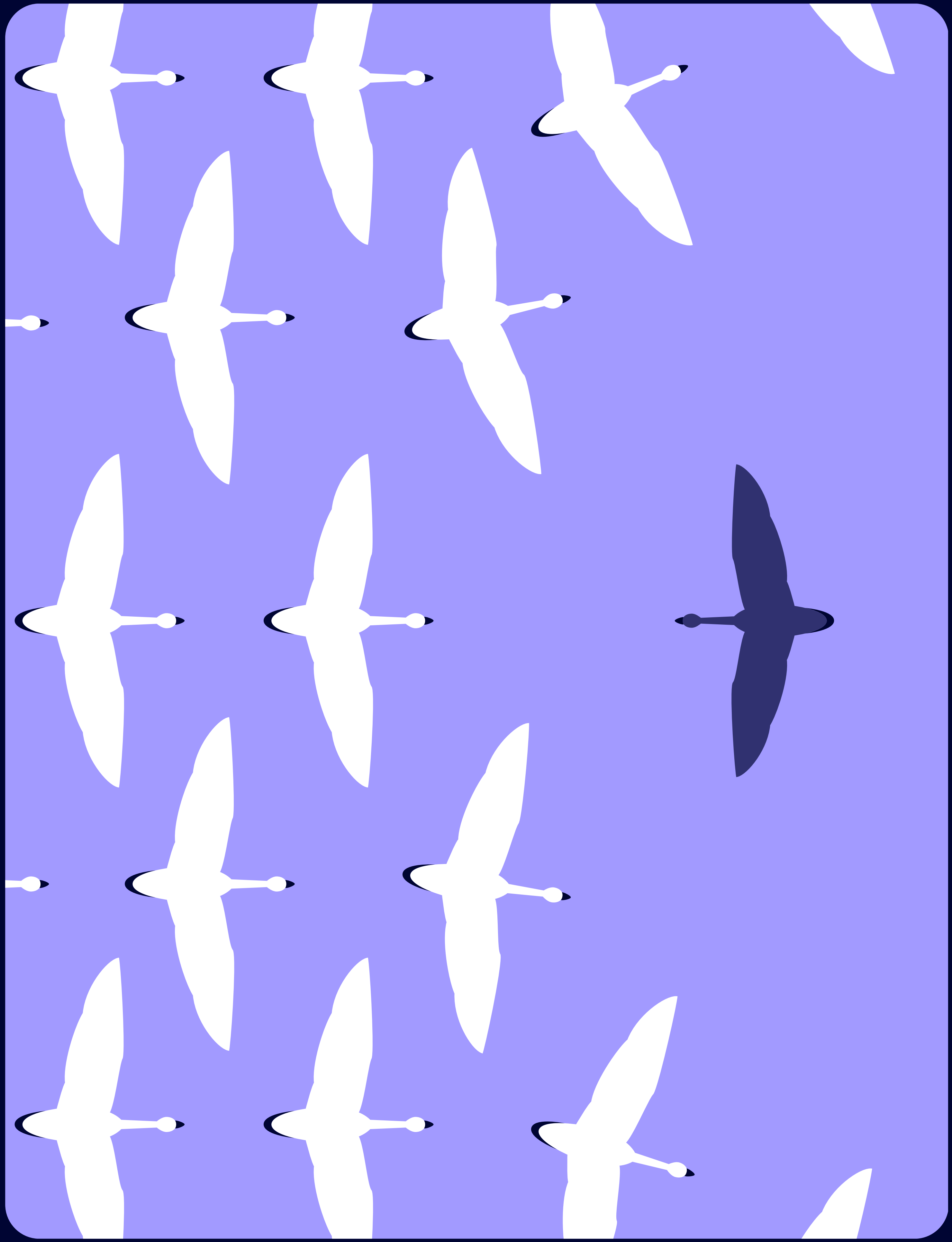
Six Grey Swans that could move markets in 2026



STATE STREET INVESTMENT MANAGEMENT

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A Grey Swan, as we define it, is an outlier scenario which—though unlikely—has the potential to shape markets in meaningful ways if it happens. Because the future rarely unfolds exactly as expected, every year we examine possibilities that sit outside our base case to strengthen our risk aware approach. For investors, such an exercise encourages more flexibility to adapt and adjust portfolios if unexpected events arise. By mapping out possibilities early, investors can better evaluate hedging strategies—and the habit of stress testing views is valuable, even if such scenarios never occur.

We have identified our Grey Swans—some less-probable, but still possible scenarios—for the year ahead and unpack their potential investment implications. For our base case viewpoints, explore the <u>Global Market Outlook 2026</u>.

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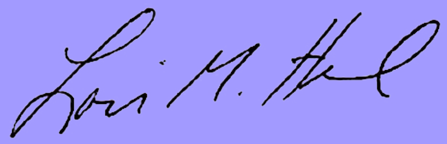
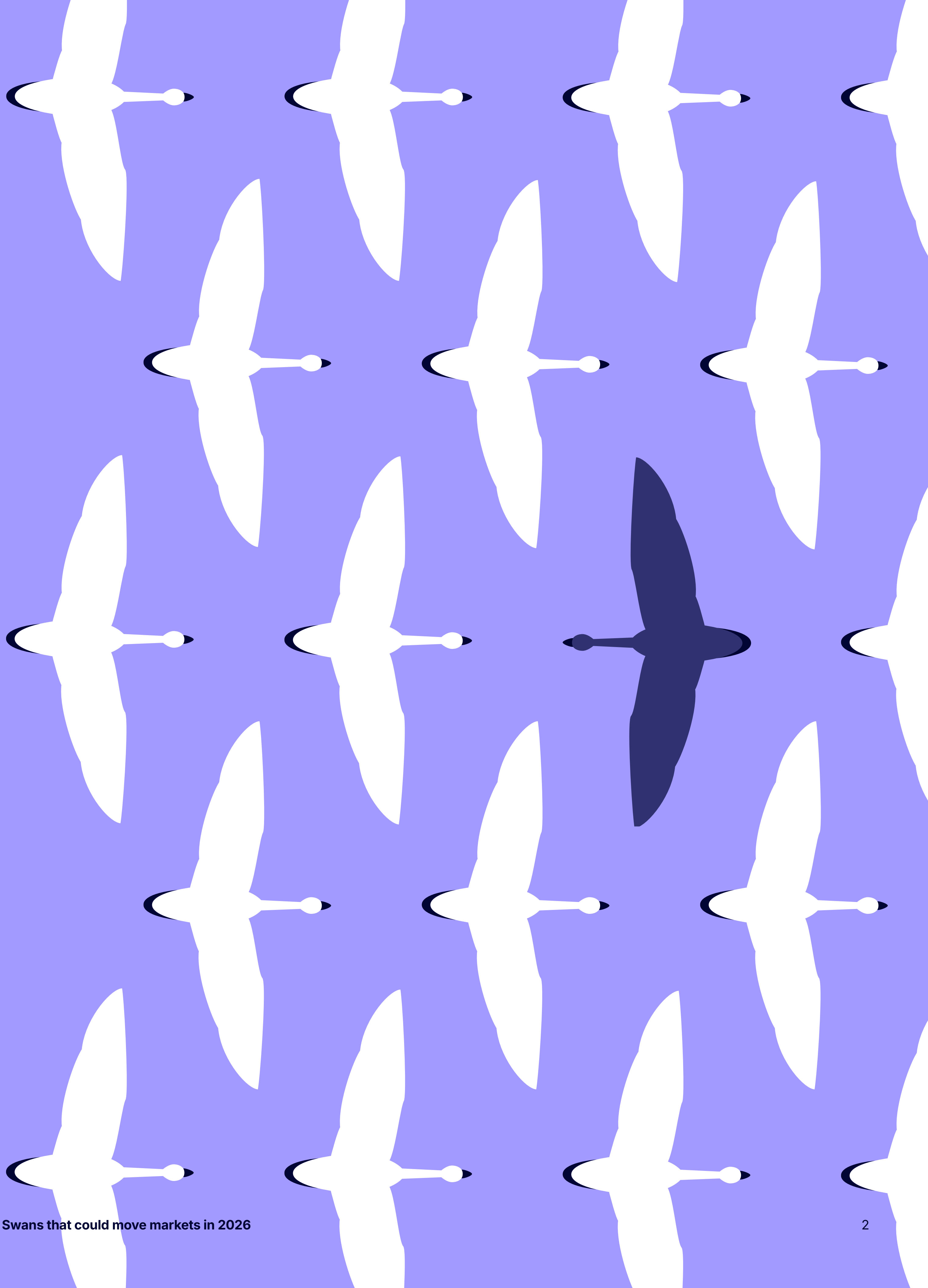
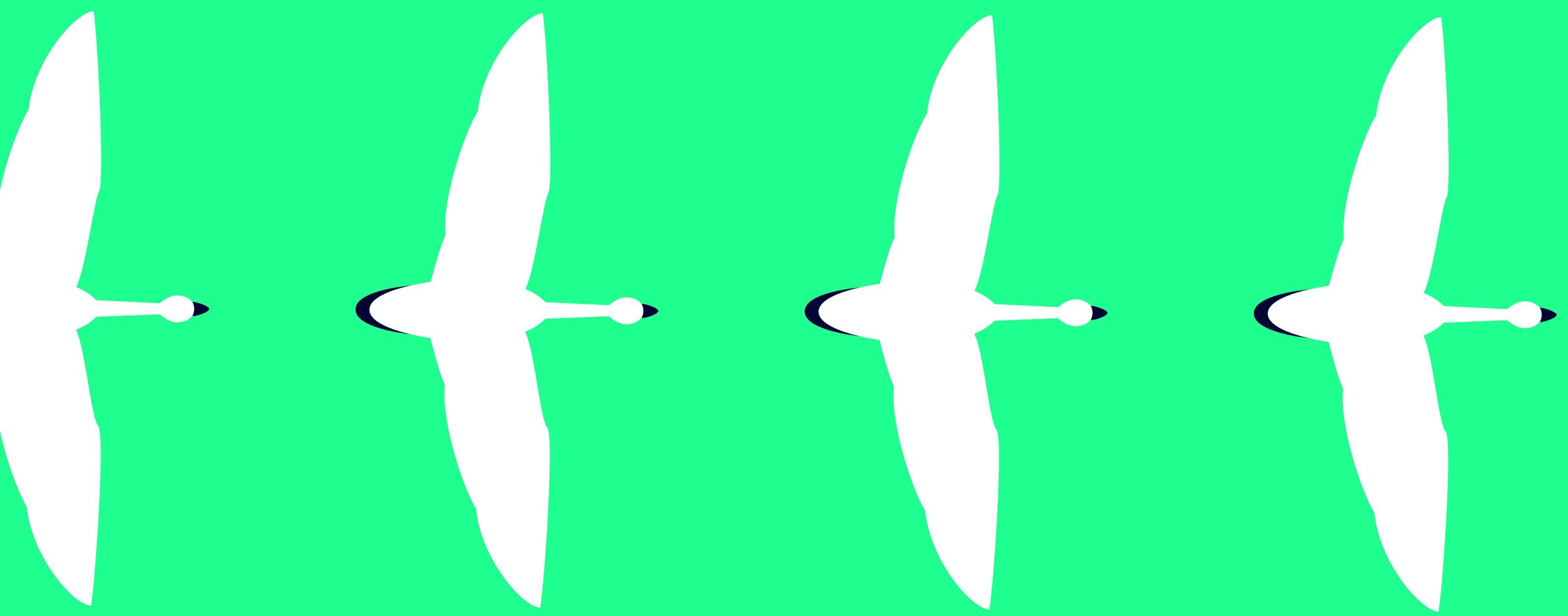




1 AI fails to scale



Artificial intelligence (AI) has been positioned as a transformative power that drives capital expenditures and delivers productivity gains. Our Global Market Outlook captures AI as a structural force influencing everything from corporate earnings to policy decisions, through accelerating productivity to reshaping competitive dynamics. While AI-related equity valuations are very high, the argument is that AI is still early in its monetization curve and has the potential for real future growth in earnings across a broad range of sectors and geographies. But what if AI fails to scale in the manner expected?

What if systemic constraints such as semiconductor shortages, energy supply limits, and regulatory barriers converge to upend the projected narrative? Such an unlikely ‘perfect storm’ scenario forms the basis of this Grey Swan.

Hardware bottlenecks

AI’s hunger for computational power has thus far proved insatiable, and scaling Large Language Models (LLMs) or advanced generative systems requires a steady supply of high-performance semiconductor chips. Because production of these is largely concentrated in a few regions and dominated by relatively few companies, supply disruption could have far-reaching effects (see table).

Energy strain and systemic blowback

Training and deploying advanced AI models consumes massive amounts of energy, running the risk of demand spiking above grid capacity. For instance, in Virginia, where Loudoun County has the world's highest concentration of data centers already accounting for over 20% of Dominion Energy's sales, demand growth is projected to double Virginia's total energy consumption by 2040. If the energy grid cannot keep pace with data center demand, a knock-on effect of rising energy prices and environmental concerns could trigger more localized public and political resistance. Higher energy prices would also erode tech margins, while a halt to data center construction could severely restrict AI progression.

Regulatory blowback

As new AI use cases emerge, there is the potential for developments to reach some threshold that sparks a regulatory clampdown in response to unexpected negative effects. Efforts to relax regulations could unravel due to content moderation failures; an outcry over AI models that generate explicit content has already raised the specter of a backlash that results in more rules and oversight. If other countries follow Australia’s ban on social media for minors the impact could slow innovation and raise compliance/ regulatory costs.

A failure to scale challenges consensus AI growth expectations. Those involved in AI development have so far proved adept at navigating a shifting environment, but a combination of unexpected developments could derail assumptions. In this scenario, it would make sense for investors to reassess exposure to semiconductor makers, data center operators, and AI-driven platforms as well as move to adopt more defensive and diversified positions.

Factor	Scenario	Potential Impact
Geopolitical Tensions	Escalation of export restrictions, such as limiting advanced chip sales	Disruption of global supply chains
Manufacturing Disruptions	Natural disasters and/ or shutdown of key fabrication plants	Choked production and reduced chip availability
Economic Impact	Shortage of chips affecting multiple industries	Stalled AI progress, slowed innovation, inflated costs, and widespread sector disruption

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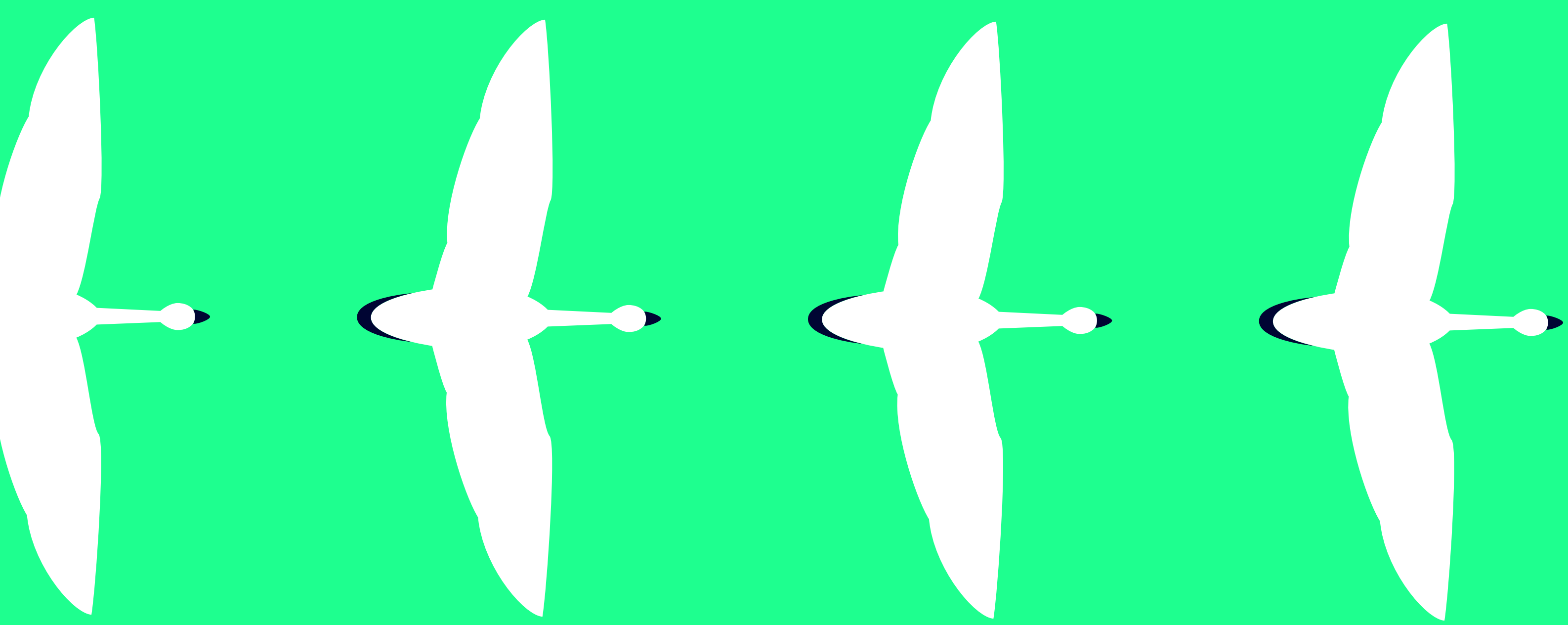
China goes shopping



There is a saying that when the going gets tough… the tough go shopping. In a world beset by inter-country rivalry and heightened tensions, what if the largest exporting country abruptly became the world’s most voracious shopper—not just to fuel growth, but to cool global tempers? In this Grey Swan scenario, China jolts markets and policymakers by unleashing a bold, demand-driven pivot: letting the RMB rocket higher and, most crucially, turning decisively inward to revive domestic consumption.

This is more than economic engineering; it's a calculated move to deescalate mounting trade rifts with Europe and emerging markets after China's trade surplus blew past US$1 trillion in 2025. The imbalance is no longer about runaway exports—export growth barely outpaced GDP—but about chronically weak household demand. In a remarkable pivot, Beijing acknowledges that the path to sustainable growth, and to restoring international goodwill, lies in empowering Chinese consumers and rebalancing toward internal demand.

Flush with confidence after regaining control of its economic trajectory—signaled by Xi Jinping's 2026 New Year message, which dropped all caution about external uncertainties—China's leadership seizes a "policy breather." The focus shifts from trade wars and technological power struggles to raising living standards at home, a core political goal.

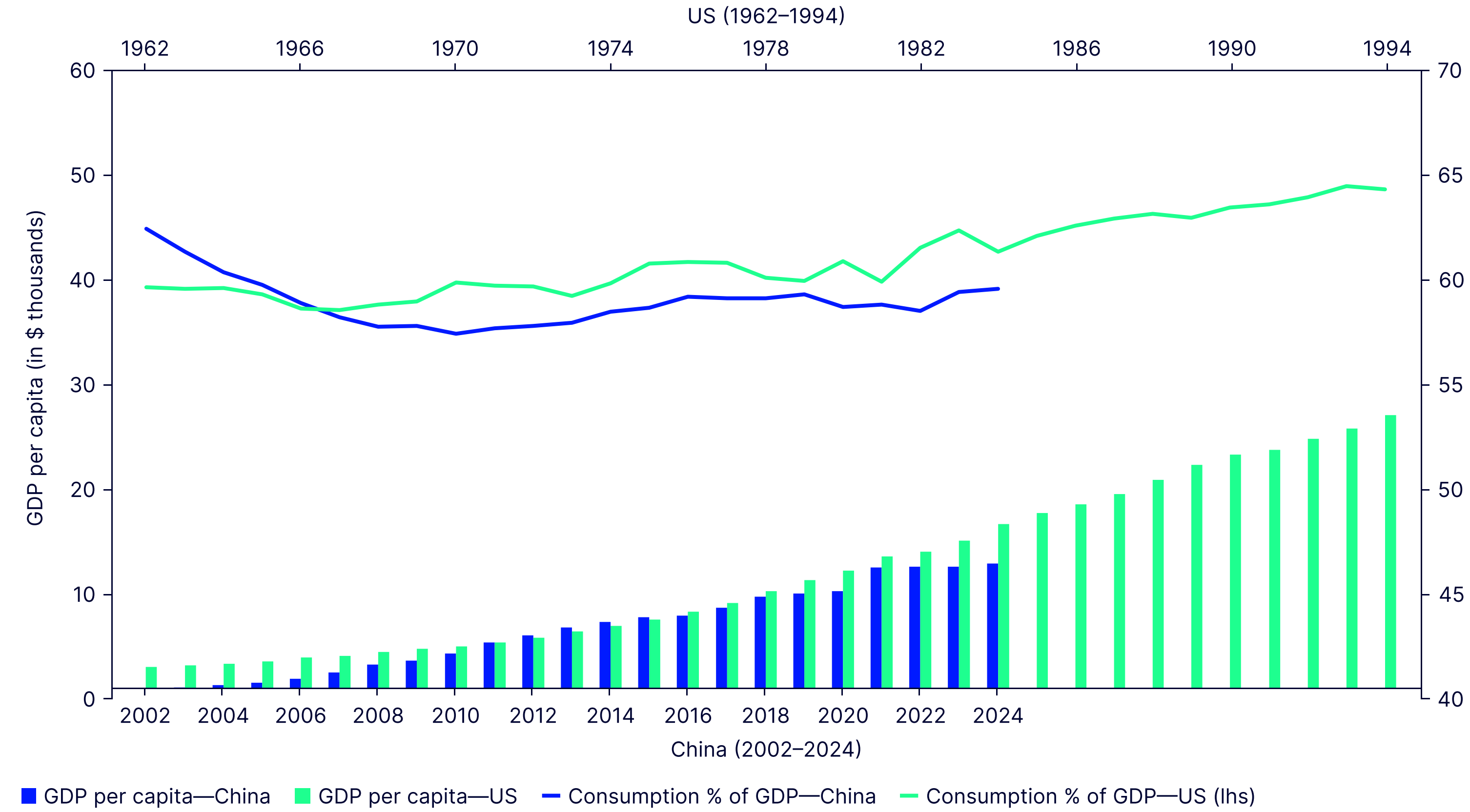
- The government rolls out demand-side stimulus to support property, expand social welfare, and incentivize household spending.
- The RMB's managed appreciation boosts purchasing power, cheapens imports, and spurs consumption, while also easing trade tensions.
- "Internal circulation" becomes the engine of Beijing's dual-circulation strategy, and the push for a "unified national market" breaks down regional barriers, scaling demand nationwide.

Using the US as a comparison, rising per capita GDP led to increased consumption as a share of GDP. As Figure 1 shows, China's consumption remains low at 35–40%. If China follows the US trajectory, rising incomes should drive a steady increase in consumption—unless it falls into the "middle income trap". This inflection point strengthens the case for a consumption-led growth pivot.

The macro and market impact of this pivot would be significant. Supportive global conditions—accommodative monetary policy, fiscal stimulus, and a fresh start into the inventory cycles—boost traditional industries and new sectors such as AI and renewables, driving earnings and fundamental growth in 2026. RMB currency strength and policy clarity attract foreign inflows into equities and bonds, lift sentiment across Asia, support regional currencies, and underpin commodity demand.

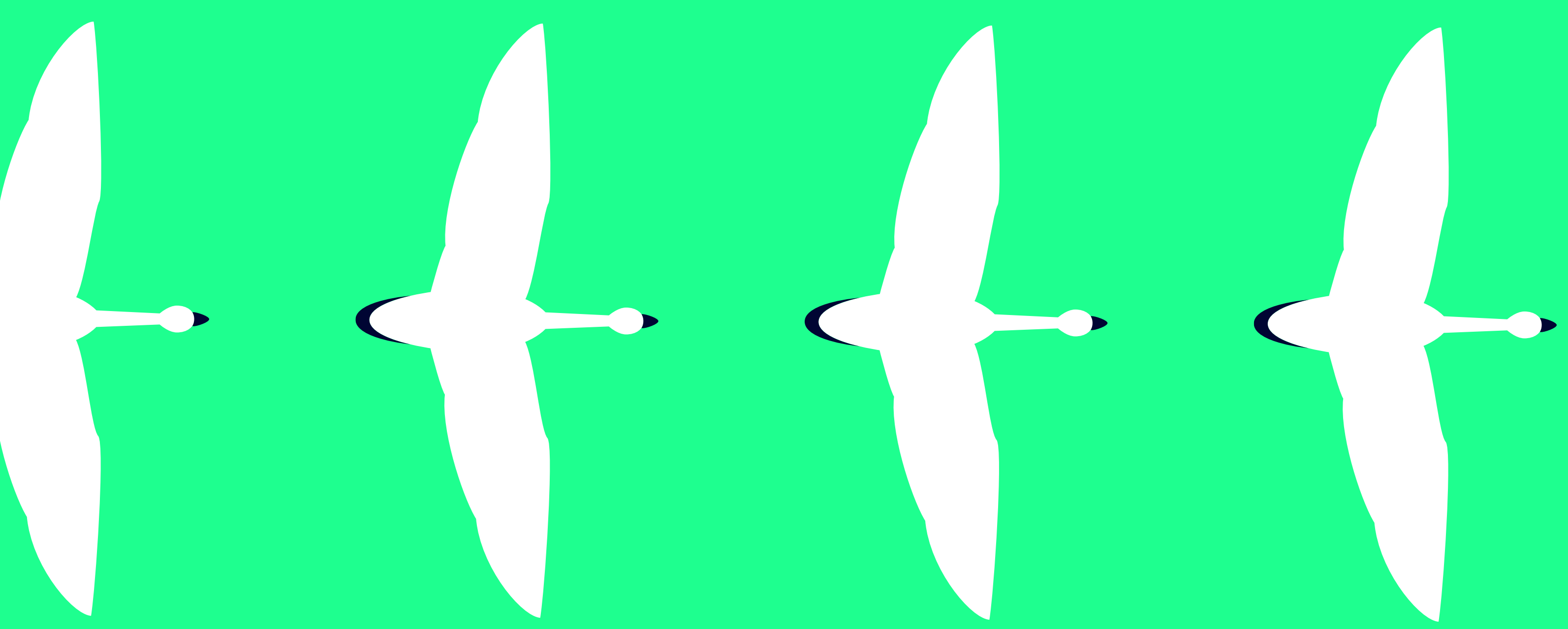
In this scenario, investors should favor consumer-focused stocks, selective cyclical exposure, and look toward ASEAN exporters and resource economies, while also maintaining positions in defensive assets.

Figure 1: China ready for consumption pivot: Parallel from US history



Source: Bloomberg Finance L.P., State Street Investment Management as of December 31, 2025.

3 Fortress North America



The April 2 tariff announcement was the defining economic and policy event of 2025. This marked the beginning of an acute, policy-driven disruption phase in global supply chains, injecting uncertainty into relatively stable international trade relationships. In this Swan, we posit that 2026 brings about a powerful reinvigoration of the US's relationships with Mexico and Canada, with the US taking a leadership role in building a strong multi-dimensional alliance.

The first joint review of the USMCA trade agreement is due in mid-2026. Given the approach initially taken by the US—the very first tariffs announced were not on China, but on Canada and Mexico—speculation has run high that the entire arrangement could simply collapse, that the US may perhaps simply withdraw just as it did with the Paris agreement or other organizations that it no longer sees as "serving America's interests".

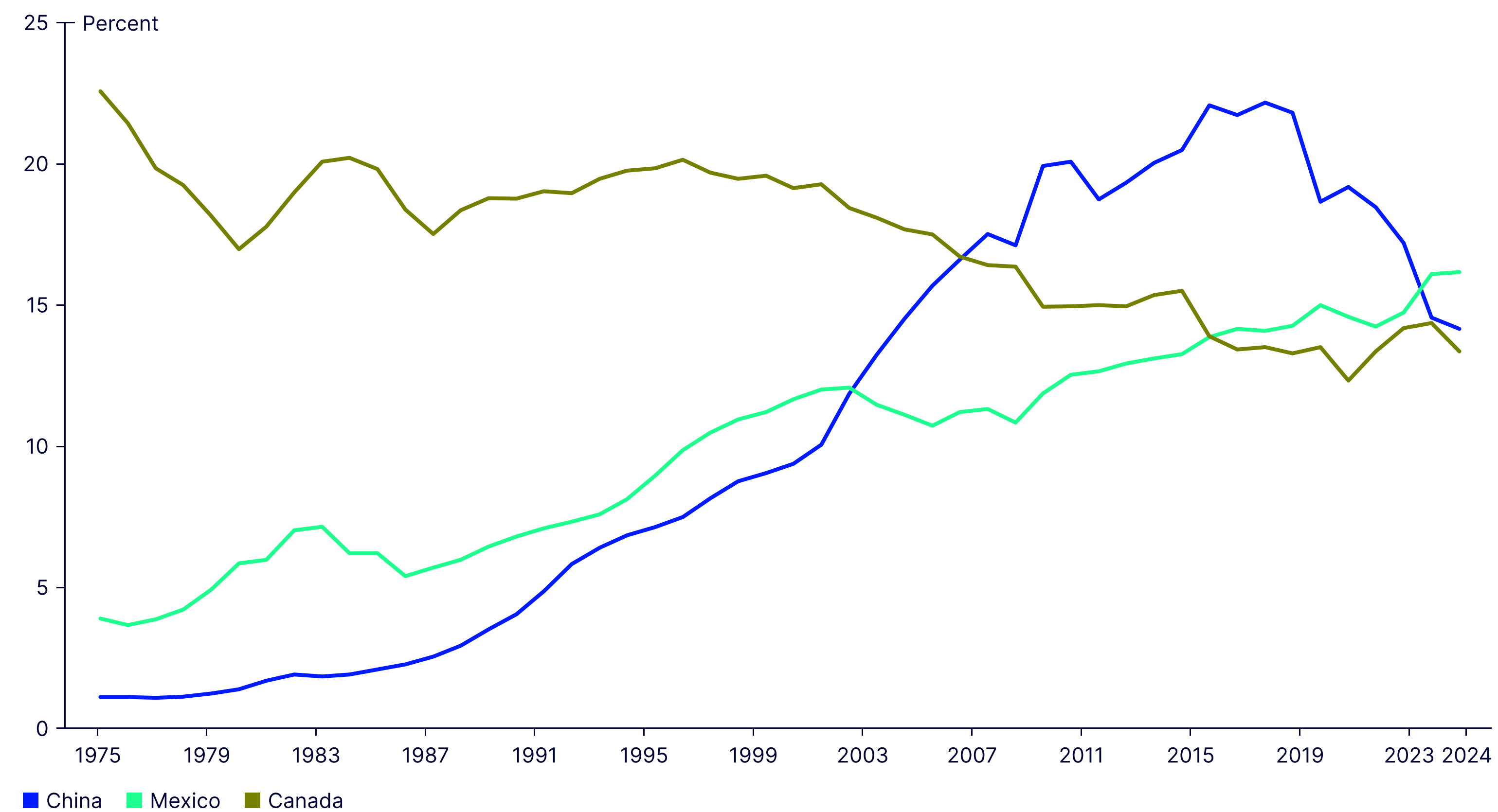
Yet, we could imagine a future where the opposite occurs: 2026 ushers in a reconstruction phase that redefines North American trade and security architecture. Renegotiations lead to a far more integrated trade and economic framework that bind both Canada and Mexico much more closely to the US economic, energy, and defense ecosystem.

Such a development is not beyond the realm of possibility. The updated US National Security Strategy released in November 2025 states that "The United States will stand ready to help—potentially through more favorable treatment on commercial matters, technology sharing, and defense procurement—those counties that willingly take more responsibility for security in their neighborhoods and align their export controls with ours." It also states that "A strong, capable military cannot exist without a strong, capable defense industrial base. [...] We will also encourage the revitalization of the industrial bases of all our allies and partners to strengthen collective defense." In other words, it is in the national strategic interest of the United States to build not only a US "fortress", but a North American one.

Friendshoring: More than a buzzword

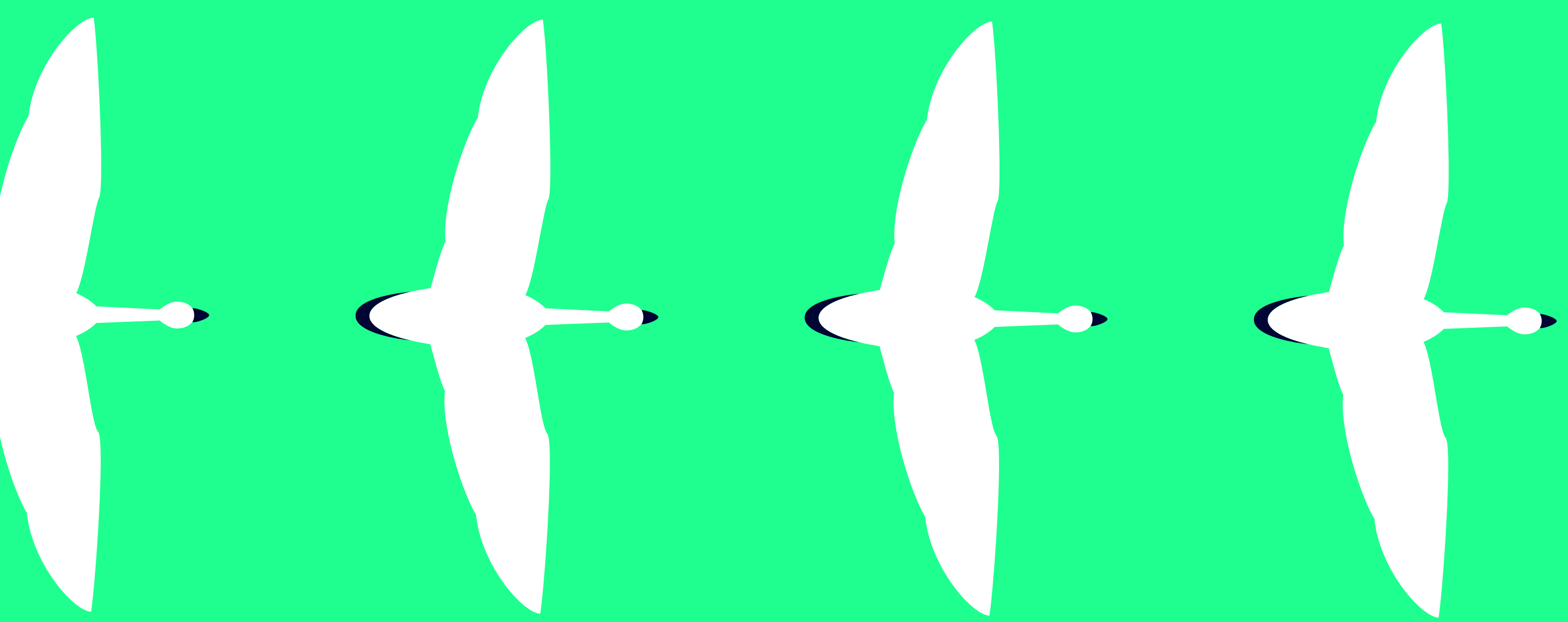
While Canada and Mexico might need some convincing about entering into a new arrangement that at face value seems built purely on the requirements of the United States, the implications would be radical. "Friendshoring" becomes more than just a buzzword—it becomes the linchpin of US-led regional industrial renaissance. And, to state the obvious, friendshoring requires...friends! Mexico and Canada are the natural candidates to be friendshoring partners and this allows them to benefit from preferential treatment in technology sharing, defense procurement, and commercial access across North America. This Grey Swan changes how they view the world, as a USMCA of this type results in a fundamental shift in supply chains and casts North America as the pre-eminent manufacturing and energy location that is largely insulated from geopolitical shocks that occur elsewhere.

Figure 2: The great realignment—Country share of US imports



Source: Macrobond, State Street Investment Management, International Monetary Fund.

4 Oil rockets toward $100 barrier



Crude oil prices slumped in 2025, posting their steepest drop since the 2020 pandemic year. Even after this drop, and with prices down to around $60-65/bbl, the broad industry consensus remains neutral-to-bearish. The simple rationale is tepid demand growth forecasts and ample spare capacity among OPEC+ members. Policymakers and consumers may be happy not to see any pickup in prices, particularly as many are still grappling with an inflation impulse and steepening government bond curves. But what if oil prices didn't behave? This Grey Swan conceives a scenario where the oil price spikes toward triple figures.

The complex economics and politics of oil extraction rarely deliver a smooth ride. And the growth in AI power demand, China stockpiling, and higher risk premia—while not the base case—are tail risks for meaningfully higher oil prices in 2026. Indeed, in the post-GFC period, yearly lows and highs in crude oil prices have averaged close to 50% of average annual prices. In short, the potential for a price shock of 30%, 40%, or even 70% can never be entirely discounted given oil trading bands in the US shale era.

Geopolitical risks

A sharp rise in geopolitical risks could significantly disrupt supply and result in the rerouting of global oil flows. A prime candidate would be political instability amid widespread anti-regime protests in Iran that spreads regionally and could have a non-linear impact on oil price premiums should production and exports be heavily disrupted and/or supply routes blocked. Iran is a key oil exporter to Asian countries, and its domestic production is already struggling.

And notwithstanding recent US intervention, it is going to be quite some time before Venezuela ramps up struggling production levels to make a difference. Moreover, no major EM oil producers in recent memory have quickly scaled up production following a regime change (e.g. Libya, Iraq, Russia, and USSR). And US administration statements suggest they will direct Venezuelan oil flows, potentially displacing barrels that were headed to China or other destinations.

Also feeding the swan

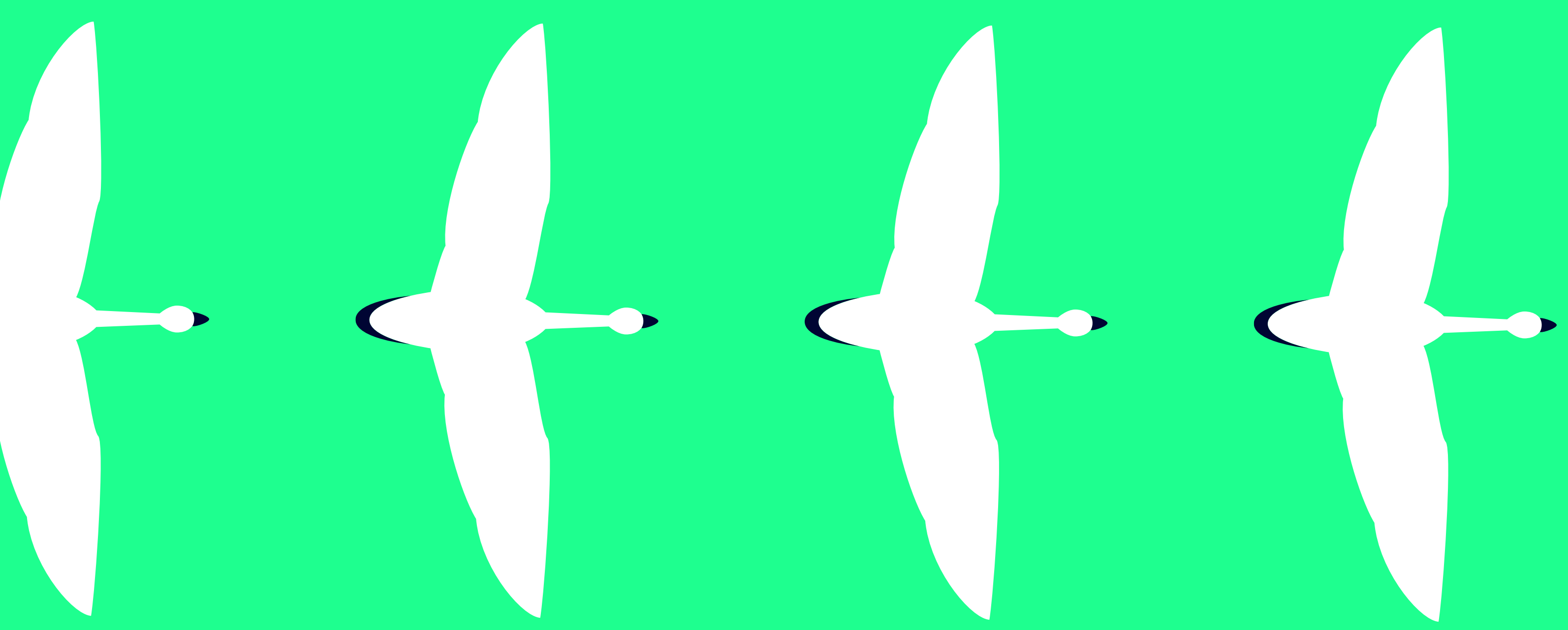
A material shift in Indian and Chinese demand for petroleum products and increased AI power consumption could also contribute to an oil price squeeze as greater use of oil products for peak and backup generation becomes material. In many economies with inadequate energy grids, diesel and fuel oil are the marginal inputs in utilities.

The ramifications of sharply higher oil prices go wide and far. Oil prices impact the wider commodities universe due to their role in indices, transport costs, and energy-intensive extraction processes (e.g. mining, agriculture, etc). The upshot of a sustained crude oil spike could have broad implications for headline inflation, consumer sentiment, and trade balances. Although elements of this Grey Swan have been fomenting, the scenario is still in the low probability bucket for 2026.

Figure 3: Annual crude oil price ranges (2010–2025)

Sources: ICE, State Street Investment Management as of December 31, 2025. Past performance is not a reliable indicator of future performance.

5 When normalization is a Grey Swan: Yen carry unwind



A gradual progression toward policy normalization in Japan is generally anticipated, but what would happen if that consensus expectation was quickly overtaken by events and there was a sharp unwind of the yen carry trade in 2026?

The seed of this swan took root with the surprise election of Prime Minister Sanae Takaichi in October. If her policy agenda accelerates fiscal expansion, technological investment, and advances JGB yield curve normalization to the extent that it marks a meaningful departure from decades of ultra-loose policy and introduces potential volatility into global capital flows, the ramifications could be very significant.

The yen trigger

Even as the possibility of Fed-MOF joint FX intervention and a perceived soft cap at 162 remains in focus, a further **sharp yen depreciation combined with rising JGB yields** could catalyze an unwind of the longstanding carry trade. Key drivers could include:

- Aggressive fiscal stimulus (prompting fiscal dominance concern) and wage growth fuelling domestic demand,
- The Bank of Japan tightening beyond expectations, and
- Political resolve to pursue yield curve normalization, addressing persistent market distortions and amplifying volatility risks.

Initially, a weaker yen supports exporters and reflation, but as JGB yields climb, leveraged carry positions face narrowing returns and heightened volatility. Given the scale of yen-funded trades, forced deleveraging could ripple across FX, equities, and bonds, creating systemic stress.

The macro risk

While rate hikes have been gradual, a sharp upside surprise in domestic growth or inflation—or a mini yen crisis—could force a more aggressive stance, provided political support aligns. With the Fed still in rate cut mode, additional BoJ tightening that compresses the policy rate differential could further narrow the yield gap. And yet the yen remains weak—a divergence that could reverse abruptly and accelerate carry trade unwinds (Figure 4).

Another critical factor is the BOJ's passive balance-sheet runoff. Monthly JGB purchases have dropped to less than half of 2023 levels, and any acceleration in quantitative tightening could add further pressure on yen-funded positions.

What it means for investors

Global markets: Unwind pressure could trigger capital repatriation, impacting US Treasuries, high-beta equities, and emerging-market debt and currencies. Liquidity shocks may extend risk-off phases and heighten volatility in global credit markets.

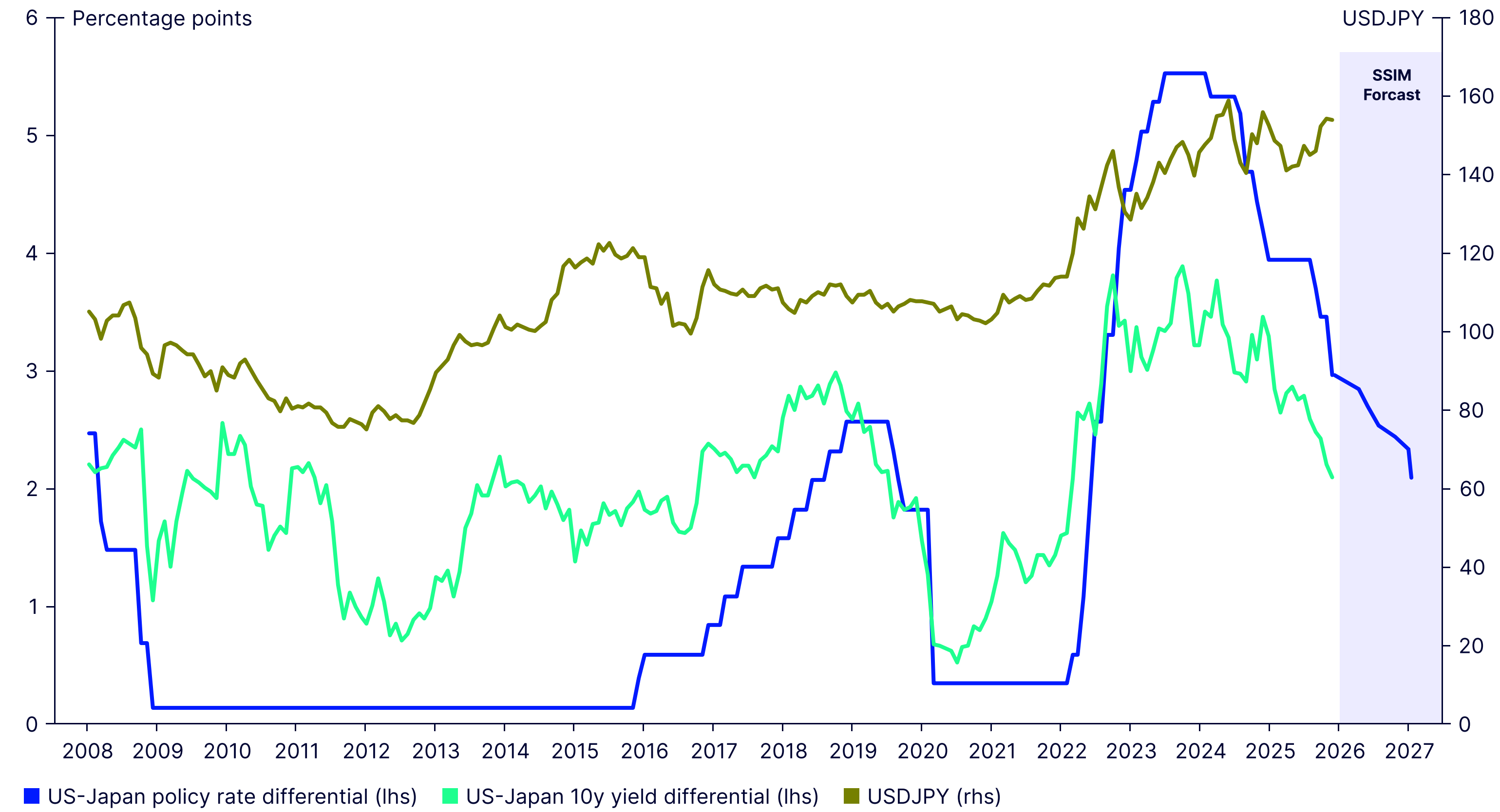
Domestic economy: Higher wages and fiscal outlays cushion consumption, offsetting pricier imports, while exporters benefit from yen weakness. Yet normalization raises funding costs for corporates and government.

Cross-asset stress: EM reliance on yen-funded flows risks currency instability; global risk assets could see sharp corrections as leverage unwinds.

Though low-probability, there is always merit in considering what steps could be taken in such a scenario.

- **FX protection:** Use options to manage yen volatility; stress-test portfolios for sharp moves.
- **Duration management:** Reduce exposure to long-dated global bonds vulnerable to repatriation flows; favor shorter-duration instruments.
- **Diversification:** Allocate to liquidity-resilient assets—gold, defensive equities, and short-duration credit. Maintain flexibility to pivot as volatility spikes.

Figure 4: Where will the yen settle?



Source: Macrobond, State Street Investment Management as of January 12, 2026. The above forecast is an estimate based on certain assumptions and analysis made by the State Street Global Advisors Economics Team. There is no guarantee that the estimates will be achieved.

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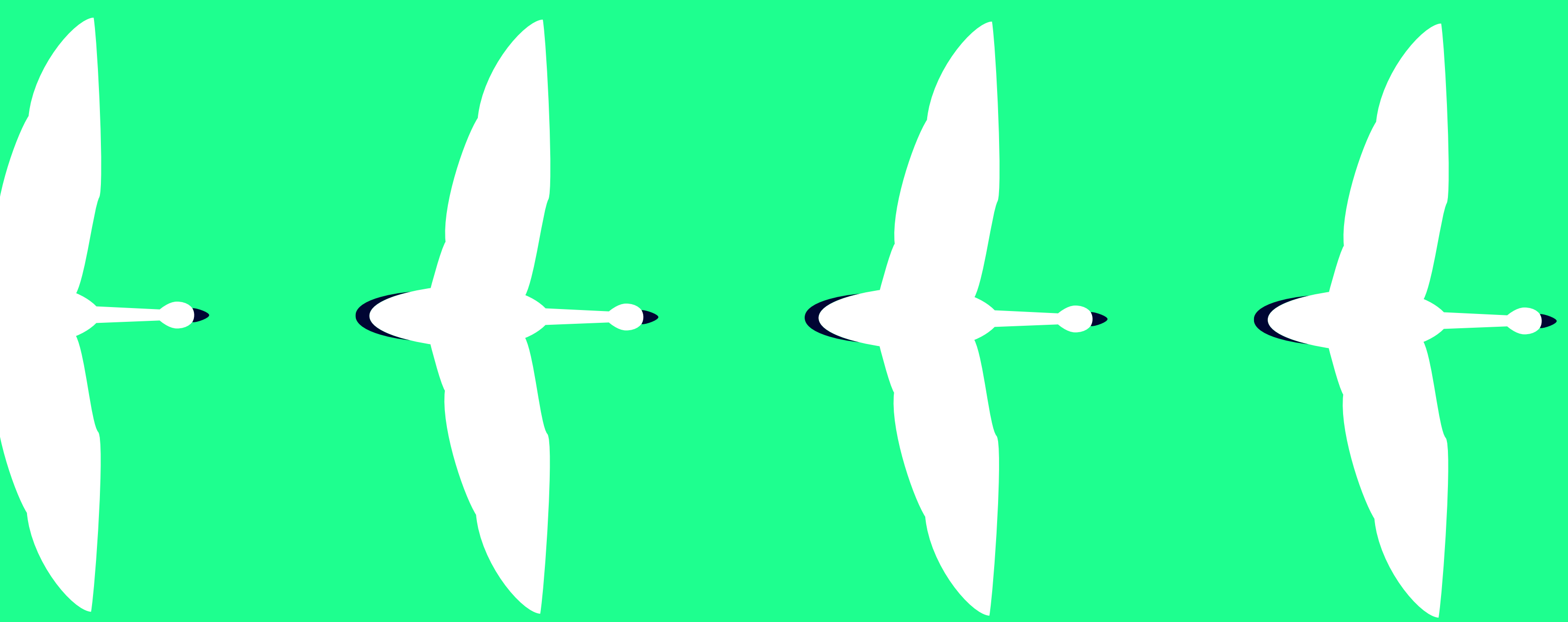
Sovereign warnings trigger bond shock



Public indebtedness has risen across most developed economies in recent decades, with a noticeable increase in sovereign debt servicing costs as interest rates normalized after the Covid-19 pandemic. The notorious bond vigilantes have been relatively well behaved to date, and our base case does not anticipate a change in that behavior. But what if 2026 sees the first episode of serious stress in government debt markets?

While there are material differences in sovereign debt sustainability among industrialized nations, the problem is global and systemic. Figure 5 shows our metric of the growth in the net supply of safe assets over the past two decades—i.e., the total bond issuance by highly rated governments minus the essential bond investment requirements of central bank reserve managers, global pension funds, and commercial banks. This rapid growth is one of key reasons why long-term bond yields are rising for most developed economies.

In nominal terms, the majority of the growth is driven by consistently large deficits in the US, but this need not mean the first crisis will originate there. Global bond markets are facing increased supply in government debt, of which an growing share must be cleared at market rates. This opens up the possibility of sharp re-pricings at random auctions. Countries that are running comparable or larger primary deficits (budget deficit prior to interest payments) to the US, but have a much lower rate of nominal GDP growth, could be most vulnerable in the near term.

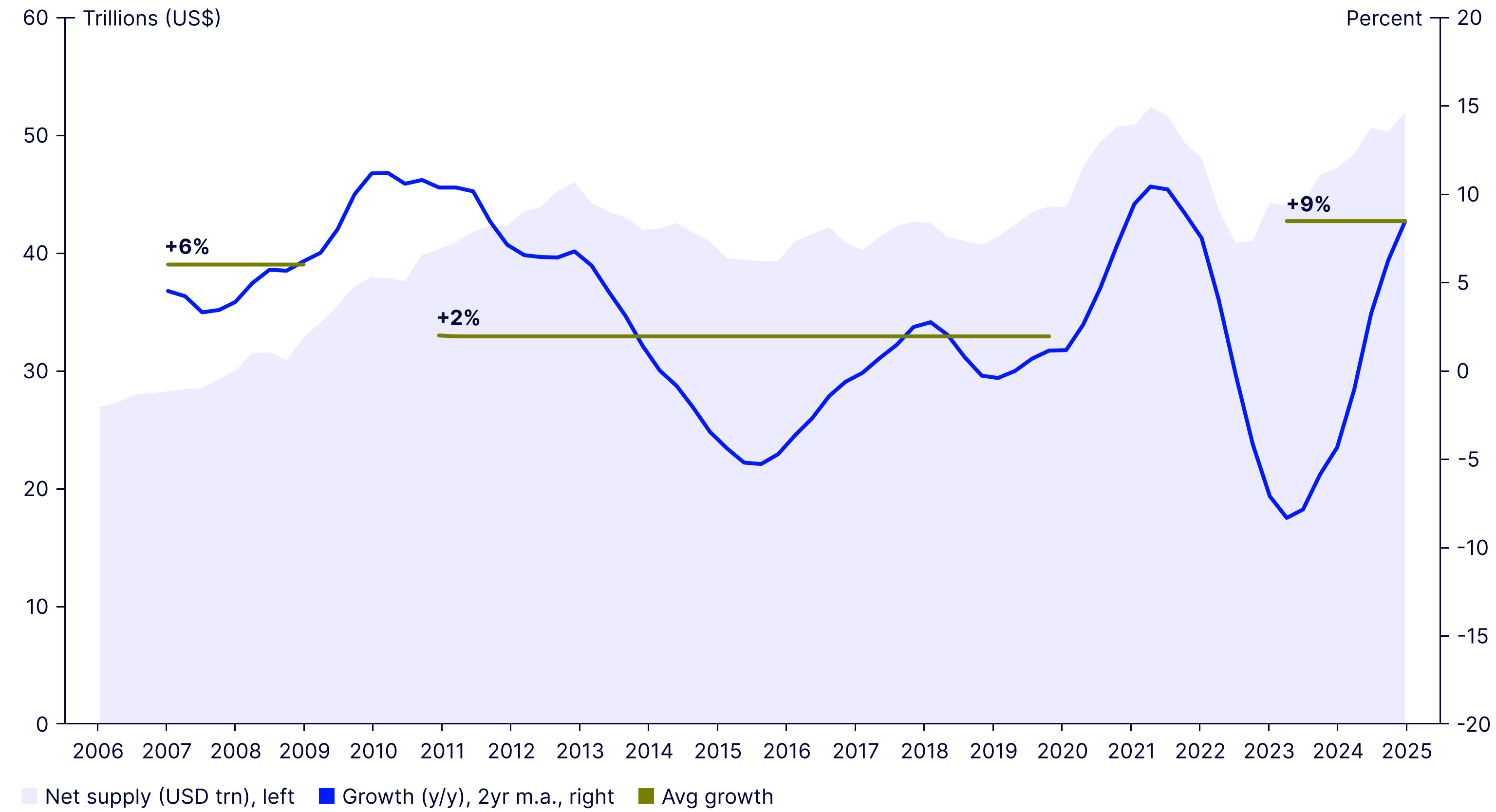
In this regard, yields on bonds at the very long end of non-US developed economies rose drastically in 2025, particularly in Japan, Germany, France, and the UK. Of those, France appears the most likely candidate for a bond shock, as high deficits are not only mixed with low growth, but are complemented by a growing political crisis.

A French shock unfolds

How might this scenario unfold? After the French government barely gets a budget through parliament in early 2026, the rest of the year then becomes characterized by increased political jockeying and gridlock. Before the year comes to a close, a rise in domestic tensions brings forward a divisive parliamentary and presidential election campaign. A fragmented electorate sees the market struggle to grasp what the future government composition might look like, bringing big swings in sentiment and an abrupt buyers' strike for French government debt. The accompanying spike in French bond yields would be unlikely to remain a local story, rippling out to impact other European and developed sovereign bonds.

In Europe, this surprise rapid bear steepening of yield curves complicates monetary policy, leading to earlier rate cuts than expected, and stoking speculation that the European Central Bank may need to intervene directly and start buying bonds once again. The effects are also seen in currency markets, with a weakening euro driving other central banks to look seriously at easing as well.

Figure 5: Net global safe asset supply growth (2006–2025)



Source: Macrobond, State Street Investment Management Macro Policy as of December 31, 2025.

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