

2025 Global Risk Report – Blind Spots: High Tides of Ambition and Undertows of Risk

This audio conversation and its speakers are AI-generated, drawing on key insights from PGIM's paper. Enjoy!

TRANSCRIPT

Host: We're diving into PGIM's 2025 Global Risk Report, and the title itself, "High Tides of Ambition and Undertows of Risk," hints at the complex economic landscape we're facing.

Guest: Absolutely. The report highlights potential blind spots that could really throw a wrench into the investment outlook. It's about looking beyond the obvious narratives.

Host: So, what are some of these underappreciated risks that investors need to be aware of?

Guest: The report focuses on three key areas: the AI infrastructure splurge, rising energy costs, and China's industrial overcapacity. Each of these could significantly alter the trajectory of interest rates, inflation, and business investment.

Host: Let's unpack these one by one, starting with AI. Is the AI infrastructure boom setting us up for a fall?

Guest: While digital infrastructure is crucial, much of the technology powering AI, from chips to data centers, could become obsolete quickly.

Host: So, are we building all this infrastructure based on hype rather than tangible results?

Guest: Not entirely. There's definitely real demand, especially for AI inference applications. But investors might be overestimating short-term returns and underestimating long-term needs.

Host: The report distinguishes between different types of AI infrastructure. Can you elaborate on that?

Guest: Certainly. The risk is more pronounced in the training infrastructure for large language models. Advancements in LLM efficiency could reduce the demand for these massive data centers, potentially stranding assets.

Host: So, the key is to focus on the more durable segments of the market?

Guest: Exactly. Low-latency cloud and inference-capable data centers, especially those located near population centers, are likely to be a safer bet.

Host: Let's move on to the second risk: rising energy costs. How is the AI boom impacting the energy sector?

Guest: AI and data centers are incredibly power-hungry. The International Energy Agency estimates that data center electricity consumption will grow rapidly, putting a strain on power grids.

Host: We're already seeing electricity prices rise in some regions. Is this a long-term trend?

Guest: The report suggests it could be. The combination of AI demand, industrial reshoring, and electrification is driving rapid capital expenditures in energy infrastructure, potentially resetting energy costs at a structurally higher level.

Host: So, even if AI delivers on its promise of increased productivity, consumers and businesses could still face higher utility bills?

Guest: That's the risk. Modernizing the grid requires upfront costs that will likely increase electricity rates, regardless of the economic payoff.

Host: What are some of the factors shaping the energy landscape right now?

Guest: The report highlights four key factors: ample supply but constrained distribution of natural gas, variable demand meeting non-dispatchable generation from renewables, uneven regional impacts, and a thriving LNG export market.

Host: So, regions with strong fuel supply and robust energy networks will have a competitive advantage?

Guest: Precisely. States like Texas, with ample natural gas and distribution networks, are better positioned to handle increasing power needs.

Host: Finally, let's discuss China's industrial overcapacity. How is this impacting the global economy?

Guest: China's excess capacity threatens to export deflation. The country is producing far more than its domestic economy can absorb, leading to a flood of cheap goods on the global market.

Host: We've seen this before with textiles and property construction. Is this just a cyclical issue, or is something fundamentally different this time?

Guest: It's a recurring problem, but the scale is significant. China's producer prices have been falling for months, and this is happening in strategic industries like solar panels, batteries, and electric vehicles.

Host: So, are we talking about a potential race to the bottom, with companies slashing prices to stay competitive?

Guest: That's the concern. China is even running an "anti-involution" campaign to combat extreme price cutting and avoid lower profit margins and layoffs.

Host: How are tariffs impacting this situation?

Guest: Tariffs are complicating things. While they may protect certain markets from Chinese overcapacity, they could also redirect the deflationary impact to other regions, intensifying global competition.

Host: The report mentions that China's exports to the US have fallen, but exports to other markets have risen. Is this a sign that tariffs are simply shifting the problem elsewhere?

Guest: It suggests that tariffs are having an impact, but China is finding ways to circumvent them by targeting non-tariff markets in Emerging Markets.

Host: Let's dive deeper into the portfolio implications of these risks, starting with AI infrastructure. What strategies should investors consider?

Guest: Investors need to be selective. Focus on resilient, inference-capable data centers close to end users. Avoid overexposure to LLM training infrastructure in non-traditional locations.

Host: So, location, location, location still matters, even in the digital world?

Guest: Absolutely. Low-latency markets with constrained supply, like Frankfurt and London, offer the most appealing opportunities.

Host: What about energy costs? How can investors navigate this landscape?

Guest: Look for opportunities in natural gas, geothermal, utility-scale solar, nuclear, and related supply chains. Also, consider investments in data center cooling, energy-efficient building equipment, and grid upgrades.

Host: So, it's about investing in both traditional and renewable energy sources, as well as the infrastructure that supports them?

Guest: Exactly. A mix of energy resources will be needed, alongside the buildout of transmission to solve strained power grids.

Host: Finally, what are the portfolio implications of China's industrial overcapacity?

Guest: Be prepared for tariff dynamism and potential trade wars. Also, consider the possibility that China's domestic consumption might surprise to the upside.

Host: So, it's about anticipating shifting trade flows and identifying markets that could benefit from US-China trade tensions?

Guest: Precisely. Countries like Mexico, with duty-free trade agreements with the US, could see growth in their industrial sectors.

Host: So, the key takeaway is that investors need to look beyond the prevailing narratives and anticipate unexpected shifts in market regimes?

Guest: Absolutely. By understanding these potential blind spots and employing strategies that mitigate risks and capitalize on opportunities, investors can stay ahead of the curve.

Host: That was a great discussion.

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