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# Thirty-Thousand Feet

*How might the markets surprise us in 2025?*

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## Preparing for the Unexpected

It has become somewhat of a Wall Street tradition each January for strategists to come up with a list of ways the markets could potentially surprise investors in the year ahead. The annual custom can be traced back to the late Byron Wien, who started publishing his widely followed list back in the mid-1980s while at Morgan Stanley. Mr. Wien defined a surprise on his list as something that the average investor would only assign about a one-in-three chance of occurring, but that he thought was closer to 50/50. I have always believed that this is a useful exercise. Markets have a funny way of habitually surprising us and proving conventional thinking wrong, so having an idea of where the potential forks in the road may come from just makes us better prepared and informed as investors.

Below is my compilation of eight potential surprises for markets in 2025. Please remember these are not all meant to be seen as forecasts or base-case views, but rather a thought exercise around potential risks and opportunities that the markets might be overly discounting in 2025.

## Eight Potential Surprises for 2025 (in no particular order)

1. **AI enters a "winter" period:** Artificial intelligence (AI) stocks have soared in recent years, mirroring past periods of tech speculation. Predicting the impact and path of new technologies is challenging, but history does offer a potential guide. Past technology booms, going back as far as the mid-19th century, have tended to follow a similar boom-bust pattern where a surge of capital fuels massive investment, leading to overbuilding, poor returns for the industry, and ultimately, a protracted decline for shareholders. It's often in the aftermath that the true value of the technology emerges, paving the way for the long-term winners in the space. While AI doesn't have to follow this path, the risk of a similar boom-bust cycle unfolding is not zero either, and there is certainly some potential that a first-wave boom ends in 2025, and the AI theme enters a winter period.

2. **Geopolitics matters again:** Since the Russian invasion of Ukraine almost three years ago now, geopolitics hasn't mattered much to the markets. As the geopolitical stage has become less stable, markets have routinely looked past the escalations in the Middle East and Eastern Europe and have quickly re-embraced risk. Geopolitical episodes are now almost seen as buying opportunities, and I would even go as far as to say that the contrarian positive response to geopolitical turmoil has become Pavlovian in nature. This cavalier attitude in the markets towards geopolitical risk reeks of complacency and complacency can only get rewarded for so long. Don't be that surprised if something happens in the geopolitical arena this year that dramatically impacts markets.

3. **Corporate credit has a Minsky moment:** Corporate credit spreads are trading near their tightest levels in more than two decades. They are basically priced for perfection, even with corporate bankruptcies marching higher. Steady deal flow, the growing importance of private credit funds, and a belief in an economic soft landing are driving the extreme optimism in the space. There is also a bit of a positive feedback loop at work as tightening credit spreads are taken as a key barometer of stability in the capital markets. But spreads can only get so tight, and we have reached levels where, historically, things happen that change the narrative and upset the apple cart. In accordance with Hyman Minsky's observation that "stability begets instability," the probability of a credit event in 2025, necessitating a credit market repricing, is probably quite a bit higher than most investors think.

4. **Energy makes a comeback:** Oil had a rough year in 2024 as the prevailing narrative within the market centered on a scenario of oversupply, characterized by a perceived accumulation of global oil inventories. However, contrary to the expectations of many, global crude oil stockpiles actually fell on balance over the course of 2024. In the U.S., crude inventories are near their lowest levels in five years even with production near record levels. The new administration's efforts to boost supply likely won't come to fruition until 2026 at the earliest, so there is plenty of risk that oil could surprise the markets by moving higher in 2025 — particularly if efforts to replenish inventories are expedited.

5. **Brazil outperforms this year:** Brazil's economic and fiscal woes were evident in 2024, with the currency depreciating over 20% against the dollar and the stock market experiencing a 10.5% decline in local terms. Not surprisingly, sentiment and positioning in Brazil are near their lowest levels in years. However, there is a lot of potential value to unlock in Brazilian assets if the current government can find a way to get its fiscal house in order. With a general election approaching in 2026, the Lula government will be extremely motivated to find a solution. If they do, there would likely be a dramatic positive repricing of Brazilian assets in which the real and Bovespa outperform global benchmarks at some point this year.

6. **Economic growth fears re-emerge:** The broader economy has a nasty habit of doing the opposite of what most people expect on a fairly regular basis. Take for instance, two years ago, consensus was certain that the U.S. was headed for recession. Some economic models said the chances were as high as 80%, yet the economy surprised to the upside. This year, we have the opposite, and almost nobody is worried about a slowdown. With unemployment turning up from near record lows, it wouldn't be difficult to see fears of a more material slowdown develop if unemployment momentum picks up just a little bit more than forecasted.

7. **There is a sovereign rates scare outside the United States:** A higher global rate environment increases the chances that something breaks outside the United States. Globally, total debt to gross domestic product (GDP) is approaching 200%; France is over 300%, while Japan is near 400%. Arguably, we have already seen concerns materialize with recent developments in the United Kingdom. The fact of the matter is such high global debt loads are much more difficult to manage when longer-term rates are moving higher. Will 2025 be the year that "bond market vigilantes" finally take issue with the structural backdrop? Time will only tell, but it certainly seems well within the realm of possibility.

8. **Response to U.S. tariff policy is not a replay of Trump 1.0:** The consensus thinking around tariffs is that countries adversely impacted by them will just respond in the exact same way they did during Trump 1.0. But this assumes countries haven't learned anything from their prior experiences and completely ignores the fact that many economies, like China, have radically transformed themselves over the last six years. In China's case, they are no longer just producers of low-margin goods. They have become an important producer of big-ticket industrial items, which they export to many emerging markets. This has seen their trade surplus increase by about 300%, and the U.S. has become a much smaller part of their total trade. With China in a much different position now than in 2018, the odds of them responding to tariffs by doing something other than just devaluing their currency is probably higher than most think.

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