FPM-Comment Reducing the Noise

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The political environment should not dominate the investment strategy

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- The new German government has not yet addressed the problems
- Today's politicians apparently do not understand how growth and prosperity are created
- The situation in the US appears even more dire
- The EU has also contributed little to growth in recent decades
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As a warning: if you don't want to spoil your mood, please only start reading this report from page 4 onwards.

The new German government has not yet addressed the problems

After the new federal government took office, there were hopes that the reform backlog in Germany could be broken and that politicians would once again focus their efforts on the productive majority of the population. Just a few months later, however, these hopes have been dashed. Our political elite continues to view only nurses and, of course, public sector employees as high achievers among the workforce. The rest are expected to stop complaining and pay for the rising social welfare costs of benefit recipients, including compensation for increased inflation rates and civil servants' incomes, without providing any evidence of increased productivity. At best, reforms will come sometime in the next few years, and the rest will be taken care of by the state, i.e., the taxpayer. Only the bureaucracy continues to grow, while industry continues to decline, with losses compared to the highs of a few years ago now often reaching double digits. The former enemy number one, the automotive industry, has drawn its conclusions and is now investing in countries where it is welcome, from the US to Mexico, Spain, and Hungary. The fact that VW will cut 50,000 jobs in Germany over the next few years was largely met with a shrug. This will also affect suppliers, the surrounding economy, and their families, negatively impacting the lives of up to 300,000 people. And the fact that, apart from VW, large corporations are now regularly prompted or forced to make waves of redundancies in the four to five-digit range does not seem to bother anyone in politics or the media close to it. People would rather spend weeks worrying about the election of a constitutional judge. Every now and then, elections are held, and the SPD in particular is surprised that its core voters seem to have shifted to the right, only

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to then continue the disastrous course of recent years with renewed vigor – for the past few months with the support of the CDU/CSU. Measures considered to promote growth, such as faster depreciation or lower energy costs, are financed by higher government debt or, in the social democrats' dreams, by tax increases.

Today's politicians apparently do not understand how growth and prosperity are created

It seems that left-wing politicians in Germany and Europe in particular still do not understand where prosperity comes from. Hint: it does not come from increasing regulations, bureaucracy, and redistribution, from stimulus measures, or from desperately searching for ways to hinder and prevent ideas. Rather, it comes from letting people who are willing to risk their existence when in doubt do what they want, supporting them, and making things possible and easier for them. The exact opposite has been happening in Europe for decades. Only projects that have been approved in advance by politicians are supported and promoted. The automotive industry is a prime example of where this leads: VW, a company with strong government influence, has, to great applause from politicians and the media, focused entirely on battery-powered e-mobility and geared its factories solely to the production of battery-powered electric cars, while BMW has been heavily criticized for wanting to maintain its flexibility and designing its factories so that cars with all types of engines can be built. This lack of flexibility is now costing VW subsidiary Porsche more than €1 billion for the new Macan alone to develop a combustion engine, not to mention the lost sales and profits, as production will not start for several years. The significance of this misjudgement for the rest of the VW Group can be imagined, even if there are no clear figures on the costs of capacity underutilization or plant closures. BMW's strategy is called openness to technology, something that is considered misguided by the government and most of the media, apparently against the backdrop that politicians and journalists already know exactly what the future holds. The latter, in addition to their own political preferences, largely report on things that have already happened and are therefore always right. This is not limited to journalists: in hindsight, we always know exactly what happened, but not everyone writes about it.

When you look at the projects in which the government, represented by former economy minister Habeck, who studied all kinds of subjects except economics, wanted to invest, it can send a chill down your spine (or perhaps inspire admiration for their willingness to deliberately run the country into the ground): Intel in Saxony-Anhalt, a semiconductor manufacturer that has now largely fallen behind, Wolfspeed in Saarland, now insolvent, and Northvolt, also insolvent. This comes close to sabotage. The full glory of government -run economic activity becomes clear when you look at the success story of Deutsche Bahn, whose decline is still attributed by left-wing circles to the IPO that was cancelled about 15 years ago. This is simply ridiculous, if it weren't so sad. Meanwhile, infrastructure in Germany and Europe is rotting away, while China is equipping the global South with roads, bridges, and airports, having apparently run out of things to do at home. Not to mention artificial intelligence, a successful semiconductor industry, or the targeted and fully supported development of technologies such as nuclear power. That doesn't mean that this will always result in a breakthrough. But at least it's more likely than the umpteenth restructuring of Karstadt leading to success.

Rather equality for all than prosperity for most

This, too, seems to bother no one outside of occasional Sunday speeches. Especially in the left-wing camp, the motto seems to be: better everyone poor than differently wealthy, and if we cannot help

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people achieve prosperity thanks to our policies, then better everyone be poor.

On the distribution debate: 1% growth in Germany corresponds to an additional national income of €40 billion. 10% growth p.a., i.e. 1% (mathematically just under 1%) over 10 years, would mean €400 billion more that could be distributed. That is more than if you were to take €1 billion from each German billionaire. And that would be every year, which would quickly mean that most of them would no longer be billionaires. So supporting growth would be more helpful for everyone than politicians trying to cover up their own failures with this discussion. And making things 1% more efficient every year thanks to growing knowledge and capital stock does not seem to me to be an unattainable goal. After many years of lamenting “growth fetishism,” especially in green circles, we can now see what happens when there is no growth for several years in a row.

The statement that all tax loopholes must finally be closed is also driven solely by the vague hope that this will miraculously close the holes in the budget, while also achieving the desired aspects of redistribution. I would be grateful to my fellow citizens who claim this if they could explain the loopholes to me. I cannot discover any. Anyone who considers capital gains tax to be a loophole has not understood the tax system, which also takes 50% of income in this area. In my experience, this ignorance even extends to relevant positions at public television stations. Tax evasion is estimated at €100 billion, giving the impression that putting a stop to it would solve all problems. First, I don't believe this figure, and second, even if it were that high, it would be another sign of the blatant failure of government agencies.

The situation in the US appears even more dire

On to the next unpleasant topic: developments in the US

Leaving aside the government's actions, which are in breach of democratic procedures and the separation of powers, what is happening here in terms of economic policy is, in our view, not necessarily, but with a certain degree of probability, a very bad idea economically. In addition to the self-enrichment orgies of the circles around the president, the most striking feature of Trump's policies is US trade policy. To say something positive for once: given the geopolitical situation, it is understandable that the US no longer wants to be dependent on China and countries that are (or could be) close to China for core products and therefore wants to have its raw materials industries, shipyards, rare earth production, pharmaceutical production, etc. under its own control. That would also suit the EU well.

Take rare earths, for example: the world's dependence on China, which has a virtual monopoly on the production of most rare earths, has the potential to lead to disaster. The time required to build up the capacities that no longer exist is estimated at 15 to 20 years in some cases. Even though rare earths can be replaced by other products and processes in various applications, this situation is an unprecedented strategic problem, analogous to the EU's defense capabilities, which were practically non-existent until two years ago. But as we all know, politicians have placed importance on other things, such as colouring roads to make cyclists happy. And the extraction, processing and treatment of rare earths is harmful to the environment, which is something we do not want here. In addition, China supplies cheaper products, which also convinced the industry. Let's see how long that lasts.

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Unfortunately, the US is overshooting the target. Extensive car production really is not strategic, and the US has sufficient capacity of its own, to name just one example that seems to be of particular concern to the administration. In the long term, this policy has the potential to emulate the path taken by China 500 years ago, when what was then by far the world's largest economy became an impoverished developing country thanks to centuries of isolationism. Trump wants foreigners to finance the US, which they are supposed to have cheated for some hallucinatory reason (instead of, as is actually the case, enabling the US to consume well beyond its means by financing a massive current account deficit). Skilled foreign workers are to pay $100,000 in visa fees, while skilled workers from companies from friendly nations are suddenly arrested on construction sites. According to Trump's logic, Americans will then have to work hard instead of being able to choose from among the smartest of the eight billion people on Earth, as they have done up to now. If there is no change of course, the result is likely to be that, as always with isolationism, inefficient structures will remain in place and this will permanently reduce prosperity. Let's see how long this mindset persists. And 500 years is certainly a long time.

The EU has also contributed little to growth in recent decades

From a European perspective, it would be better to remain silent here too: we are wasting our resources on rampant bureaucracy and welfare states that punish rather than reward performance, as described above. The dismantling of the welfare state in Germany means that it is believed that the redistribution of €1.3 trillion is sufficient to finance a reasonably decent life, often without any corresponding return. The most popular solution among many politicians is to once again raise taxes significantly in a country with high taxes and levies such as Germany, whose economy has not grown for more than half a decade despite population growth due to misguided tax and economic policies – instead of focusing on growth; see above. However, since the leader of the Green Party in the Bundestag, as recently demonstrated on German television, has no idea about the size of the federal budget or the level of social spending, but knows full well that any cuts would be devastating, it is hardly surprising and we should not delude ourselves into thinking that her like-minded colleagues have much more factual knowledge.

Instead, we hear nonsensical discussions about roofers who can no longer work at the age of 65. There are approximately 60,000 roofers in Germany, most of whom take up other jobs well before their 60th birthday. Even if there are other stressful professions, the myth that Germans can no longer work when they reach retirement age is easily refuted by taking a look at cruises or sightseeing trips to cities. 70% of citizens who take advantage of early retirement, known as “retirement at 63,” have worked in professions that are not particularly stressful. And that means they weren’t roofers.

And because it is important in terms of perception: there is occasionally good news too. For example, the share of European GDP spent on energy purchases has fallen back to the level of 2015-2020, even though the share of gas coming to Europe as liquified natural gas has doubled to almost 40%. Thus, the price increases that everyone is talking about are primarily due to political decisions, such as CO2 taxation, grid fees, and infrastructure costs for renewable energies. In any case, energy prices should no longer be cited as the main reason for a deterioration in the economic environment.

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But: a correct assessment of valuations is crucial for good returns

The coming months will show whether the government is prepared to implement significant reforms. Anything is possible, and as equity investors, we tend to be optimistic. Ultimately, it is possible to earn money from equity investments even if the environment is not perfect, provided the valuation is right. Let us now consider what this means for investing, with the aim of striking a more positive note.

The above is not pleasant, but it should be mentioned now that the narrative has spread: the debt brake has been smoothed out, and now everything will be great. That is only part of the truth. The crucial question is whether the good and bad aspects are priced into stock prices. And since both the structural problems and the effects of the debt brake adjustment are quite obvious, it is hardly surprising that this is reflected in the prices to a significant extent, in the form of an increased risk premium or a growth premium, depending on the case. Companies that will benefit directly from growing government activity have achieved impressive performance in some cases. This is in contrast to the broader market. This is evident in the valuation discounts compared to the US, but also in relation to the valuations achieved for comparable assets in the private equity markets. Depending on the calculation, the discounts to these two comparable markets are at record levels. This does not mean that things cannot get worse. However, there is a valuation buffer for this scenario, or a price opportunity if things in the political environment develop better than one might think.

Indices don't tell the whole story: one-third of DAX and MDAX stocks are in the red in 2025

Contrary to what the indices suggest, it's not all sunshine and roses on the markets. Alongside the big winners such as financial services providers, the defense industry, and large technology companies, there are a number of stocks that have suffered significant price losses.

As we have repeatedly emphasized here, the quality of a company alone is not a reason to buy. We are certainly in a position to determine whether a company is above or below average in terms of quality. However, this is only one aspect of evaluating an investment. Ultimately, you are buying the stock, and what you pay and what you get in return is crucial. And quality is only one aspect.

Formerly expensive quality stocks are now affordable again...

Why am I emphasizing this? 2025 turned out to be a year in which even companies with well above-average quality had a tough time. A weak economy, competition from China, tariff discussions, excessive inventories at various stages of the value chain, the effects of rising inflation, and, above all, the impact of interest rate hikes, which are now considered to be sustainable, have all left their mark. As a result, disappointments led to substantial double-digit percentage losses in share prices.

...while defense and banking stocks benefited from the environment...

On the other hand, at least two formerly pariah industries benefited from the changed environment: banks and the defense industry, both of which saw significant increases in profits. As a result, portfolios had to be restructured on a massive scale. When the growth rates and margins of formerly indispensable quality stocks, which had previously recorded steady but not particularly high growth, proved disappointing even within a manageable range due to weak growth, some of them suffered massive price losses.

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...and valuations across all sectors have leveled off

Many of these companies, some of which we have avoided for more than a decade due to their valuations, are now trading at reasonable, and in some cases low, valuation levels. However, we have learned (hopefully correctly) that capital flows only change in the longer term. Capital is withdrawn from underperforming strategies and invested in those that have been successful recently. The reasons for the better performance are not examined in detail, which is sometimes a pity, but sometimes perhaps better for the issuer.

In absolute terms, many German stocks remain worth buying

In summary, we see the environment as follows: We do not expect much from the economy, especially as long as global economic policy remains on a path that hinders growth. Not everything is rosy in China either, given the huge misinvestments in infrastructure, real estate, and, in recent years, industrial capacity. We accept interest rates as a given, now that the structure has largely returned to normal. In this respect, the significant distributional effects of recent years have largely been reflected in share prices and priced in, both positively and negatively. In short: banks up, real estate down. With the exception of companies that are expected to achieve significant growth in the coming years, primarily in defense and, to some extent, technology, most stocks are still not too expensive, and in many cases are even undervalued. Based on the assumptions made, this also applies to banks. Equally important, this is increasingly true for quality companies, especially those that have recently disappointed their quality- and safety-focused investors for one reason or another. If these disappointments are temporary, the outlook will be positive again.

Sincerely yours,

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