



## FPM-Comment Reducing the Noise

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### Turning point 2.0 - this time with consequences

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- Dramatic events in the USA, unfortunately in the wrong direction
- Tariffs, growth concerns and stock market prices are by no means the biggest problem
- What can be relevant for the capital markets? Everything!
- The age of seeing things through rose-colored glasses is over
- New priorities: Growth and resilience instead of sustainability at all costs
- The potential of a united EU is vastly underestimated in the public debate
- Upside after massive underperformance against the USA over a long period of time

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What is currently taking place in plain sight has the potential for major shifts in the world, including on the financial markets. Interest income is likely to remain weak to negative in real terms, the US dollar is deliberately under pressure from the US government and the fundamental liberal order in the US is at risk. On the other hand, there is unprecedented pressure and a willingness in the EU and Germany to realign political and economic objectives. Germany probably has the greatest potential. This is due to the comparatively low national debt and the most unrestrained bureaucracy to date, the reduction of which should bring corresponding relief after 20 years of nothing being geared towards growth and everything being geared towards redistribution and regulation. The potential for the shares of German companies then lies not only in a higher earning power, but even more in the reduction of the high risk premiums at many companies and the expansion of the valuation across the board, even if not so much at the top. The special

fund only plays one role in this, but the aspects of bureaucracy reduction and economic growth are decisive if implemented correctly. The latter can also arise from the fact that the state does not primarily see its task as preventing everything that is possible but, as it should be in a free society, allowing people to do what makes sense.

First disclaimer for the following text: I do not see myself as part of the left-green woke bubble. I have not seen the end of democracy in Germany, just because the CDU once held the chancellorship. Just in case anyone is wondering what bias is behind the following.

#### **Dramatic events in the USA, unfortunately in the wrong direction**

To start with the important second disclaimer: If the whole thing we are currently experiencing is not the result of an ingenious US plan to wake up the West from its lethargy, especially the EU, in order to

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strengthen it for the fight against the autocracies of the world, then what we are currently experiencing is a fundamental turning point that may only be temporary, but may also be lasting and will change everything that has been walled up for eternity. The EU stands for many things that are a thorn in the side of the new US administration. Given the threats being made against Canada, Denmark, Panama, in the customs dispute, but also within the US against dissenters, it is naïve to assume a larger plan beyond what is visible and becoming more visible every day. In a nutshell: Under this administration, the USA is no longer part of the Western community of values, at best on the way to becoming an autocracy, at worst on the road to fascism. As far as corruption is concerned, what is happening right now is worthy of a banana republic at best. Or a copy of present-day Russia. For an impression, 30 minutes is well invested in [Murphy: Six Weeks In, This White House Is On Its Way To Being The Most Corrupt In U.S. History](#), if you are attached to the view/hope that the new administration is perhaps a little heavy-handed, but on the whole taking sensible action against a pervasive waste of money.

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What is particularly depressing, apart from the fact that the American people have largely failed to revolt against the breaking of rules that were considered to be the rule of law, is the fact that the American people have largely failed to revolt against the breaking of rules that were considered to be the rule of law. In this respect, perhaps the Land of the Free, Home of the Brave was mistaken after all. It is easy to wave rainbow flags at demonstrations “Against the Right” when that is the mainstream. How quickly everything can fall: The week before last we received mail from a proxy voting service that always made sure that women had to have a place on boards of directors, otherwise they should vote against the administration. Now it looks like this: Shareholders are ultimately being advised to stop voicing their support for diversity and inclusion at shareholder meetings because the new US administration doesn't

like it. This has never been a major concern for us in our investments, but the fact that those who have just carried this like a monstrosity in front of them are now immediately caving in is unbelievable.

In view of this opportunism, and this is just one example of many, we should not assume that things will quickly swing back to their original position. Nor should we assume that this is all Donald Trump's fault: apparently he is just the figurehead of people who can implement their agenda with him, after all his style was enough to get him elected president once before. Which means that nothing has to be over after four years. And internal tensions in the USA could continue to rise.

### **Tariffs, growth concerns and stock market prices are by no means the biggest problem**

You can take the position, and the stock markets are doing so, if you look superficially at the fact that the tariffs are the problem and that things might not turn out so badly. The US is a gigantic domestic market, so a good portion of the price increases from tariffs are likely to be diluted, and otherwise things will even out, for example, because BMW sells more SUVs (production in the US) than sedans (production in the EU and Mexico). But the problem goes much deeper and is much more comprehensive.

Ironclad principles of the free world are under attack here: The rule of law, the separation of powers, checks and balances. Tariffs are just one aspect: introduced one day, abolished the next, all without consulting parliament, trading partners or companies and without giving the whole thing any kind of lead time and meaningful (if that can be said in this context) structure. Dissolve federal agencies without reorganizing their missions, without listening to those affected, and in the process dismantle icons of the rule of law such as the FDA, SEC, FBI, CIA or the Internal Revenue Service. No longer paying for subscriptions to the best-known newspapers such as the NY Times or Washington Post in US government agencies, instead paying for

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some obscure press products. It's not about this being economically relevant, it's about suppressing opinions that don't suit you. And Trump's well-known lies, which are more likely to serve as a test of the loyalty of those around him and his supporters: If everyone knows this is a lie and yet it is not denied, then that is a sign of a reliable supporter. And anyone who says Gulf of Mexico instead of Gulf of America is kicked out of the press conference. This is on the subject of free speech, which should no longer exist in Europe.

Two other issues are catastrophic (without going into detail here):

### **Ethically and morally established values are being destroyed**

Even the temporary withdrawal of support for Ukraine for the defense of civilian targets through missile defense is high treason against a country that has just received support and wants to live the same values as the USA has for 250 years, especially after the USA was involved in "liberating" Ukraine from its nuclear weapons. You can read whatever you want into the relationship with Putin, but the true face of the new US administration can be seen here. The main thing is that the president can be the peacemaker, regardless of the conditions.

And secondly: Migration means stress for every society. The large flows that are currently taking place in plain sight have two causes: Wars started or supported by Russia/the USSR, from Afghanistan to Syria and Eritrea to various African states. And drug use in the USA, Europe and other rich countries, which have turned the countries of origin of the drugs and refugees into failed states in Central and South America. No normal person there wanted this, and the blame does not lie with these states. The way Trump describes the people who see no other option but to flee their homes because of the failure of the US and other rich states is the intellectual equivalent of the failure to defend civilian targets in Ukraine. As a German, you can certainly see parallels here with

Julius Streicher's agitation against the Jews. And from today's perspective, the storming of the Capitol after the 2020 election defeat was not accepted looks less like an event that has gone off the rails and more like the storming of the Feldherrnhalle in Munich on 9 November 1923, with the subsequent release of convicted criminals as soon as Trump was able to. Does it all sound too dramatic? For the last few years, I've always thought it wasn't all that bad. Now it's probably time to consider the worst-case scenario as a possibility.

You shouldn't fool yourself here: The situation has changed dramatically. And if you think that nothing is eaten as hot as it is cooked: this is not the US government's plan.

### **What can be relevant for the capital markets? Everything!**

And from here we try to assess the impact on the capital markets.

The most important asset of a country from an investor's point of view is the rule of law and reliability. This has been severely affected in the USA. We don't know what will happen if the mood sinks before the mid-term elections: Will every American then receive a \$50,000 transfer from the Federal Reserve? What rules apply to non-American investors? Allegedly, there were discussions in Mar-a-Lago about extending the maturity of outstanding US government bonds, with stable coupons or even eliminating them, as it is known that current interest rates have risen and the national debt (for which Trump is not solely to blame) is getting out of hand, which would be nothing more than a default in economic terms. Tech entrepreneurs who do business globally grovel, the major shareholder of the supposedly most valuable car manufacturer insults the main Mexican customer of his satellite company, whereupon the latter cancels orders worth USD 7 billion. Never mind, he gets a deal with the

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government and a competitor (verizon) is kicked out after years of preparation. How secure are American defense systems if Ukraine is betrayed in the middle of a war? How are American brand values being affected when they recently stood for completely different values? All this against the backdrop that the US was until recently seen as the last bastion in the event of an emergency and investors were therefore prepared to pay high valuations for the US dollar and US equities, combined with an economy with low savings and growing foreign debt. The US has NOT been ripped off by the rest of the world, rather it has had goods and services written off to its suppliers for a trillion US dollars a year, indirectly in the form of a massive increase in government debt abroad, repaid by rising inflation figures. So: deterioration in the rule of law, political stability both internally and externally, chaotic economic policy, grinding institutions of statehood: it is not clear to me in any form why you still have to pay a valuation premium for something like this. Except that there is a theoretical possibility that this spook will soon come to an end.

And now for the counter-trade.

### **The rule of law is becoming an even scarcer commodity in the world**

First of all, a brief digression: Switzerland has a democracy that is a few centuries older than that of the USA, a government that represents almost all groups of the population, across various parties and levels of government. With around 1 per thousand of the world's population, it is not too significant in mathematical terms, and yet it has a currency that is overvalued by 50% according to purchasing power parity and which stands for solidity throughout the world. This is the premium for stability and security that can be achieved in a free system in which one is forced to reconcile different wishes and ideas. And these regions have become rarer in the world, which can also be seen in the price of gold as a last resort for friends of security.

In view of the USA's impending drift, we can consider where we can find something similar, albeit not to perfection. And there is not much more left of relevant regions than the EU. Which was still on an irreversible descent. What is the upside?

First and foremost: political leadership is required, which should not be as difficult as in recent years. The deficits are clear, the shock caused by the events of recent years and months is huge, and there is a high level of unity in the political center. The Merkel years in Germany were characterized by the fact that everything looked great, money was not an issue thanks to low interest rates, the bureaucracy got on with the job and made everything more and more complex without really hurting anyone. The US took care of defense, and (almost) everyone could bask in their moral actions, in which defense was superfluous, but diversity and inclusion played a major role as long as it didn't cost anything.

To paraphrase Wolfgang Schäuble: "Isch over".

### **Germany and the EU are starting to move, and they have the reserves to do so**

In a nutshell and in relation to Germany, similar things often apply in the EU:

- First of all, both Germany and the EU are designed for consensus; people are forced to agree. And only the permanent suppression of the will of the voters can lead to conditions like those now prevailing in the USA. Germany and the EU were heading in this direction; perhaps the warning shot will be fired in time before the extremists spread here too.
- Defense, external security, is the core of the state's tasks. This can now be seen again in the shares of defense companies, after years of pretending that Germany only had a Bundeswehr. What is now possible, and perhaps also in other policy areas, can be seen in the Greens and to some extent the SPD: In their youth, they still protested against the rearmament with US missiles and conjured up the

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end of the world, but in a short space of time this was a 180-degree turnaround (even if R. Habeck was certainly one of the first to point out the problems in Ukraine, to the annoyance of the SPD and to some extent the CDU). When existence is at stake, you can change your mind. And that is not a criticism, but a positive perspective. The Greens are quite Keynesian: “When the facts change, I change my mind - what do you do, sir?”

- Save in time, then you will have in need: The two “special funds” under discussion or the exemption of defense from the debt brake in Germany would correspond, spent over ten years, to approx. 2-3% of GDP per year gross, including the returns to the state less. If this is flanked by countermeasures such as the abolition of a public holiday or the freezing of social benefits, even less. So it is not the drama that it is now seen as.

- Germany has a capital outflow of more than €100 billion a year. The current account surplus is more than €250 billion. This means that the country is not mathematically dependent on external financing and can easily raise the money for these measures itself.

- The same applies to the EU, which also has a considerable current account surplus even without Germany, which to some extent contradicts the statement about a lack of competitiveness.

- From a historical perspective, the stock market is still fairly valued to low, apart from a few exceptions which, however, push up the index valuation.

- The euro is undervalued, whereas we have doubts as to whether bonds are a good idea given that interest rates for German government bonds are still below 3%. But interest rate savers are used to suffering, with nominal interest rates close to zero over the last 10 years, but also a good night's sleep (as long as you haven't been dreaming of real interest rates).

## **The age of seeing things through rose-colored glasses is over**

If you want to describe the EU, its states and their actions as well as the rationale behind them in a positive light, then it looks like this: The involvement of most social forces and the different trends in the individual states have so far (we will see how it continues) prevented a rift like in the USA. Wars and demonstrations of power were seen as pubescent forms of behavior. The EU was preoccupied with making the world a better place: socially, environmentally and resource-friendly, non-discriminatory, worldwide, and with a great deal of trust, an endless meticulousness was created in the bureaucracy, which ultimately overshot the mark and led to the weak growth of recent years.

Here too: Turning point (at least light) with no alternative. There are other priorities now. And if the high level of performance and willingness to perform is steered in other directions, this probably has a potential that is underestimated today. What supports companies instead of hindering them, what saves costs and generates revenue. With a defense sector that is innovative and not evil for the first time in decades (this is how the tech industry in the US came about), with infrastructure investment radiating throughout the economy, with higher interest rates and a structurally more profitable financial industry. And if all of this is no longer designed to hinder growth, but to promote efficient growth, we can expect to see a corresponding impact on all areas of the economy.

None of this is guaranteed, but the conditions have not been this good for a long time. The USA has always had such a large domestic market that the companies that were able to establish themselves there had a huge, often unassailable advantage. This was not necessarily due to better technology, it was often the sheer financial power with which technologies could be bought and incorporated in Europe if necessary. A serious European single

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market could create a level playing field here. There is also the question of what potential could arise from a possible brain drain from the USA. Think not only of the thousands of scientists on leave in state institutions, but also in the knowledge industries, now that the focus in the USA seems to be on reviving the steel and shipbuilding industries. And then, at the end of the day, there are of course talented people from all over the world who perhaps don't like to be insulted. As I said, it's all up to Germany and the EU to simply roll out the red carpet here too.

### **New priorities: Growth and resilience instead of sustainability at all costs**

Why should we be optimistic about the EU's willingness to change? With the "Green Deal", the EU wanted to develop a narrative and set a goal behind which the peoples of the EU could unite: The whole world can benefit, rich countries, which include most EU states, can afford it more at the beginning and thus build up skills that should be in demand everywhere and ultimately, as Chancellor Scholz hoped, achieve growth rates like in the 1950s. This has not worked out for various reasons: Too bureaucratic, too little openness to technology, too slow, moreover functioning technologies shut down without having a comparable replacement, in short: too much wanted, too badly done, too much prosperity lost.

It looks as if this gigantic waste of resources in Europe will not continue. We are now seeing more flexibility, more realistic assumptions and more openness, and at the same time the technical possibilities for achieving the objectives of the Green Deal have developed further. However, the really big common task now is defense capability and economic competitiveness. For example, it now seems to be happening very quickly that European car manufacturers will be given a more sensible framework in terms of CO2 compliance instead of paying penalties for things they were not responsible for, or even better: making compensatory payments

to companies that do not pay taxes, only look at workers' rights and supply chain regulations with binoculars and have also been subsidized by the state, preferably from taxes paid by long-established companies.

And there are heaps of examples of this kind, from subsidized house renovations that have an energy payback of 50 years, renewable power generation plants that are built wildly in the landscape without making any positive contribution to the power supply, etc. If energy, which has had a destructive effect over the last 15-20 years, is now only neutral or even moving in the right direction, then there is a lot of room for improvement. The pressure from the left-wing and right-wing populist parties is starting to have an effect, even if not on everyone involved. But the fear that further elections in Europe will result in things like those in the USA should make even the most stubborn ideologues think twice. Let us be surprised.

### **The potential of a united EU is vastly underestimated in the public debate**

Finally: When you hear the discussion that the small EU no longer has much to say between the major powers, you can only scratch your head in the face of this dwarfism. One of the three major powers (excluding India) has the economic power of Italy, which is nice, but nothing to be in awe of. Without going into the multitude of relevant data points because it is too obvious: a little more self-confidence, knowledge of the facts and a willingness to put things right can work wonders.

### **Upside after massive underperformance against the USA over a long period of time**

If a share (and ultimately an economy) achieves better than expected and priced-in growth rates, not only do profits rise, but valuations also increase. It works the same way in the opposite direction. There are signs that the EU will be able to overcome its weak growth, while the opposite is true for the US.

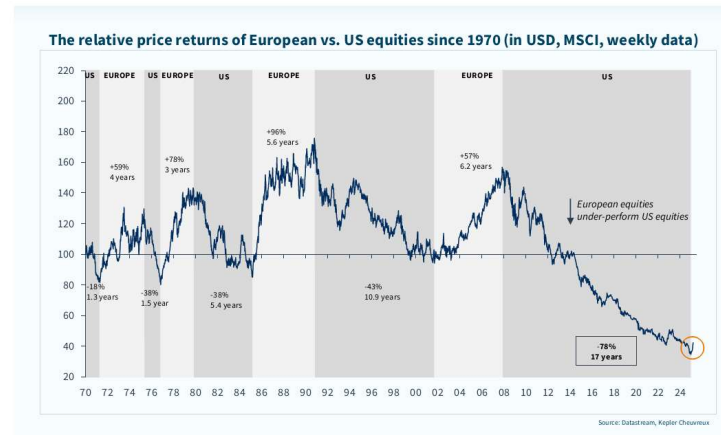
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At the very least, however, it will be difficult to exceed the high relative expectations. If these trends materialize, the valuation discrepancies, which are still at a record high, will no longer be justified. These differences also apply to companies with comparable assets in the same regions but with different headquarters. Economically, this makes little sense, but if you invest your money by region via ETF asset allocation: You can't go into that much detail. And if you look at the other asset classes: It's more like the Ugly Contest. Inflation is no longer low, in contrast to historical interest rates, currencies that are overvalued in terms of purchasing power parity (except for the yen) and government debt that should cause worry lines to appear on the foreheads of many countries. There is not much left to invest capital in with any confidence. In Germany, apart from the defense stocks and individual exceptions, especially among the large stocks, many shares are still cheap in historical terms. Now the turnaround 2.0 is upon us. To bring Lord Keynes back into play: "When the

facts change, I change my mind - what do you do, sir?"

### European outperformance: just a blip for now!



Sincerely yours,

Martin Wirth

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