FPM-Comment Reducing the Noise

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Politics continues to dominate the financial markets

Martin Wirth – Fund Manager, founder and Member of the Board FPM AG

- Experience in German equities since 1990
- Funds: mutual funds FPM Funds Stockpicker Germany All Cap

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1 US politics continue to dominate the financial markets in the second quarter

The second quarter of 2025 started with a bang from Washington called Liberation Day, which, according to its wise leader, was apparently intended to free the beleaguered USA from decades of servitude. Full of anticipation, stock markets around the world initially plunged, only to recover to their previous highs when it gradually became clear that not everything is as hotly eaten as it is cooked. The geopolitical strategy, which had caused widespread political chaos in the first quarter, particularly in Europe, initially took a back seat until the disputes between Israel and Iran, which, however, ended as quickly as they began in terms of the hot phase of the conflict. Most recently, a significant tax cut was passed in the US, which is likely to drive the already escalating deficit to even more alarming heights, because unlike the US president, the capital markets do not believe that the budget gaps can be closed even remotely with the comparatively low tariff revenues. Thanks to the double deficit in the national budget and current account, the USA is dependent on international capital to maintain its apparently modest prosperity. The fact that international investors have a different opinion than the US government regarding the meaningfulness and sustainability of these measures can be seen from the performance of the US dollar. The US government's idea that international suppliers to the USA could simply forgo 10, 25 or 50% of the proceeds at the expense of their own margins for the grace of being able to sell their products there is hard to beat in terms of absurdity. The USA also has at least one advantage over Europe in terms of budgetary policy: the tax burden in Europe is already at a level that inhibits performance and does not appear to be rationally expandable (unless you are active in left-wing political parties). So before the USA slides into national bankruptcy, it has a whole range of other options to counteract this, even if this will be accompanied by disruptions.

All in all, the lasting effects of the US government's chaotic behavior are still unclear. Uncertainty remains high worldwide with regard to tariffs, geopolitical conditions and general economic development. This can also be seen in the operating performance of many companies, particularly those that are sensitive to the economy. At least the attitude towards Russia seems to have moved somewhat closer to the European view, which is anything but trivial in these times.

Consensus in Europe on improving defense capabilities...

Many things have changed in Germany and Europe, some for the better, but not always at the speed that was hoped for. The main fact is that there is a consensus that the defense capability of European states must be restored now that the USA is no longer seen as fully reliable and at the same time Russia (and China) have become adversaries, at least politically speaking, who are also working massively on their armaments.

As far as the economic outlook is concerned, not much has happened apart from the use of the budgetary leeway created by the change in the German debt brake. In other European countries, people are watching Germany with bated breath and are doing little or can only do a little, as debt is already far too high in most countries.

...but the willingness to reform is less pronounced

What is actually much more important than the question of a debt-financed surge in demand is the reduction of bureaucracy and the reform of the social systems. These reforms are still in the embryonic stage at best. It is obvious that this will take a long time, even at best. After all, laws need to be changed and then procedures need to be adapted to a considerable extent. However, it is still unclear to what extent this will be supported by politicians. The view of the SPD party conference is deeply depressing: the majority of delegates are obviously of the opinion that the SPD's situation is so bad because there is too little welfare state, too little bureaucracy, too little social security, whereas the issue of controlling immigration seems to have been resolved. One of the leaders, the Vice-Chancellor, almost fails the election after daring to question the SPD's recipe for failure in recent years. At least we can now get an idea of who went off the rails in the chancellor election in May. This is not just an anecdote: for reforms you need the parliaments and the parties, visions of individual members of government are not enough. And in this respect, the implementation of the necessary reforms remains unclear. They even want to take four years to implement a pension reform that is clearly necessary due to demographic factors. At least that has been clarified.

The stock market is guided by facts and not by hopes

Accordingly, despite significant price gains, our interpretation of the stock market was dominated by skepticism regarding the ability to reform beyond the increased possibility of new debt. Companies that were and are valued low were able to make significant gains if they show a solid operating performance even in the current environment or will visibly benefit directly from the infrastructure or defense projects that have been initiated. Examples include banks and insurance companies, but also telecommunications companies and a large number of industrial companies.

In contrast, quality companies with above-average valuations underperformed significantly, after reaching very high valuations in some cases in recent years, driven in part by the low interest rates at the time. Companies that could benefit from an economic upturn, but which were not yet visible due to the conditions described above, also suffered. In this respect, it can be said that the promised reform measures and the resulting positive aspects for the economy as a whole are still a long way off. In contrast, the tariff discussion, the foreseeable government investments and the generally still weak economy are

FPM Frankfurt Performance Management AG · Freiherr-vom-Stein-Str. 11· D-60323 Frankfurt am Main
Telephone: +49 69.795886-0 · E-mail: kontakt@fpm-ag.de · Website: www.fpm-ag.de

currently the reality, and the stock market is not prepared to give more credit.

The valuation differences between the market segments have narrowed

Overall, the equity market is more balanced across the board than it has been for many years. Compared to the USA, European equities are still valued lower, like for like, as far as one can tell. Some of the former favorites of recent years, which have lost considerable ground due to what is probably only a temporary weakness, remain interesting, especially in the mid and small cap segment. None of the companies have included a still possible and not unlikely economic recovery in their valuation. However, the weakness of the US dollar, which will have different effects on companies, has probably not been fully taken into account either. This may explain some of the weakness in share prices, but there is still some time before company forecasts are adjusted, and only then will company estimates be more reliable than they are today. Most companies that need to make adjustments in this respect will probably communicate this with their half-year figures. This could then be a purifying element for share prices and allow investors to look to the future again.

What is important, but remains to be seen, is the impact of the disruptions caused by the US government. We can imagine that this will be more important for the next one to two years than the willingness of the Europeans for reforms: no clear-headed investor makes decisions for the next few decades that could become obsolete tomorrow due to a presidential whim. In this respect, the wait-and-see strategy makes sense.

As a result, many things are simply not happening. Action remains focused on the short term, which of course will not improve growth potential. It doesn't have to be the really big decisions such as whether to build another car factory in the USA or a steel mill that won't start production until after 2030 anyway. There are also small things, such as taking an extremely short-term approach to ordering chemicals when you don't know whether they will be subject to tariffs or not, or whether, to be on the safe side, you should order domestically but pay a higher price if tariffs are not introduced. Or how to structure the supply chains, depending on whether an alternative delivery location will result in a lower tariff burden.

The clarification of tariff issues provides the lagging sectors with a potential to catch up

In this respect, we are still in a period of uncertainty, with corresponding effects on the valuation of the companies particularly affected by this. This phase will not be permanent, and even a less-than-perfect decision on US tariffs is better than no decision at all, as it provides a basis for calculation that can be used to make effective decisions in the longer term. So if everything normalizes, even if higher tariffs are introduced than in the past (which will eventually be paid for by importers, i.e. ultimately by American voters), then there will be planning certainty, and this alone should be enough to make the market segments that are currently still neglected look better again by normalizing demand.

As you can see: There is always something going on and you should always be able to adapt to a new situation. Despite the significant price gains in the first half of the year, the overall outlook remains quite solid.

Sincerely yours,

M. Wirth

Martin Wirth

FPM Frankfurt Performance Management AG · Freiherr-vom-Stein-Str. 11· D-60323 Frankfurt am Main
Telephone: +49 69.795886-0 · E-mail: kontakt@fpm-ag.de · Website: www.fpm-ag.de