

## Research @ Citi Podcast Episode 72: Wild Cards — Tail Risk in an Increasingly Fragile World

Recorded: March 17, 2026

Published: April 2, 2026

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Transcript:

Rob Rowe (0:00)

Hi, everyone. I'm Rob Rowe, U.S. Regional Director of Research. Welcome to our Research at Citi podcast. Our guest today is Dan Tobon, who is our head of G10 FX Strategy. And most recently, Dan, you published a Must C: — that's one of our banner publications here at Citi — on wild cards for 2026. Welcome, Dan.

Dan Tobon (0:25)

Thanks for having me.

Rob Rowe (0:26)

Maybe you can explain what the Wild Cards publication is, and what the expectation for it is? What do you do with it? And how should clients be reading this publication?

Dan Tobon (0:38)

Yeah, of course. We get a lot of questions from clients — both corporate and investor clients — about what are those tail risks that keep you up at night, that maybe they're not a base case but there's still some probability of them. And if they were to happen, it's a low probability, but huge-impact-type scenario. So, we got together across all of Research, across different products in equities, rates, FX, credit, etc., along with our economists, and we started having these brainstorming sessions to figure out what could be some interesting scenarios that fit that description: lower probability, but very high impact. And across the entire Research department came up with some potentials here for things that we're focused on.

The main thing I would point out is these are really meant to be timely. There's all kinds of wild cards that you could have put on a list 10 years ago and could still be on a list 10 years from now. We really wanted things that if they're going to happen, they might happen this year. There's things that are going on in the backdrop, which could trigger some of these from becoming wild cards into actual base-case scenarios.

Rob Rowe (1:45)

And I think I'm not giving anything away by saying one of those wild cards actually sort of came to fruition just after we published. And we'll probably touch on Iran a little later on. Maybe what we should do now, Dan, is describe a couple of the wild cards that you and the team identified for the publication and give us an example of those.

Dan Tobon (2:10)

We might as well just stay on what you touched on, which was Iran. That was one of the ones that, sadly, did actually come to fruition within days of us publishing the note. And it was the risk of an attempt at regime change or a much more increased conflict that could see massive disruptions to oil flow. And in fact, that is what we've seen over the last couple of weeks and I think that ties into the idea, you know, these aren't really out-of-left-field-type ideas. These are themes or wild cards that it's a low probability, but a very real probability nonetheless, especially as we are moving into an environment of greater global fragmentation.

And that was actually one of the themes that a lot of the wild cards by chance ended up falling under, right? It's this shift that we're going from a unipolar post-Cold War U.S. hegemony world into one of greater fragmentation, a lot more nationalism. And that starts creating a lot of global tensions, which then leads to a lot of these wild cards becoming more realistic scenarios.

Rob Rowe (3:12)

When you and the team were looking at these various wild cards and scenarios, it's not happening right now but one thing that I noticed about last year is that we had a lot of idiosyncratic event risk. And I didn't feel like volatility in particular was shooting up or going high. It seemed to have become a bit somnambulant. In other words, the message almost felt like the financial markets were telling us that they're resilient and they can handle most of these events.

How are they playing out right now? And also, does one event happening actually suggest that it would affect other wildcards? In other words, are there knock-on effects between these wildcards? Are they truly idiosyncratic?

Dan Tobon (3:56)

Yes. And I think last year, you're right, there was a very surprising amount of resilience across asset markets. And ultimately, it was a good reminder that at the end of the day, you're trying to figure out, What is the bottom-line impact for earnings? What is the growth impact? The labor-market impact? And I think that there was some offsetting themes that obviously we had a lot within terms of trade and tariffs, but we also had a lot of positives, including a lot of very big spend on the AI side that basically ended up helping to offset some of the growth impacts from tariffs.

One of the things that makes a shock like the oil shock so significant is that there is no hiding — it starts feeding through into absolutely everything. And so something like the Iran wildcard does then have potential knock-on effects that does make some of our wildcards more likely and then some of the other ones less likely. And so maybe I can point out two which I think are quite interesting.

One that becomes more likely is a wild card where we basically thought about the Monroe Doctrine and took it to an extreme. This scenario, it's basically what would happen if the U.S. blockaded all of the Americas oil exports that would go to the rest of the world in an attempt to kind of keep some energy resilience more toward the Americas. And I think back to it was only 15 years ago that the Brent WTI spread — the spread between oil price in the U.S. vs. oil price in Europe — got to around \$30 because the U.S. at that point was producing a lot of oil without exporting it.

So we've moved into a world like that again, that the oil moves are becoming so extreme that the U.S. does create a blockade like that. That's going to have massive repercussions globally, but also create different playing fields from an energy perspective for different regions.

That then ties into one of the other wild cards, which was what happens if we were to see European growth that looks a lot more like U.S. growth. Two and a half percent plus real GDP growth. There was a lot of excitement about the fiscal spend that was going to be coming in through Europe and potentially a lot of reforms that could boost growth now. Well, now we're worried about a higher premium in energy prices. That's especially vulnerable for Europe, which doesn't have energy independence, really relies on energy imports. Originally from Russia — that's become more complicated. From the Middle East — that's currently complicated. And from the U.S., which those flows still continue, but obviously there are some U.S.-European tensions.

So absolutely one wildcard could then have, if it actually comes into fruition as the Iran one did, implications for the other wildcards.

Rob Rowe (6:45)

Dan, I want to talk about a couple more. But before we go there, one thing that I've noticed with the Iran conflict is that duration is becoming a big issue: How long will this go on? And the idea that if it's short-lived, the global economy would be more resilient to that, but as this thing drags on, it's going to have a more pernicious effect on the global economy and on markets. Is that something that you and the team identified among these wild cards? I know that Dirk Willer often likes to fade the event risk tactically when he's looking at his macro strategy. Is that something that was considered as well?

Dan Tobon (7:28)

I think for the wild cards, we were a little more focused on the risk themselves vs. how you tactically trade them a little bit more. So, if this has big-picture implications, what would those be? I also come from the same camp as Dirk that historically these are fades. The trick with fading is always timing, right? You know, we tried fading the Iran conflict last week. The timing didn't work out well, but we are still technically in that window that our commodities team has identified as a situation where this can be resolved. If oil flow starts coming back by the end of the month, we can avoid a lot of the more serious risk that could happen if this becomes a lot more prolonged.

And I think that what you're seeing in this curve flattening in a lot of global curves is reflecting that, OK, for now this might have a little bit of an inflationary impact, but it's not going to be a whole full hiking cycle across the board because it starts having a growth impact over time. And so yes, a little bit backing up in the front end, you know, two years, but certainly still an expectation that this will have a growth effect at some point if it continues.

And I think Europe here is another interesting one. How many times did we see Trichet hike for the ECB, both in 2008 and 2011, because oil was going higher, despite the fact that Europe in both cases was actually going into a severe economic recession? Hiking into economic weakness, I think has got to be clear that it's not good policy. And yet we're already starting to hear language of central bankers for getting lessons learned and talking more hawkish paths. So at least something that we'll have to keep a close eye on.

Rob Rowe (9:09)

And Dan, one of the scenarios that you looked at was this idea of U.S. pursuing its U.S.-centric agenda and what the impact would be to foreign holdings of U.S. assets. Tell us more about the risks here? And do you think that they're prevalent? Also, all things considering now we have this Iran conflict.

Dan Tobon (9:32)

Right. So we really split this up into two risks, because there's the risk that is the one that you hear a lot more about in the media, which is that foreign investors will actually begin to unload U.S. assets, both equities and fixed income. I mean, this has really been a narrative that has exploded over the past year, especially after Liberation Day. That actual risk to us is quite low. And it's because at the end of the day, a lot of these savings really don't have another market that they could easily move from if they were to leave the U.S. It's just a very unique market.

And so, while there have been a lot of concerns about these flows leaving, the reality has been a lot less significant. You certainly see some examples of countries maybe rotating a little bit, but this isn't really happening on the grand scale that investors were

originally worried about. And so, the more likely risk related to this is actually more the sentiment factor, which is if the market believes that there's going to be a lot of outflows from the U.S., then as an investor, you want to get ahead of the crowd. And so maybe this can start having some self-reinforcing mechanism that leads to a sell-off in U.S. assets. We would view that as more likely than an actual divestment from U.S. assets.

Now, the effect in the short term is the same, right? U.S. assets go down in price. But how far they go down in price and how long that lasts, it really does matter if it's just a sentiment trade vs. an actual divestment trade. So the higher-probability risk ends up being that it's that sentiment trade. And we've seen bits and pieces of that. But one thing I would flag is, let's look at the dollar, which is the asset that was supposed to be the most vulnerable to this global rotation out of the U.S. You know, the moment you start getting risk-off again, geopolitical tensions increasing and uncertainty becomes the norm, you're starting to see a lot of dollar strength again.

And so we had an out-of-consensus dollar view for dollar strength this year. And that's actually starting to manifest itself as the world recognizes this still remains a very turbulent time and the dollar is still a relatively safe place to hide in that situation.

Rob Rowe (11:44)

This is a little bit of a tertiary question to the one on wild cards, but I had a discussion with one of our counterparts in Wealth and was wondering how you would identify a risk-free asset in this current environment. With long-end Treasuries coming under pressure — a bit from fiscal, gold overpriced here, and this actually goes to whether you see more flows into the U.S. or not — do short-dated Treasuries still hold the lure as a risk-free asset for the world, do you think, under these circumstances?

Dan Tobon (12:16)

Yes, I think absolutely that — especially very, very front end — you could just keep rolling through this scenario and should still do quite well. Ultimately, you brought up gold as a great example. Gold has been doing very well since 2022 and yet actually has underperformed, I think, relative to expectations during this more intense geopolitical climate.

Ultimately, the issue ends up being one of positioning. Whatever is owned, when you have a volatility shock, those positions get reduced. And that's why gold actually has underperformed. And if you recall, you think back to I think it was October 2008, gold actually took a 30% decline quite rapidly, because it was owned and because people needed to reduce positions.

So one of the ways that I always try to think about these, what could work well in a world where everyone is unwinding is basically the things that were most sold. And I think that's exactly what we're seeing now. The issue is that the world was long assets across

the board, whether they were commodities, fixed income, equities. And so, everything seems to be under pressure. One of the things that wasn't owned because of concerns was actually the dollar, and that's performed really well. And I think, as you mentioned, very front-end Treasuries, because we still have confidence that those are priced based on the Fed. As long as that relationship holds, those will always remain a viable source of safe haven as well.

Rob Rowe (13:37)

And maybe we can switch to another wild card, which is obviously a popular one: asset bubbles. There was a lot of focus early on about whether AI-related stocks, hyperscalers, were in bubble territory. There's also an argument that we will see continued growth with AI expansion and adoption.

Private markets have also entered the fray in terms of whether they're overvalued or whether this is a moment when we might see a pullback in private credit, private equity. How are we viewing that wild card? And has that wild card been exacerbated a little bit also as a result of recent events?

Dan Tobon (14:18)

Yeah, more so from the AI disruption maybe than from Iran. When we're thinking about the risk in the credit market, it's a bit twofold. One is specific to software, where software is about 20% of the loan market and historically was viewed as relatively safe from a cash-flow perspective. These companies were supposed to last for a very long time.

We really don't know how disruptive AI is going to be, but certainly the progress, at least from my perspective, the speed at which things are changing, you have to have some probability that there could be some major disruption. Funny enough, the one thing that could hold back some of that disruption is actually the energy needed to run all of this AI. And as energy prices go up because of the conflict, maybe that's easing some of those concerns that it'll take a bit longer while the energy dynamic and infrastructure is built out.

But at the end of the day, the key thing remains is we don't really know how much disruption is going to hit the software industry. That is a big chunk of the loan market. And so that uncertainty is going to keep some pressure on it.

The other side of it is just in general, there's some opaqueness to private credit. And so I think there's a lot of uncertainty in terms of where the exposures really lie, because it's not as transparent as maybe some other asset class. And so, of course, there's always that concern. But for all of us that were around in the Great Financial Crisis, it was something small that seemed idiosyncratic and contained that started spilling over into other assets, and eventually we had a whole banking crisis. That's always the concern

when we're looking at securities where there's some opaqueness to them, some uncertainty. And there's that fear that it has a domino effect.

I think the domino-effect risk we see as being a bit lower. The banks seem to be in a better position, they're less exposed to this. But certainly within the asset class itself, this AI disruption theme is going to be really important for how this continues to get priced.

Rob Rowe (16:18)

But you would still classify it as a wild card? In other words, something that is more a tail risk scenario?

Dan Tobon (16:23)

Well, I think that at the moment, if you listen to what our equity and credit folks believe, there is still some value in software. It's not like these software companies are going to go to zero. And so, for the time being, it's really about figuring out the right valuation. The thing about software where it becomes a little bit more of a tail risk is what value is going to be recouped. If most credit, you're getting at least 50 cents on the dollar, whatever it may be, when the value is IP, and suddenly the IP's value is lost because AI can do it, that recovery rate might be significantly lower.

And if that's right, that's really not priced in yet. So, figuring out where those recovery rates are going to land — and that will take some time — that's what leaves it more as a tail risk vs. base case. That is where we really ultimately going to land here on these software companies.

Rob Rowe (17:16)

Got it, Dan. And maybe we can switch over to Europe here for a bit. There's a wild card there. It's kind of funny for a wild card to be a success story, but a wild card in regard to a Europe where you could see potential U.S.-like growth trajectory. And I think you were talking about that earlier on in the podcast.

What are the implications for that? And is that wild card less likely now, given certain circumstances?

Dan Tobon (17:44)

Yes. I mean, last year was all about optimism in the EU. That started with real attempts on the fiscal side to alleviate a lot of the defense spending that never took place, that maybe should have took place. Germany separately has been dealing with major manufacturing issues as it's finding it difficult to compete with China. And so, Germany was one of the first ones to really take advantage of the potential room to increase their fiscal spending as a way to boost their growth.

Now, the question really becomes, Can we get to a higher growth? Because even with the fiscal spend on defense, that's a good development for sure. And that has a positive growth impact. But that's not going to get you to the type of growth that's going to create a U.S.-like engine. That's more of a momentary 2027 kind of story, then we kind of flatline on that growth.

So the question is, Can we really get this massive manufacturing recovery? Maybe we start seeing more reforms as well on the labor markets and things like that. You know, Europe has the potential — the potential is there for this kind of growth. There are headwinds to it, there are structural dynamics to it. So we hope that we can get over those. But obviously, one of the key elements for Europe does remain that energy dynamic. Unlike the U.S., it is not energy independent and it doesn't have as clear of channels to import energy the way that China does through Russia and the Middle East and the like.

So, a higher bar, I should say, to be able to achieve this one now that we're seeing those energy shocks. And it was already a little bit of a high bar because it effectively requires a more unified Europe vs. we still see some issues with political risk internally, inabilities for a real, fully unified EU to make the changes that it needs to. The potential is there, though, and I'd like to be optimistic for it. But obviously, from an investment standpoint, we're not quite there yet. And then this energy shock is going to hurt.

Rob Rowe (19:45)

Is the European wild card also dependent or not dependent on resolution of the Ukrainian-Russian conflict? Or is it actually incentivized by it?

Dan Tobon (19:57)

Yeah, it's independent. For sure, the resolution would help. A big way in which the resolution would help is actually on the fiscal side, because right now it is Europe that is basically paying for the war. And that capital could then be used as part of productive defense spending vs. just arming. And at the end of the day, arming with U.S. weapons, right? So you're still selling euros to buy dollars to buy U.S. weapons. That's still positive for U.S. earnings, that's still positive for U.S. productivity. It's not really helping the EU that much. If one of two things happen, with the war ends, that capital can then be used in more productive ways. Or if the war continues, but the EU is actually able to build an industrial military complex from which the supply is now coming from Europe instead of the U.S., these could be a lot more productive towards growth. But we're not counting on that necessarily as part of this wild card.

Rob Rowe (20:55)

And Dan, real quick, have I missed any wild cards or any other ones you might want to mention?

Dan Tobon (21:00)

I would just mention the Japanese carry trade because funny enough to start this year, I had more client calls with non-FX clients than with FX clients because everybody wanted to hear about the risk of the end of the yen carry trade. And we're not there yet, but this might be a year that we finally start seeing the locals moving more into their own domestic fixed-income market — their own JGB market now that yields are very attractive — and Japan is one of the biggest buyers of global fixed income.

So that kind of shift where they're moving more toward domestic assets from foreign assets at the size of flow that they're at can absolutely have an effect. It's definitely something to watch.

Rob Rowe (21:43)

Dan, thanks very much for our audience. Thank you for participating. And also, look for the wild cards Must C: on our public site. It's [available for everyone to read](#). Thanks again, Dan.

Dan Tobon (21:55)

Thanks, Rob.

Rob Rowe (21:57)

This episode of Research @ Citi was recorded on Tuesday, March 17, 2026. I'm your host, Rob Rowe.

Disclaimer (21:15)

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