Infrastructure Index is designed to track 75 companies from around the world chosen to represent the listed infrastructure industry while maintaining liquidity and tradability. To create diversified exposure, the index includes three distinct infrastructure clusters: energy, transportation, and utilities.
MSCI ACWI IMI Core Real Estate: The MSCI ACWI IMI Core Real Estate Index is a free float-adjusted market capitalization index that consists of large, mid and small-cap stocks across 23 Developed Markets (DM) and 24 Emerging Markets (EM) countries* engaged in the ownership, development and management of specific core property type real estate. The index excludes companies, such as real estate services and real estate financing companies, that do not own properties.
Cboe S&P 500 Dispersion Index (DSPX): The Cboe S&P 500 Dispersion Index (DSPX) measures the expected dispersion in the S&P 500® over the next 30 calendar days, as calculated from the prices of S&P 500 index options and the prices of single stock options of selected S&P 500 constituents, using a modified version of the VIX® methodology.
Caldara Iacoviello Geopolitical Risk (GPR) Uncertainty Index (GPRXGPRD): Geopolitical Risk Index (GPR) is compiled by Fed economists Dario Caldara and Matteo Iacoviello. It measures the occurrence of impactful geopolitical events/threats/conflicts since 1985 by counting the keywords used in the press. The Caldara and Iacoviello GPR index reflects automated text-search results of the electronic archives of 10 newspapers: Chicago Tribune, the Daily Telegraph, Financial Times, The Globe and Mail, The Guardian, the Los Angeles Times, The New York Times, USA Today, The Wall Street Journal, and The Washington Post. Caldara and Iacoviello calculate the index by counting the number of articles related to adverse geopolitical events in each newspaper for each month (as a share of the total number of news articles).