

Building Risk Discipline Amid Market Uncertainty



Muhammad Danish



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The global economic landscape in 2025 is characterized by a complex interplay of inflation, evolving monetary policies, and heightened geopolitical tensions. In recent weeks, escalating geopolitical tensions, particularly in the Middle East have captured global headlines and injected fresh uncertainty into financial markets. In such a dynamic and unpredictable environment, merely reacting to market shocks is no longer a viable strategy for corporates, investors, banks, and Non-Bank Financial Institutions (NBFIs). Such periods present a dual challenge: the need to assess fast-moving risks while resisting the urge to react impulsively. This article examines the importance of maintaining a proactive and composed approach during periods of heightened market uncertainty. It outlines practical steps institutions can take to strengthen their risk discipline and navigate evolving market conditions with greater confidence and control.

■ Panic is not a Risk Management Strategy

Reactivity stems from lack of preparation. Periods of heightened market volatility often led to hasty decisions: rushing to a hedge at unfavorable levels, liquidating assets in thin markets, or overreacting to every new headline. Such reactions often do more harm than good. When a shock hits, consider these common pitfalls.

- **Locking in losses:** Hedging or liquidating positions when markets are most stressed often means crystallizing losses that might have been temporary.
- **Overpaying for protection:** When volatility spikes, so do the costs of options, swaps, and other hedging instruments.
- **Breaking Risk discipline:** Panic can damage communication lines between risk managers, treasurers, boards, and other stakeholders leading to uncoordinated or contradictory actions. Decisions are made based on fragmented news, rumors, or lagging indicators, increasing the risk of costly mistakes.

■ Risk Radar: Key Market Risk Signals in Times of Stress

Successfully navigating today's market environment requires more than reacting to headlines. Sound market risk management often involves monitoring indicators that can help signal shifts in sentiment or underlying risk. While there are many metrics that institutions may consider, the following are some

commonly observed indicators shared as reference points worth noting.

1. **Yield Curve Dynamics:** The shape of the government bond yield curve (e.g., 2y, 10y, 30y) is a powerful recession and growth signal. A flattening or inverting curve often precedes economic slowdowns. A steepening curve can signal expectations of stronger growth or higher inflation. Pay attention to shifts in the curve shape.
2. **Volatility Indices:** Commonly known as the market's "fear gauges," indicators such as the CBOE Volatility Index (VIX) and the MOVE Index (which tracks U.S. Treasury market volatility) provide valuable insight into expected fluctuations across major asset classes. The VIX measures implied volatility in S&P 500 options, serving as a barometer for equity market sentiment, while the MOVE Index reflects anticipated volatility in U.S. Treasury yields. Another key measure is oil price volatility (OVX), which is particularly relevant given the critical role of energy markets in global macro dynamics. Elevated or rising levels across these indicators often signal increased market uncertainty or growing stress.
3. **Credit Spreads:** The difference in yield between corporate bonds (both Investment Grade and High Yield) and comparable government securities serve as a key barometer of market sentiment. When these spreads widen, it typically reflects rising concerns over credit risk and a shift toward risk aversion. A pronounced and sustained widening is often seen as an early warning sign of broader market stress. It is important to monitor not just the current level of spreads, but also the direction and pace of change.
4. **Commodity Price Trends:** Monitoring commodity price trends, particularly in oil and gold, can provide early signals of cost pressures or supply-side risks. It is important to assess how different sectors may be sensitive to these fluctuations.
5. **Key Macro Data:** Surprises in key macroeconomic data such as inflation, employment, PMI, consumer confidence or GDP figures can significantly shift market expectations and trigger volatility across asset classes. Monitoring these data is critical for anticipating risk sentiment and positioning adjustments.

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■ Looking Ahead: Stay Ready, Not Reactive

As we move into the second half of 2025, the global financial landscape remains complex. Instead of reacting to headlines, the key is to track the right markers, ask the right questions, and act with discipline.

1. **Central Bank Signals:** Central bank communications, even subtle shifts in interest rate guidance, can

significantly influence bond yields, credit costs, and capital flows. It is essential to closely monitor forward guidance from major central banks such as the Federal Reserve, Bank of England, and European Central Bank through their speeches and statements.

2. **Geopolitical Uncertainty:** Geopolitical risks remain a key source of market uncertainty, as conflicts and major political events can disrupt energy prices, supply chains, and investor sentiment. These unpredictable developments often lead to increased volatility across global markets.
3. **Tariff Policy and Trade Frictions:** Renewed trade restrictions and tariff policies can have wide-ranging impacts on equity sectors, foreign exchange markets, and global growth forecasts. Key developments to monitor include the progress and timelines of U.S. – China and U.S. – EU trade negotiations, sector-specific tariff announcements, and any signs of disruptions such as spikes in freight rates or supply chain slowdowns.
4. **Oil Supply Discipline:** The stability of oil supply remains uncertain, relying heavily on OPEC+ to maintain cohesion amid evolving market conditions. Equally important is how non-OPEC producers, particularly U.S. shale operators, respond to price signals, as their production flexibility can introduce significant volatility and risk to global energy markets.

■ Conclusion: Building Enduring Resilience

The first half of 2025 reinforced the importance of discipline over prediction. But discipline should not be passive. This means actively watching the right signals, asking timely questions, and building the internal reflexes to respond without overreacting. The institutions that thrive will be those that treat volatility not as a threat to fear, but as a signal to prepare, adapt, and evolve.

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Institutions that want to build true resilience must go beyond broad awareness. They should:

- Design dashboards that support timely decisions by integrating forward-looking risk indicators and setting threshold based triggers (e.g., volatility moves, commodity/equity price changes, credit spreads etc.)
- Hold frequent cross-functional sessions between treasury, risk, and business teams to reassess exposures, validate scenarios, and align strategies.
- Conduct post event risk reviews following major market disruptions to evaluate response effectiveness, identify gaps in risk protocols, and enhance future response frameworks for timely and informed decision making.
- Review and revalidate core risk models under stressed market conditions to ensure they remain

relevant and reliable. Assumptions that worked under normal conditions may no longer hold in volatile or disrupted environments.

- Perform targeted stress testing and reverse stress testing since they not just simulate extreme but plausible scenarios, but also to identify critical thresholds where capital, liquidity, or hedging strategies could become ineffective.
- Establish a model risk governance protocol that ensures periodic reassessment of model inputs, calibration methodologies, and macroeconomic assumptions, especially in response to new data or market shocks.
- Appoint “risk champions” within each business line to own dashboards and response frameworks, ensuring timely coordination, data readiness, and swift decision-making when alerts are triggered.

Resilience is not built on perfect predictions rather it is built on prepared responses. The true measure of your risk framework is not how accurately it forecasts the next shock, but how swiftly and effectively it guides action when the shock arrives. The real question for decision-makers is no longer “What if something goes wrong?” but rather “Are we prepared to absorb it, respond effectively, and keep moving forward?”

As we enter the second half of 2025, those who adopt this mindset will not just navigate market disruptions. They will help define what it truly means to be ready for risk.

For more information, please contact Mr. Muhammad Danish, Associate at Ehata Financial, mohammad.danish@ehata.com.sa . You can also read the article from the website [here](#).

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