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Flossbach von Storch

1/2025

# POSITION

Thought-provoking issues for investors

## A WORLD IN UPHEAVAL 2025

**EQUITIES**

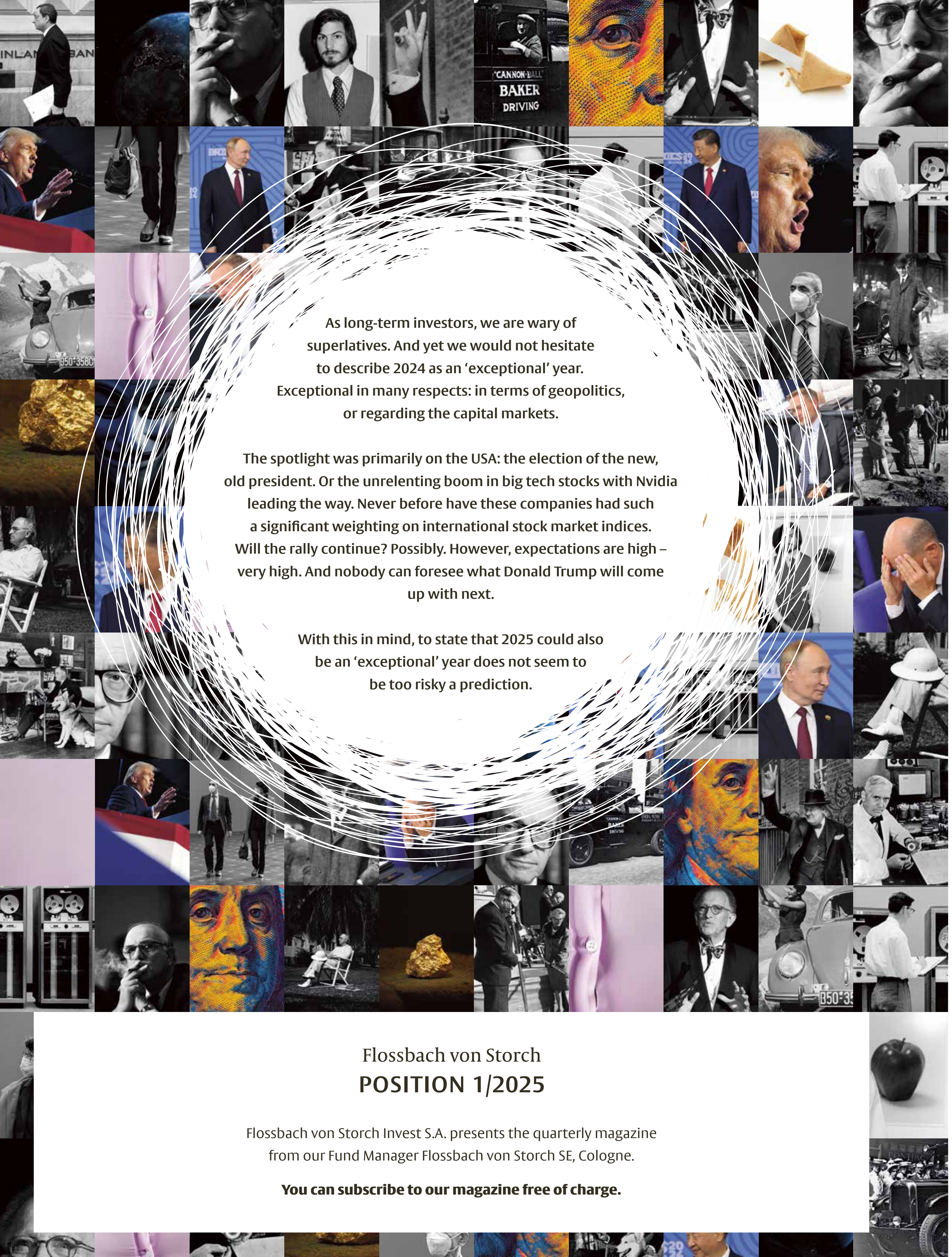
Historical US dominance

**BONDS**

New possibilities

**GOLD**

A remarkable rally



As long-term investors, we are wary of superlatives. And yet we would not hesitate to describe 2024 as an 'exceptional' year. Exceptional in many respects: in terms of geopolitics, or regarding the capital markets.

The spotlight was primarily on the USA: the election of the new, old president. Or the unrelenting boom in big tech stocks with Nvidia leading the way. Never before have these companies had such a significant weighting on international stock market indices. Will the rally continue? Possibly. However, expectations are high – very high. And nobody can foresee what Donald Trump will come up with next.

With this in mind, to state that 2025 could also be an 'exceptional' year does not seem to be too risky a prediction.

Flossbach von Storch
**POSITION 1/2025**

Flossbach von Storch Invest S.A. presents the quarterly magazine from our Fund Manager Flossbach von Storch SE, Cologne.

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## IN A WORD

The recent weeks and months have been turbulent. Donald Trump is the new, old president of the USA. Germany's "traffic light" coalition has collapsed, causing untold squabbling and finger pointing. The war in Ukraine is threatening to escalate, and an intensification of hostilities in the Middle East also seems far more likely than a long-lasting ceasefire.

Anyone who regularly follows the news will inevitably come to the conclusion that things have not been this bad for a long time and will therefore wonder where it's all going to end. I don't know the answer to that question.

As an investor, you learn to focus on the things you are able to know. You learn (or condition yourself) to be guided by facts rather than emotions. You learn that the perceived state of the global situation does not necessarily track index performance on the stock markets. We are seeing this now, with the major indices nearing new highs despite the world seeming more uncertain than ever – and there are good reasons for this.

You also learn that while stock market pessimists are given much more credence by the public (as voices of caution and enlightenment), it is the optimists who are proven right in the long term – or at least this has been the case to date. So, let's remain confident, both on and off the trading floor.

The articles in this magazine aim to pinpoint the current risks and, where possible, highlight potential solutions.

We wish you an enjoyable read!

*Kurt von Storch*
*Founder and Owner of Flossbach von Storch SE*


Flossbach von Storch

# POSITION

1/2025



**Currencies**

## The US Dollar Phenomenon

What has made the greenback indispensable?

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**Interview**

## “Never Bet Against America”

Bert Flossbach on the two-tier system in the equity market.

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**History**

## A Century of Visionaries

What do the visionaries who have been at the forefront of development since 1925 all have in common?

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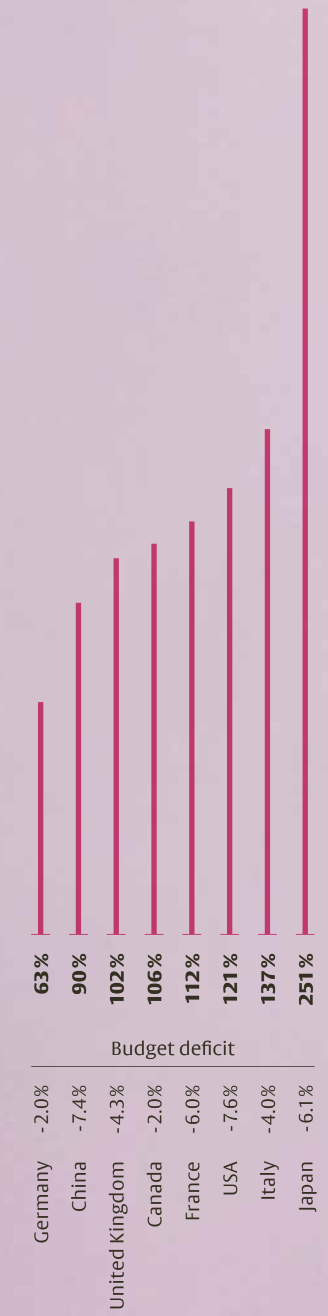
Stephan Fritz

# How Much is Too Much?

Public debt is increasing worldwide.
In Europe, in China, and not least in the USA.
An insight into budgetary discipline ...

Figure 1
**Unrestrained debt**
Public debt in 2024 and budget deficits in 2024*
of the G7 countries and China as a percentage of GDP




* IMF estimates
*Source: LSEG Datastream, Flossbach von Storch, data as at 31 December 2024*

The ever-increasing mountain of public debt the world over is not a new issue. It's a familiar tale, one we have also explored previously in this magazine – and Donald Trump's return to office as US president may well see another chapter added to the story.

His plans to cut taxes while also investing heavily in areas such as border protection and the military are likely to drive up US debt further, perhaps even faster than previously. And this despite the radical austerity plans of Elon Musk, head of Trump's newly created Department of Government Efficiency (DOGE), an agency that does not fall under the remit of the US Senate.

The challenges are not unique to the new US government. Debt is also rising rapidly elsewhere, as Figure 1 illustrates.

Japan still has the biggest public debt ratio – a country's public debt in relation to its gross domestic product (GDP) – at 250 per cent, with a budget deficit exceeding six per cent. Italy and the USA are next, though by some distance. The USA is currently reporting a huge budget deficit of 7.6 per cent. To put this in perspective, the Maastricht criteria dictate a limit of just three per cent for euro countries. The budget deficits of France and Italy show how closely such criteria are followed though ...

## GERMANY THE STAR PUPIL

Directly behind the USA and approaching the same level is China, with a current deficit of 7.4 per cent. The days of the world's most important economy next to the USA being lauded for its sound fiscal management are over. The debt ratio has now climbed to 90 per cent; 10 years ago it was 40 per cent. This trend is unlikely to reverse any time soon. China is facing structural problems, above all the real-estate crisis and high youth unemployment.

Of the debtors shown in the graph, Germany is the star pupil. Both the debt ratio and the budget deficit are well below the average – do we have Germany's balanced budget amendment (the "debt brake") to thank for this?

Robust performance is rightly considered a valuable asset – for entrepreneurs and treasurers alike. But does this still hold true if Germany is largely alone in its austerity mindset? When German bridges and universities are rusting away whilst the country's neighbours (and competitors) are taking on greater debt in order to invest in critical infrastructure and education? What good is a balanced budget and a pat on the back for being frugal if the location's attractiveness and therefore its competitiveness suffer – simply due to a lack of investment, and most importantly good investment?

There is no doubt that robust performance is a must, and our generation has a responsibility towards all those yet to come. This responsibility is not limited purely to the level of "inherited" debt; it also extends to the assets that we leave for our children and grandchildren, such as the infrastructure mentioned above, and not least the digital infrastructure – fast Internet, reliable mobile networks. Germany is not sitting on huge supplies of raw materials it can simply tap into. Germany has and needs its spirit of invention and development, its much-vaunted talent of tinkering away – and it needs it now more than ever before. But this is only possible if Germany is able to foster bright minds within the country and attract them from around the world. To do this, we need excellent universities aside from anything else. But they don't come for free.

## GOOD DEBT, BAD DEBT

When the interest rate on German Bunds fell noticeably below zero a few years ago, we pointed out that it might be a good idea to take on substantially more debt in order to build up a capital stock for pensioners-to-be – by buying equities in sound companies with the borrowed money, for which the federal government was even paid at the time as the borrower. It would certainly not have been a bad investment – in the future!

This would have allowed us to ease the burden on statutory pension insurance, which will increasingly weigh on the federal budget in coming years given the ageing population.

So not all debts are the same. While in Berlin the various parties are veritably foaming at the mouth debating the debt brake, this "equation" should at least be raised for consideration. Increasing debt levels in order to make meaningful investments will raise the future tax base, and there is little to complain about in that – quite the opposite in fact.

Increasing debt levels for consumerism purposes alone is another thing altogether; in particular where this is to fund costly pre-election promises for the benefit of political supporters in order to secure another term in office. This is the kind of debt we need to put the brakes on, but unfortunately it is also the kind of debt that is particularly popular with those in power and those seeking to take power.

## POLITICS – ALWAYS IN A GIVING MOOD

Austrian Karl Pisa once said that debt is the only thing people can get into even when they have no money. So that is what they do. Pisa was a politician as well as a journalist and author, so he knew what he was talking about.

Regardless of whether it's Europe, the Americas or Asia, election promises need to be fulfilled and that requires financing. This also applies to China too, incidentally. Although parliamentary terms aren't a factor there, the idea that "politics buys the favour of the people" still holds true. There is nothing that the Communist Party fears more than dissatisfied comrades.

*"From now on, I will only spend as much as I earn – even if I have to borrow money for it"* Mark Twain, US author

In today's environment, the idea of one day paying off the huge mountain of debt seems nothing more than a pipe dream, especially since it is already seen as a success if the annual budget deficit does not rise too much – or even ends up at "black zero". Federal Ministers of Finance from all of Germany's parties have traditionally always enthusiastically celebrated a black-zero result.



"When the public debt has exceeded a certain amount, there is, I believe, not a single example where it has been possible to repay it fairly and in full", well-known economist and philosopher Adam Smith once said.

So, the question we must ask is how can we at least reduce debt? There are essentially four options. The first, and the most pleasant by far as no sacrifices are required, is growth. When an economy grows, tax revenues and the number of people in employment also increase. Conversely, social expenditure falls – for example for unemployment insurance or contributions to the statutory pension fund. Debts can be paid off using the surplus money, and the budget deficit should decrease in relation to economic output. So, the theory is not rocket science. In practice, unfortunately, it doesn't work the way we would like it to. For decades real growth rates have been falling in developed industrialised nations, and they are now far too low to offer any prospect of paying off the mountain of debt in the future.

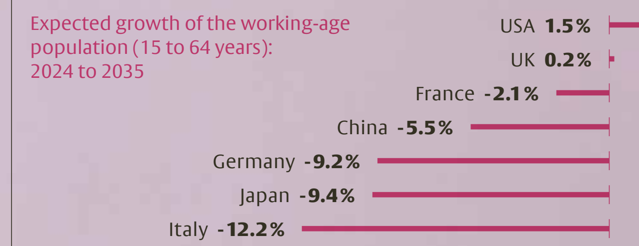
## INDUSTRIALISED NATIONS FACING STRUCTURAL PROBLEMS

Weak growth in industrialised nations can be put down to structural issues, such as an increasingly ageing population. The gap between "young" and "old" has grown significantly in recent decades, and this trend will not be halted any time soon (see Figure 2). This is a problem for the social security system, in particular the statutory pension insurance fund, because while the number of contributors is falling, the volume of recipients is rising. Ultimately, this means that the state must keep "injecting" more and more money into the contribution system to prevent it from collapsing. So, pensions become a subsidy business, driving the public debt up more and more (see Figure 3).

And debt becomes harder to deal with as it increases, because if a sizeable portion of revenue is dedicated to covering interest and repayments on liabilities, there won't be money for other considerations such as investment and research.

Figure 2
**Demographic change is reducing the supply of labour**
Many economies are facing a decline in their labour forces

*Source: United Nations World Population Prospects, Flossbach von Storch, data as at 31 December 2024*



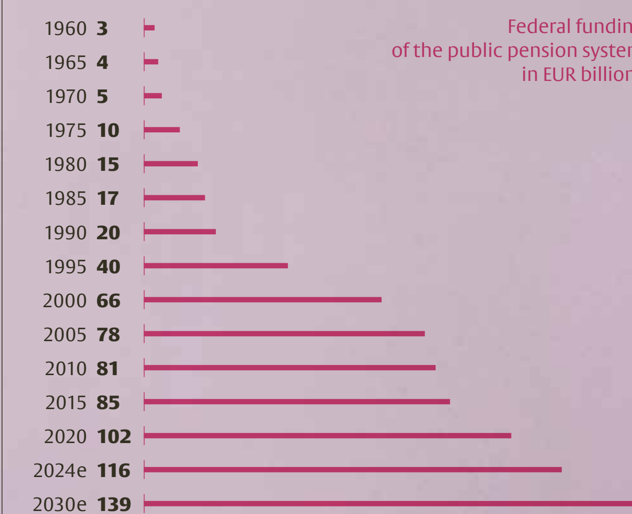




Figure 3
**Employee and employer contributions are not enough**
Statutory pension insurance is becoming increasingly dependent on federal funding

* Until 1990: former federal territory; 2030: own estimate.

Assumptions:
The pension level will remain at a constant 48 per cent.
The contribution rate will rise to 20.6 per cent in 2030.
The retirement age will gradually increase to 67 in 2031.
Wages and pensions to rise by a nominal 3.25 per cent p.a.

*Source: Federal Ministry of Finance, German Pension Insurance, Flossbach von Storch, data as at 31 December 2024*

“From now on, I will only spend as much as I earn – even if I have to borrow money for it”

Mark Twain
US author

The second option for paying off debt is significantly more painful. This entails increasing taxes and radically slashing expenses in order to improve the revenue situation. Such austerity measures must be borne by the overwhelming majority of the population; all groups must experience the cutbacks, without exception, and the measures must target a clear outcome. Without this framework, sooner or later the people will begin to push back.

And even if a broad consensus exists among the population, there is still no guarantee that radical austerity measures will be successful. Simply slashing spending will be of little use if we fail to also consolidate the competitive position of the country’s economy.

## THE CAUTIONARY TALE OF THE GREAT DEPRESSION

A further complication is that restructuring is often limited solely to individual economies and the knock-on effects are not considered. In a globalised world, if country A implements savings, it follows that there will be knock-on effects for countries B and C. If all countries that are struggling financially tighten their belts, we could end up with a situation like we saw in the 1930s with the Great Depression.

The third option, conversely, offers countries a guaranteed solution to their debt problem, albeit temporarily and with the side effect of a loss of trust on the capital markets – declaring bankruptcy. A country might simply not be able to honour its financial commitments. This could be a result of not having the economic means or not wanting to for political reasons. A strong haircut can be beneficial in situations like this, as we saw with Greece a few years ago. History has taught us, however, that haircuts alone are not a long-term solution. Without reforms, the situation after the haircut is very like that seen before the haircut and the problem only appears to be solved due to the short-term solution.

That leaves option four – the central banks, the financiers of last resort. Independent on paper and above reproach (governmental financing is actually prohibited for them!), they have long adopted a supporting role in relation to political matters, as was clearly seen during the financial and debt crisis and in the depths of the COVID-19 pandemic.

## AN UNSTABLE SYSTEM?

Over the past few months, the focus for central bankers has been fighting inflation and thereby ensuring monetary stability, but this could all change quickly if further doubts arise about the stability of our financial and monetary systems. The continual and at times rapid increases in the mountain of debt pose a latent risk for this system. As everyone knows, including central bankers, debt must remain affordable. Delivering on the remit of defending the value of money while ensuring that the interest burden does not become unsustainable for state borrowing is easier said than done. The priority must always be protecting the system rather than monetary value.

It will therefore be interesting to see how much pressure Donald Trump will put on the US Federal Reserve Board (Fed). In his first term of office, he fiercely attacked Fed Chair Jerome Powell on several occasions and called for further interest cuts. The current real interest rate of around two per cent is much too high for the USA in the long term (see Figure 4).

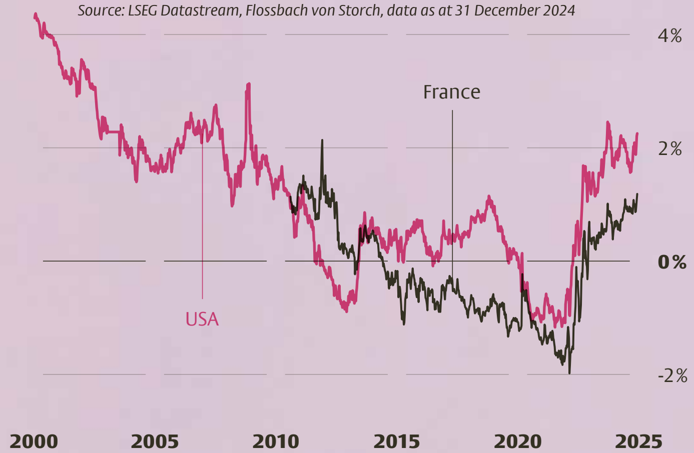
There will be another debt crisis; it is to some extent inherent to the system, making it a matter of “if” rather than “when”.

One indicator of trust, or rather mistrust, in our monetary system is the price of the competition for paper money. Of gold, for example, or bitcoin. In the past, the more global debt has increased the higher the price of gold has been (see Figure 5). The euro crisis of 2010/11 is one such example. When currencies are weak, and potentially under threat, gold becomes strong – the money of last resort. ◆

*Stephan Fritz is the Head of Capital Market Strategy and Product Communication at Flossbach von Storch SE in Cologne.*

Figure 4
**Too expensive to sustain**
Comparison of real yields on 10-year inflation-linked government bonds

**Past performance is not a reliable indicator of future performance.**
*Source: LSEG Datastream, Flossbach von Storch, data as at 31 December 2024*



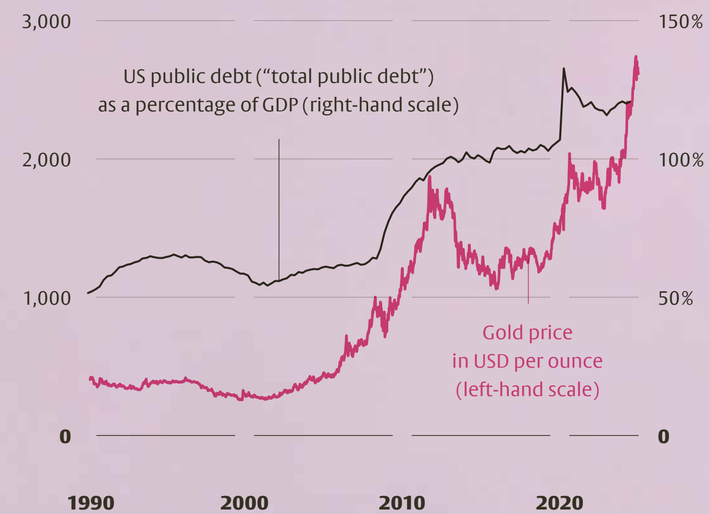




Figure 5
**No counterparty or hegemonic risk for gold**
Development of the gold price and US public debt

**Past performance is not a reliable indicator of future performance.**
*Source: LSEG Datastream, Flossbach von Storch, data as at 31 December 2024*

# THE US DOLLAR PHENOMENON

Julian Marx

The US dollar is considered the world's reserve currency, with its dominant position reflected in central banks' currency reserves. But many countries – including China in particular – have now swapped their US dollar reserves for gold.



Anyone looking at the world through the eyes of a US central banker would have good reason to be satisfied. After all, the US dollar is a currency of superlatives: around 57 per cent of the world's currency reserves are denominated in US dollars, well in excess of 80 per cent of currency trading transactions involve the US dollar, and overseas demand for the physical US currency is also huge. According to an estimate by the US Federal Reserve (Fed), approximately half of the nearly USD 2.4 trillion worth of American banknotes and coins in circulation are in non-US hands – and non-US ownership rises to around two-thirds for 100-dollar bills.

So, it's clear that the US dollar is popular around the world and enjoys a unique position. However, there's now a sense that cracks are starting to show in the US dollar's dominance. China in particular – the world's second-largest economy – has significantly reduced its dollar reserves in recent years. Is the US dollar losing its supremacy as the world's reserve currency?

## CHINA'S SLOW TURN AWAY

China has been cautiously reducing its exposure to the US dollar for several years now. This can be seen from the Chinese central bank's declining US dollar reserves, which are usually invested in US Treasuries. In 2013, Chinese investors held US government securities worth as much as USD 1,300 billion at times, but this amount has shrunk by more than USD 500 billion, suggesting that China is trying to systematically reduce its dependence on the US dollar.

From a Chinese point of view, this makes sense. For one thing, China's long-simmering trade conflict with the USA provides reason enough to look for alternatives to the US dollar. Moreover, China could interpret the sanctions imposed by the USA and its allies against Russia as a portent, making the US dollar less attractive as a reserve currency. For example, fewer than four weeks after the Russian invasion of Ukraine, foreign currency reserves held abroad by the Russian central bank were frozen. As a result, Russia's central bank lost access to a large portion of its currency reserves worth almost USD 600 billion.

But it's not that easy to replace the US dollar, despite there clearly being no lack of motivation to do so. In practice, there are few alternatives to the US dollar for potential geopolitical counterparties, as other key reserve currencies – such as the euro, the Japanese yen or the British pound – are all issued by close allies of the USA. There is little international demand for other options, such as the Chinese renminbi (see Figure 1).

The leading role of the "US dollar bloc" in currency reserves is underpinned by the fact that the USA and its allies still dominate the global economy and international financial markets. In recent figures they accounted for more than 50 per cent of global economic output, and their footprint in terms of international bonds in circulation is even larger. At the end of 2023, more than 80 per cent of international bonds in circulation were denominated in either US dollars or euros.

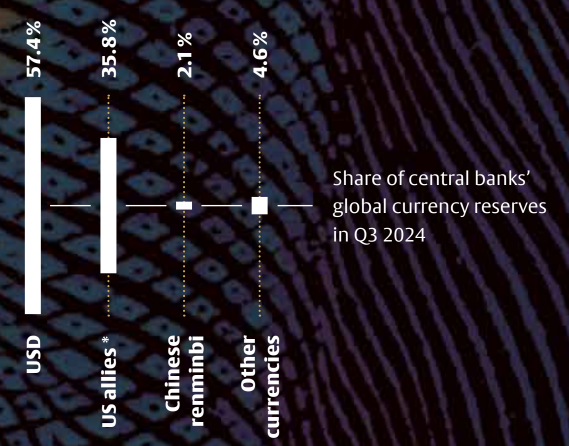
So, in the short term, a country "noiselessly" distancing itself from the US dollar on a large scale seems an almost impossible task. In the absence of alternatives, so far China and a couple of other emerging economies have sought to reduce their US dollar reserves in favour of gold. Not surprisingly, China was the largest gold buyer among central banks in 2023, with 215 tonnes of net gold purchases. Overall, however, China has made more of a gradual move away from the US dollar so far.

## THE US DOLLAR COMES OUT ON TOP IN TIMES OF CRISIS

While China is trying to reduce its dependence on the US dollar, one African country is showing just how much it still →

Figure 1
**What's the alternative?**
Currency reserves are concentrated on the USA and its allies

*Source: International Monetary Fund, Flossbach von Storch, data as at 31 December 2024*



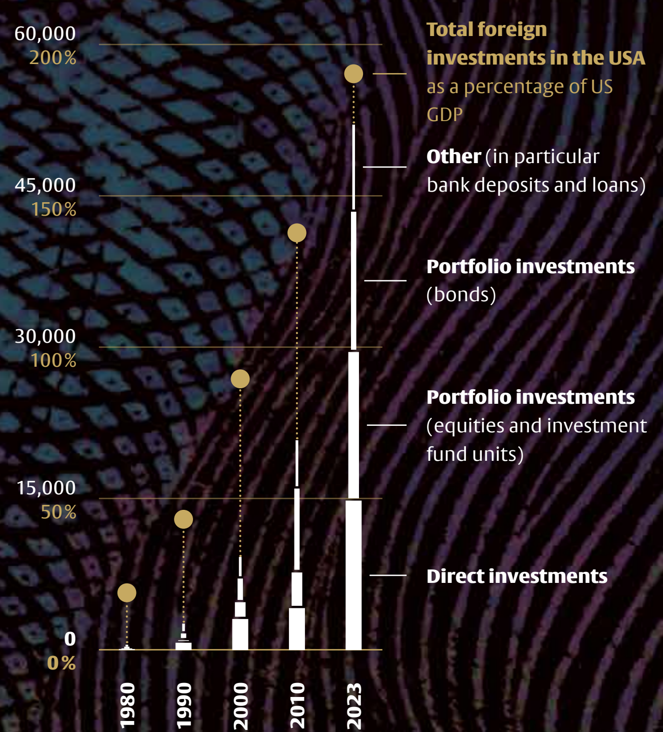




Figure 2
**The US capital market is unparalleled**
Foreign investments in the USA in USD billions and as a percentage of US GDP

*Source: U.S. Bureau of Economic Analysis, LSEG Datastream, Flossbach von Storch, data as at 31 December 2024*

* Taken into account: Australian dollar, euro, Japanese yen, Canadian dollar, British pound.



values the world's reserve currency. In Zimbabwe, home to the famous Victoria Falls, almost 17 million people trust the US dollar far more than their own national currency – which is no wonder given that Zimbabweans have repeatedly experienced genuine hyperinflation in recent decades. In 2006, for example, inflation stood at more than 1,000 per cent. In July 2008, when the Zimbabwe National Statistics Agency last reported inflation figures for that year, the stated annual inflation rate was more than 200 million per cent. Attempts by the government to combat spiralling inflation during these years by controlling the prices of staple foods and services failed. More than 10 years later, in 2020, inflation once again exceeded the 500 per cent mark. For a long time now, there has been no question of Zimbabweans having confidence in their own currency; the yearning for alternatives is great.

As a result, the country's economy has moved towards full US dollarisation. According to the Reserve Bank of Zimbabwe, the US dollar accounts for more than 80 per cent of all transactions in the country. This is not a problem at the moment because Zimbabwe's current account balance has been positive in recent years. As one might expect, new currencies are coming into the country as well, though there is no guarantee that this will continue in the future.

## MONETARY REFORM IN ZIMBABWE

Given the scenario outlined above, in April 2024 Zimbabwe decided to implement (another) currency reform. First of all, however, it was necessary to restore confidence in the national currency. The banks converted the Zimbabwean dollar into a newly created currency called the Zimbabwe Gold (ZiG). The plan was to use the new currency in the economy in parallel with the US dollar initially in the hope that its use would gradually increase – the idea being to build confidence that the Zimbabwe Gold is fully covered by currency reserves and gold. On 5 April 2024, the date of the currency changeover, the central bank's currency reserves amounted to USD 100 million in cash and 2.5 tonnes of gold (equivalent to roughly USD 185 million as at 5 April 2024). At the time of the currency reform, Zimbabwe's currency reserves were therefore worth around three times as much as its cash holdings in local currency.

Consequently, the success of the new national currency will be closely linked to confidence in the country's currency reserves. Assuming that a successful currency reform were to contribute to dwindling demand for US dollars in Zimbabwe in the future, this would not be interpreted as a sign of weakness in the world's reserve currency. Rather, confidence in the US dollar (and gold) as a reserve currency may have made such a success possible in the first place.

## STRENGTHS OF THE US DOLLAR

So, what are the benefits of the US dollar that inspire such confidence? Historically, the US dollar initially benefitted from its leading role in the Bretton Woods system. Under the Bretton Woods system, 44 countries agreed in July 1944 to use an international monetary system with fixed exchange rates against the US dollar as the reserve currency. The US committed itself to a "gold redemption guarantee", promising to redeem gold at a fixed rate of USD 35 per troy ounce at any time. The fact that the US dollar became the reserve currency in the Bretton Woods system was largely due to the fact that, towards the end of the Second World War, an estimated 70 per cent of the world's gold reserves were stored in the USA. It therefore seemed impractical to assume that national currencies could be redeemed directly, as they could under the gold standard.

In the early 1970s, however, the Bretton Woods system collapsed after the US currency came under pressure in the face of large US deficits. Convertibility of the US dollar into gold was terminated. The US dollar has nevertheless retained its status as the world's reserve currency. The fact that a significant proportion of international trade in goods is still invoiced in US dollars today may be one reason for the US dollar's continued dominance. Furthermore, the US has been seen as a "safe haven" thanks to its capital markets, which are considered particularly liquid and safe.

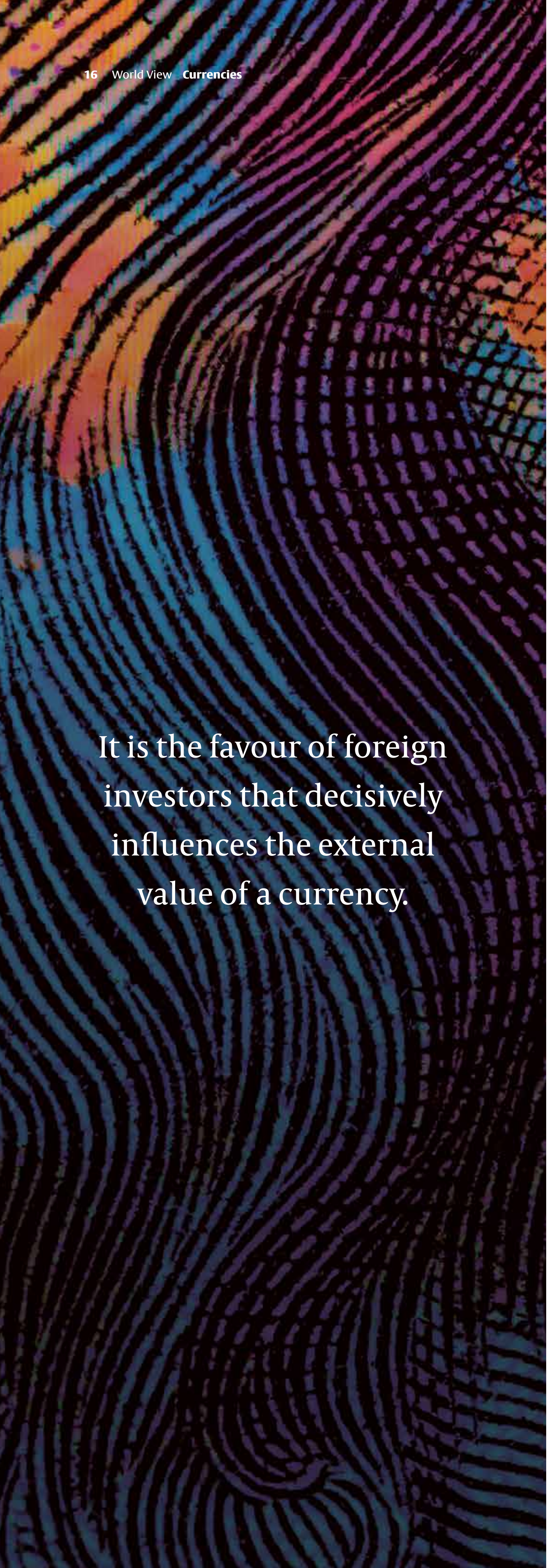
The US capital market remains unparalleled. No other country or currency area is able to replicate it. The US equity market is more than twice as large as its European counterpart, boasting market capitalisation of around USD 60 trillion. The depth of the US bond market is peerless too – marketable US Treasuries worth more than USD 25,000 billion speak for themselves and are complemented by US dollar corporate bonds in the double-digit trillions. This unprecedented pool of liquid investment opportunities in an open market has allowed foreign investments in the USA to grow steadily over decades. Meanwhile, non-US citizens have invested more than USD 50 trillion in the USA, which at the end of 2023 accounted for just under 200 per cent of US annual economic output (see Figure 2).

In the search for the world's reserve currency, there's hardly any way around the US dollar for the time being. That said, there are some questions about the continued significance of the US dollar in the future.

## WEAKNESSES OF THE US DOLLAR

One weakness would be the chronic current account deficit of the USA, which in itself would point towards increased US-based demand for foreign currencies and therefore devaluation of the US dollar. Since 1992, the world's largest economy has only recorded current account deficits, most of which have been quite substantial. On average, the deficit has been around three per cent of GDP. In absolute terms, a cumulative current account deficit of around USD 15,000 billion has accumulated since 1992.

There is a simple reason why the US dollar has not depreciated in the face of these chronic and significant current →



It is the favour of foreign investors that decisively influences the external value of a currency.

account deficits. It is because, mirroring the current account deficit, foreign investors have also been investing ever-increasing sums in the US capital market, which has provided a bulwark against depreciation. The significant current account deficit of the USA is therefore due not least to the dollar's status as the world's reserve currency. After all, global demand for the US dollar for investment, transaction and reserve purposes is what is causing the dollar to appreciate.

Recent figures reveal that, on balance, non-US citizens have invested around USD 22,500 billion more in the USA than Americans have invested abroad – and it is precisely this strength of the US capital market that inevitably carries a risk to the US dollar.

If foreign investors were to liquidate their US dollar holdings quickly, the resulting loss in value could jeopardise the status of the US dollar as the world's reserve currency. Nevertheless, this risk is currently somewhat theoretical in nature as there are still no 100 per cent realistic alternatives to the US dollar for foreign investors, and those foreign investors with close ties to the USA in particular are unlikely to want the value of the US dollar to suddenly fall.

## LONG-TERM RISK: SHIFT IN WORLD ORDER

In addition to reliance on a large foreign investor base, another risk factor endangering the status of the US dollar is major shifts in the world order. The Asia-Pacific region has gained enormous economic weight in recent decades. While the region's share of global economic output was just 27.4 per cent in 2010, by 2020 the figure had risen to 33.5 per cent. According to forecasts by the Asian Development Bank, this share could even climb to as high as 50 per cent by 2050.

A shift in global economic activity to the Asian region then also suggests that the international relevance of Asian currencies is likely to increase. The Chinese renminbi is regarded as the natural challenger to the US dollar. After all, China is already the second-largest economy in the world. The pattern of how the renminbi may benefit in the future is clear: a higher Chinese share of global trade – measured by the imports invoiced in renminbi – will initially increase the use of the renminbi in international payments. Countries that trade more with China are likely to hold more renminbi reserves as a result. This could increase the renminbi's share of total reserves in the future.

However, there are a number of factors working against the renminbi that go beyond a nation's mere economic strength – (geo)political interests being a particularly pertinent example. In the East China Sea, for instance, China and Japan both regard some islands as their territory. The border conflict with India has never been resolved conclusively since the border war of 1962. Even more prominent are the clashes over the island state of Taiwan, whose population has been concerned about the possibility of a Chinese invasion for years.

This shows that in the face of such political disputes it could be difficult for China to implement the renminbi as a kind of central currency even in the Asian region. This is likely to be more difficult still when dealing with Western industrialised countries. Furthermore, the willingness to accumulate reserves denominated in renminbi may be limited if the ability to use this currency is also limited and the reserves are not sufficiently liquid when needed. In this context, a complete liberalisation of the Chinese capital market would probably be necessary. The question, however, is how likely such a scenario is to happen. The increasing opening up of capital markets always entails risks for a country's currency. After all, open capital markets do more than just attract capital from foreign investors – they also allow domestic investors to invest their money abroad. From the perspective of an autocratic government, liberalisation could therefore lead to an unwelcome loss of control.



## WILL THE US DOLLAR CONTINUE TO DOMINATE?

Barry Eichengreen, a professor of economics at the renowned University of California, Berkeley, caused a stir with a headline in the Wall Street Journal when he declared that "the reign of the dollar is coming to an end". It's not uncommon for economists to sometimes get carried away with making self-confident hypotheses, but what is unusual in this case is that Eichengreen sounded the death knell for the US dollar more than a decade ago.

Why is this relevant? Because it shows that a certain degree of scepticism around the US dollar is not a new phenomenon. What the financial crisis was 15 years ago could now be concerns about China's process of cutting its ties with the US dollar. The fact is the US dollar has seen off numerous sceptics in its time. There are also good reasons to assume that the US dollar will remain the world's reserve currency for some time yet.

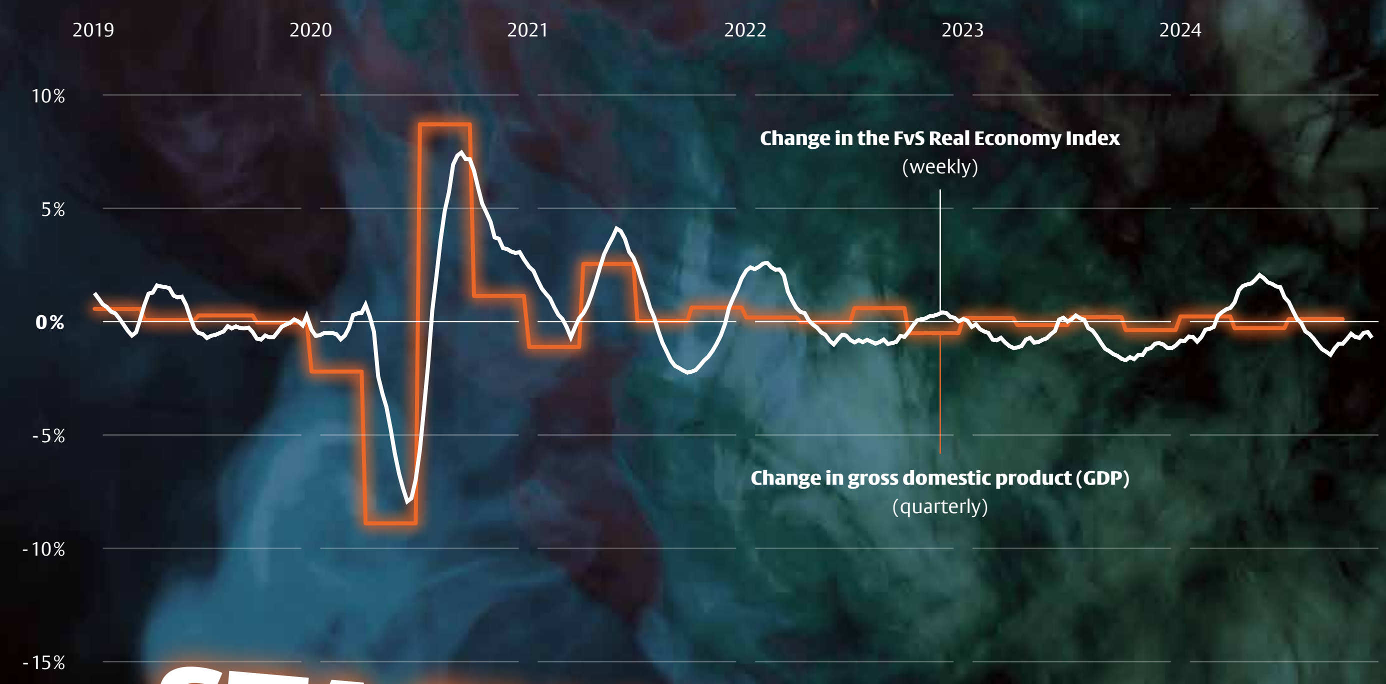
Acceptance of an "international currency" is usually assessed on the basis of three dimensions: its use as a store of value, its use as a means of exchange and its use as a unit of account. Despite some alarming headlines, the US dollar continues to dominate all other currencies in these three areas, and by a considerable margin too.

From the perspective of a US central banker, however, there is still a small fly in the ointment. That being that neither US central bankers nor US citizens determine the success of the US dollar in isolation – the goodwill of foreign investors plays a far more decisive role in establishing a currency's external value. Nonetheless, factors such as the incomparable US capital market in particular suggest that the US dollar will continue to shape the world of finance for many years to come as its reserve currency. ◆

*Julian Marx is an Analyst at Flossbach von Storch SE in Cologne.*

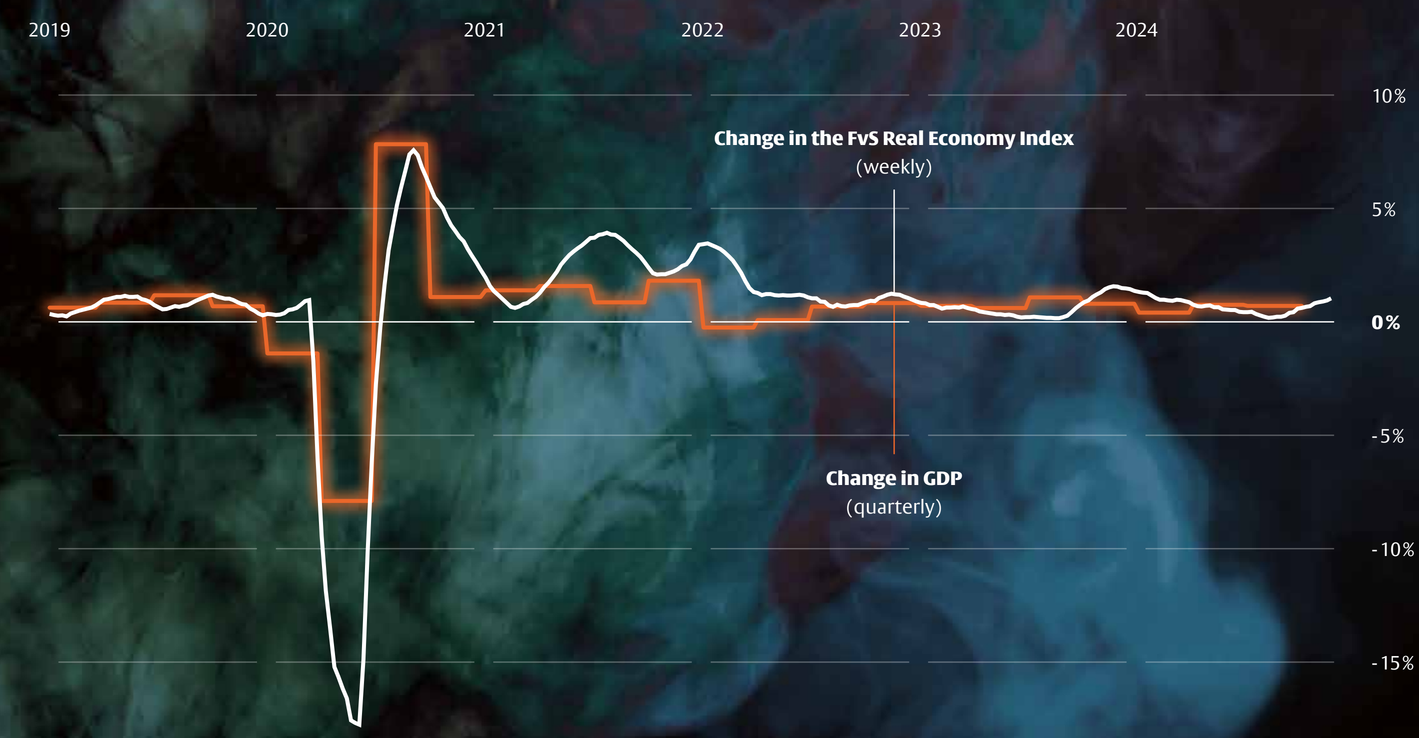
**Stagnating economy in Germany**
(Change in GDP and FvS Real Economy Index in per cent)

*Source: Federal Statistical Office of Germany, Flossbach von Storch Research Institute, data as at 31 December 2024*




**Growing economy in the USA**
(Change in GDP and FvS Real Economy Index in per cent)

*Source: U.S. Bureau of Economic Analysis, Flossbach von Storch Research Institute, data as at 31 December 2024*




# STAGNATION OR ACTUALLY A RECESSION?

**While the US economy is consistently growing, official figures reveal that the German economy increased by just 0.1 per cent in the third quarter of 2024 – narrowly avoiding a recession. Yet there is a sense that our economy is in deep crisis. Could it be that the economy has long been in decline and that the indicators are lagging behind?**

The FvS Real Economy Index from the Flossbach von Storch Research Institute was created to monitor the real economy in Germany and in the USA in real time. It uses indicators, such as electricity consumption, the number of trucks on motorways and the frequency of particular Internet searches to map current developments. "The tracker combines these data sources to allow us to assess the economic situation promptly without having to wait for official statistics," says Pablo Duarte, Senior Research Analyst at the Flossbach von Storch Research Institute. This is important because official statistics are often published with a delay. Changes in electricity consumption or mobility, for example, could provide early indications of economic trends and changes in trends.

And looking ahead, Duarte believes that the US economy is still following a slightly positive growth trajectory, while the German economy remains stagnant. For example, electricity consumption in Germany remained below the average of the past seven years until the end of October, while consumption in the USA was higher. By contrast, the truck-toll-mileage index has signalled weakness for Germany since 2022 but has recovered slightly in recent weeks. The FvS Real Economy Index has nevertheless pointed to a slightly negative overall trend in Germany since 22 July, though economists, who typically update the figures on a weekly basis, are not (yet) predicting a recession.

The Index was first published in June 2020 and has so far correctly anticipated – several weeks before the official data was published – the sharp decline in the second quarter of 2020 due to the pandemic lockdowns, Germany's current economic weakness, and the consistently strong growth in the USA. The latest version of the Index as well as a detailed description is always available on the Flossbach von Storch Research Institute website.



# *“Never Bet Against America”*

Bert Flossbach on the dominance of the USA, its new, old president and the implications for investors in Europe.

**Which region should investors focus on more this year – Europe or the USA?**
I would move away from regions – and instead look at individual companies, their business models and long-term earnings prospects. Where the headquarters are located is of secondary importance.

**And if you had to choose between Europe and the USA – where are the best prospects for returns in the coming years?**
Then I would say that the two regions are not comparable and would probably refer to Warren Buffett ...

**In what way?**
In one of his highly regarded annual reports, he wrote the following words: “In its brief 232 years of existence, however, there has been no incubator for unleashing human potential like America [...] Our unwavering conclusion: Never bet against America.”

**Why is that?**
According to estimates by the EU Commission, US companies account for 42 per cent of global expenditure on research and development. The figure for expenditure on software development is as high as 70 per cent – a key reason for the high level of productivity. In total, the USA generates more than a quarter of global economic output and around a third of corporate profits worldwide. At the same time, the USA accounts for just four per cent of the world’s population.

**But where does this dominance come from?**
Nowhere else is the entrepreneurial spirit and the associated willingness to take risks more pronounced than in the USA. This quintessentially American trait attracts talent from all over the world. Many of today’s leading technology companies were founded or shaped by immigrants. Take Jensen Huang and Nvidia, for example.

**Productivity growth in the USA accelerated once again after the 2008 financial crisis – what are the reasons for this?**
The reasons for this are massive investments and innovations in the high-tech sector. The major technology companies have achieved global supremacy, which is also reflected in significantly higher market capitalisations. At the end of 2008, the market capitalisation of the companies included in the S&P 500 was just USD eight trillion. At the end of 2024, it was 52 trillion, 6.5 times as much. The increase in value of the so-called “Magnificent Seven” (Apple, Nvidia, Microsoft, Alphabet, Amazon, Meta and Tesla, editor’s note) →

“Nowhere else is the entrepreneurial spirit and the associated willingness to take risks more pronounced than in the USA.”

is particularly striking. At the end of 2008, their total market capitalisation was only USD 372 billion. Meta and Tesla were still start-ups back then. Today it is 17.6 trillion, so the companies are worth 47 times as much!

**What about Europe?**
Although it conducts successful basic research, it rarely manages to transform new technologies into successful products and companies. This is particularly true for Germany.

**Why is that?**
This is due to the poorer financing environment compared to the USA – there are fewer venture capitalists – and a less pronounced entrepreneurial spirit.

**Why do you think that is?**
Personal responsibility and entrepreneurship are not very popular in Europe, especially in Germany. In contrast to the USA, there is a “fully comprehensive insurance” mentality. The state is seen as a saviour in all situations and a safe employer of choice. A sprawling EU bureaucracy covers the corporate landscape with a thicket of regulations, which are often supplemented or tightened by different national regulations.

**Do you have an example of what you see as excessive bureaucracy?**
German legislation specialises in implementing EU requirements from Brussels at an earlier stage, let’s take the Supply Chain Due Diligence Act as an example. Or to tighten, expand and complicate them even further – such as the Building Energy Act (GEG).

**How big is the damage?**
The annual costs of bureaucracy in Germany are estimated at up to EUR 65 billion. This means less time for core business, less innovation, less sustainability in real life, but more paperwork.

**Do you think that many companies might turn their backs on Germany?**
It would not be surprising. Especially as it is not only the bureaucracy that scares off entrepreneurs, but also the planned industrial policy; it hinders economic change. Volkswagen and the political interventions are a good example of this.

**In what way?**
Existing structures are to be cemented instead of enabling adaptation to new realities. This ties up skilled labour in old structures, whereas they are urgently needed in other companies. Such an economic policy will not enable us to keep pace with the USA.

**Meaning?**
Germany is losing its appeal as a business location. A crumbling infrastructure, backward digitalisation, a messed-up energy policy and a Kafkaesque bureaucracy are deterring investors. Corporate investment is currently around 10 per cent below the 2019 level, which means that the existing base is shrinking without much new growth. Growth is only happening in the public sector.

**What can be done to reverse the trend?**
The hope remains that the crisis will make people realise that a healthy economy is a prerequisite for a functioning welfare state, for external security and ecological transformation – and that the funds required for this must be generated anew every year. For years, politicians have deluded people into believing that things could be done differently: you don’t have to bake the cake, you just have to share it.

**France, too, is not a haven of stability and prosperity in political and economic terms. The pension reform pushed through by President Emmanuel Macron in 2023 against staunch opposition and the austerity budget planned for summer 2024 contributed significantly to the resignation of the Barnier government. How do you assess the situation?**
It takes courage to push through necessary but unpleasant measures and not revise them again – this is probably even more true in France than elsewhere. The country is also struggling with a high mountain of debt, which at 112 per cent of gross domestic product not only restricts the scope for political action but is also being viewed with increasing concern on the financial markets. After Italy, France now has to pay the highest interest rates in the eurozone. For 10-year French government bonds, it is currently around 3.4 per cent compared to 3.2 per cent in Spain and 3.0 per cent in Portugal.

**France’s interest-rate premium isn’t that high ...**
I’m more interested in the signalling effect – which is huge. And it is not without a certain irony.

**What do you mean by that?**
As a co-initiator and former core country of the eurozone, France is now slowly moving to the periphery. The interest-rate level is still manageable in absolute terms, but every additional one per cent means an additional burden of EUR 30 billion with a national debt of EUR three trillion. Political instability and increasing populism could cause government spending and debt to continue to rise sharply.

**How great is the risk of a sovereign debt crisis in France?**
The European Central Bank (ECB) will probably come to France’s rescue as the saviour of last resort.

**Is concern about the national budget also the reason why the French equity market fell far behind the other markets in 2024 with a gain of less than one per cent – including dividends?**
There are certainly various reasons for this, although increasing concerns about financial stability and France as a business location are certainly among them.

**Will the USA’s lead over Europe and the rest of the world grow or shrink under the new president? Is Trump more of a curse or a blessing?**
The experience of Donald Trump’s first term in office is that you have to take him seriously, even if you don’t have to take everything he says seriously.

**Specifically, what do you have in mind?**
He has neither left NATO, nor imposed tariffs on European car imports, nor bombed North Korea, nor closed the Mexican →

border with a continuous border wall. But you never know how serious he is about something.

**But how do you deal with it?**

Exaggeration is part of his negotiating style, which is why predictions about his policies always run the risk of being overtaken by chaos. In an interview with the Wall Street Journal in October 2024, Trump claimed that China's President Xi Jinping respects him because he is "fucking crazy". Even before his inauguration, he is endeavouring to confirm this self-assessment. Greenland, Canada, the Panama Canal: nothing seems safe from him. Trump is using the exceptional economic and military power of the USA as leverage wherever he pleases.

**And he promises what he likes …**

Ending wars, securing borders, beating inflation, repaying debts, boosting US growth and creating jobs. In short: a "golden age" for the USA.

**Will he be able to keep his promises?**

The conflicting goals are obvious: reducing debt and taxes at the same time; increasing tariffs and expelling immigrants while combating inflation. This is a difficult endeavour.

**What about inflation?**

The high inflation of the Biden years was a decisive factor in Trump's election success. This is a major risk for him. If inflation picks up again, for example due to high import tariffs or the mass deportation of illegal labour, this will fall on Trump's shoulders. It is therefore unlikely that he will make good on his threat and impose high tariffs on all imports. This would drive up prices across the board and hit his supporters particularly hard.

**Most recently, the focus has been on the high US debt – will he be able to reduce it significantly with the help of "savings commissioner" Elon Musk?**

The US government's revenue shortfall recently amounted to USD 1.8 trillion, which corresponds to around six per cent of GDP – despite the booming economy. The hoped-for savings potential from the efficiency commission for the civil service headed by Elon Musk is expected to bring savings of USD two trillion in the long term. That seems illusory.

**Why?**

A good half of the almost USD 6.8 trillion budget is spent on social programmes, of which a good two trillion is spent on pension schemes and health insurance for pensioners. Trump doesn't want to go there – antagonising baby boomers of retirement age would not be a good idea. Another trillion or so will go on interest, which has to be paid. The USD 900 billion in defence spending is equally untouchable. That leaves USD 1.5 trillion in discretionary spending. If this could be reduced by a quarter, the bottom line would be a potential saving of around USD 400 billion. That is around 1.3 per cent of economic output, which means that in the best-case scenario, new debt could fall to just under five per cent of GDP …

**So, the debt won't be reduced?**

It doesn't look like it, no. I would rather assume the opposite.

**The USA now has a debt of around 120 per cent of US GDP – how much is actually sustainable?**

There is no simple answer to this question. The USA has the privilege of possessing the unchallenged global reserve currency, the dollar. This increases its room for manoeuvre when it comes to taking on debt. But even that has its limits.

**Who or what sets the limit?**

The bond market. No government in the world can successfully stand up to its creditors in the long term. If investors no longer want to buy or hold US Treasuries because they have lost confidence in the US government's policies and the country's financial stability, things will be tight for Trump too.

**Trump's success is measured not least by the level of the S&P 500 index, which has been soaring in recent months. Is there not a threat of trouble ahead?**

Two very good investment years do not necessarily have to be followed by a bad one, as a look at stock market history teaches us …

**But?**

Investors' expectations have to be met, or even better, exceeded. And expectations are high: decent economic growth, significantly rising corporate earnings, declining inflation and a further fall in interest rates. This would be a continuation of the previous year's development and corresponds to the "Goldilocks scenario" named after a fairy tale – the best of all worlds.

**Isn't the "best of all worlds" rather an unmistakable warning sign?**

There are currently no signs that the technology boom is coming to an end or that a recession is imminent. There are no signs of any real stock-market excesses like those at the start of the year 2000, when company valuations shot into the stratosphere and share-price charts resembled flagpoles. However, the potential for disappointment has increased due to investors' high expectations. And who knows what Donald Trump will come up with. In any case, the probability of a market correction has increased.

**When could this happen?**

That is the question to which no one has a definitive answer. It is difficult to time a setback, as the past year has impressively demonstrated.

**Then let's look at the long term – how do you assess the return potential of shares over the next 10 years?**

Considerably more modest compared to the past 10 years. The reason for this is the current high valuation of the US equity market, which has already anticipated some of the future growth in corporate earnings. Since the start of 2015, corporate earnings of S&P 500 stocks have doubled, i.e. risen by seven per cent annually, which is pretty much in line with the long-term average. Conversely, share prices have tripled, which means an annual increase of 11.2 per cent. Shares have therefore become more expensive. Around one-third of the share-price gains over the past 10 years can be attributed to the higher valuations. Two-thirds have been "fair" gains.

**Could you perhaps be more specific about your return expectations?**

In the best-case scenario, US corporate earnings would grow at around their long-term average annual rate of seven per cent – and valuations would remain at their current high level. This would mean a doubling of the share price of the S&P 500 Index over the next 10 years. Plus dividends, this would be a total return of around 8.5 per cent per year.

**And in the "normal case"?**

Corporate earnings would rise by seven per cent. Valuations would fall back to their long-term average of around 18, which would mean an annual share-price increase of just under four per cent and, plus dividends, a total return of around 5.5 per cent per year.

**And if things get worse?**

Profit growth and/or valuations fall below the "normal case" level. The expected total return would then be even lower.

**What does this assessment mean in concrete terms for a long-term investment strategy?**

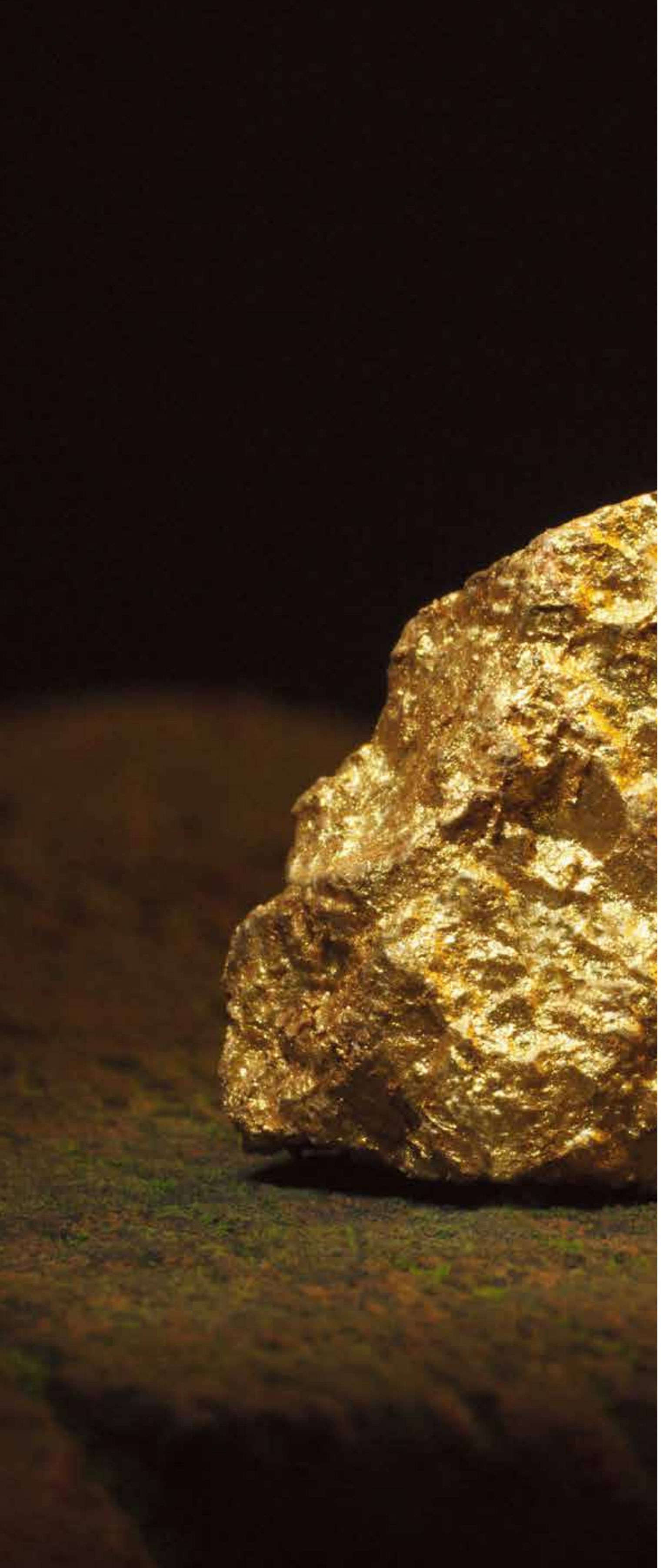
Bonds have become more attractive compared to equities, which justifies a higher weighting of bonds, provided a sustained higher level of inflation is ruled out. The long-term potential of the major equity indices, let's take the S&P 500 and MSCI World as examples, is modest. They could lose their status as the "Holy Grail" of the investment world.

**What does this mean?**

The potential for undervalued stocks, which are not among the index heavyweights and have therefore long been out of favour, appears to be greater. Active management should also pay off again with equities.

**Thank you very much for the interview.**

*Dr Bert Flossbach is Founder and Owner of Flossbach von Storch SE in Cologne.*





Simon Jäger

# A HARD CURRENCY

## The price of gold has risen significantly recently. An explanation in five steps.

If you've known us for a while, you'll know that we tend to hold back on the jokes. In view of current developments, however, we are making an exception this time: 2024 was a 'golden year' for investors. The precious metal increased in price by a good third in euro terms.

This development raises a number of questions. Who is buying gold and what is driving the price? Our analysts have scrutinised large amounts of data to provide you with some answers. The following five charts help to understand what makes gold so popular.

Not only traders know this: the price always depends on demand. Gold can be purchased physically (for thousands of years), for example as coins, bars or jewellery. Professional investors often use exchange-traded securities. With exchange-traded commodities (ETC), the precious metal is physically deposited. The shares are easier to trade, and investors do not need vaults.

This graph shows that investment demand has turned around this year. For the first time since 2022, there were inflows into ETC gold holdings. On the one hand, rising demand is causing prices to rise. On the other hand, demand has been significantly higher in recent years. This means there are other buyers in the market. These include the central banks, which have recently increased their holdings significantly.

→

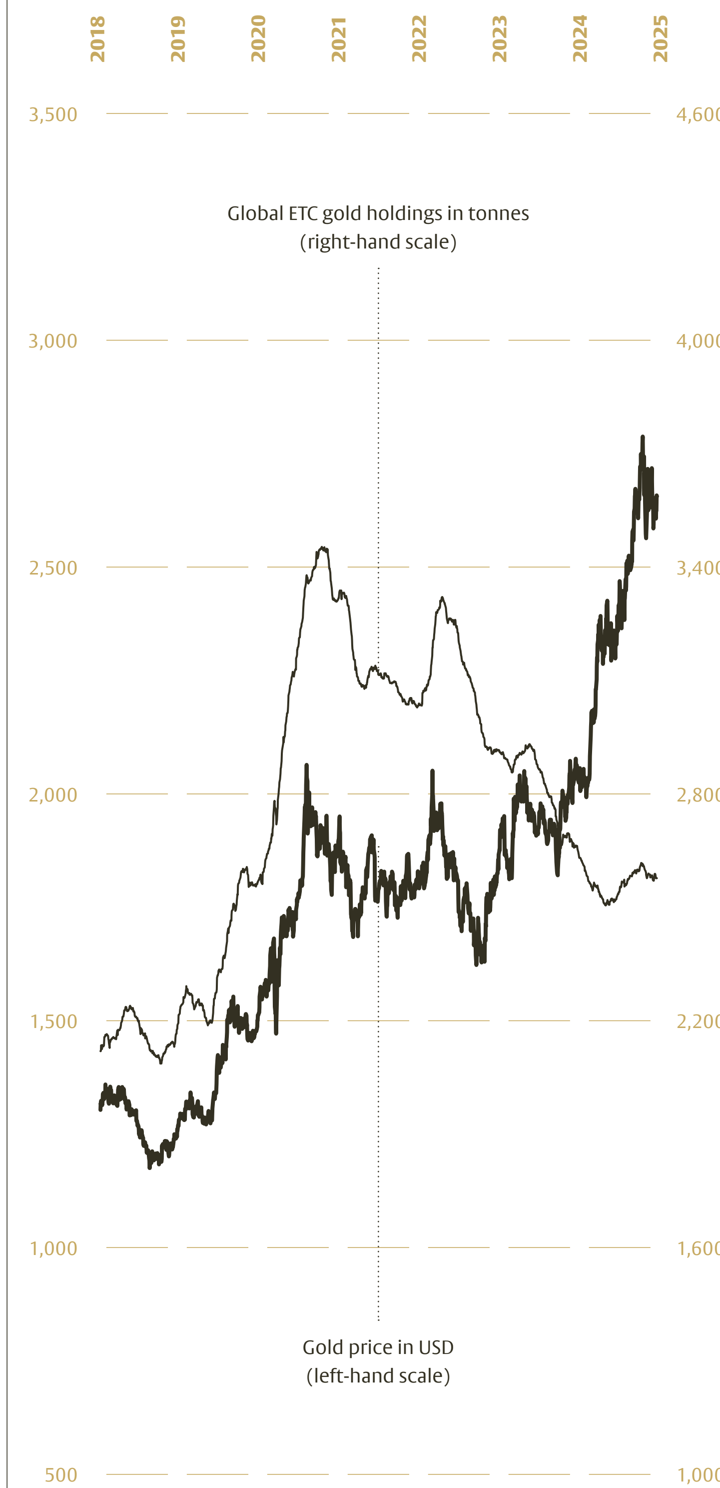



Figure 1
**Investment demand has stabilised**
Global ETC gold holdings remained roughly unchanged last year

**Past performance is not a reliable indicator of future performance.**
*Source: Bloomberg, Flossbach von Storch, data as at 31 December 2024*

*Simon Jäger is a Portfolio Manager at Flossbach von Storch SE in Cologne.*

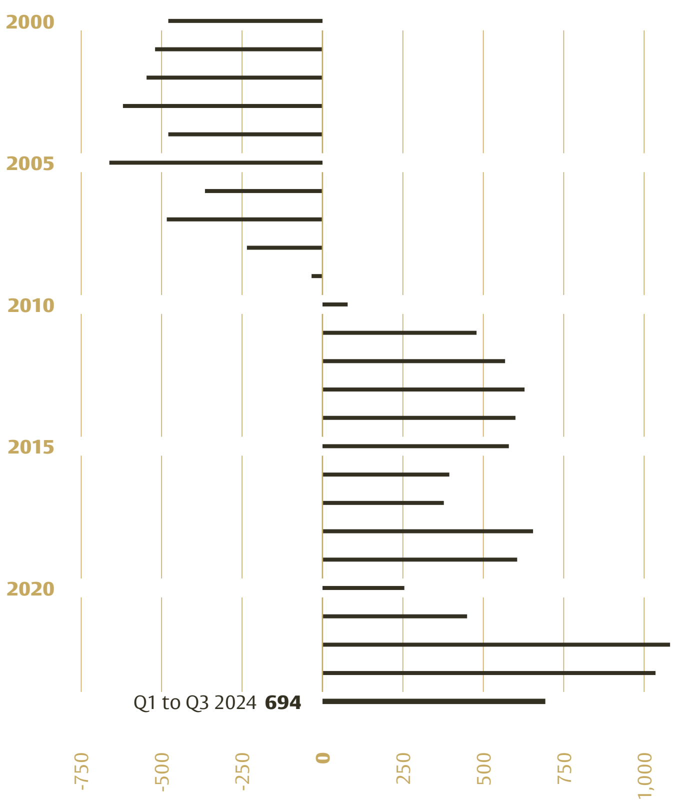



Figure 2
**The currency of last resort, also for the guardians of fiat currencies**
Central bank net purchases of gold at an all-time high (net purchases of gold in tonnes per year)

*Source: LSEG Datastream, World Gold Council, Flossbach von Storch, data as at 31 December 2024*

Such demand data is rather reassuring for gold investors. Prices are currently not being driven by speculators, who always jump on the 'gold train' when the price rises and sell again when it falls. These include private investors, for example, but also institutional investors without a sound strategic plan. Gold prices have been rising since 2022 – and this is not due to demand from tacticians.

Strategic demand from central banks, governments and long-term investors is permanently reducing the amount of gold available. Or to put it another way: the strategists are reducing the (limited) amount of gold that is still available to the tacticians. The expectation that they will dump the precious metal back onto the market in the long term seems rather unlikely.

All of this is happening in an environment in which tangible assets are in demand. Government debt has risen massively and will continue to rise. In Europe, China and the USA (see article "How Much is Too Much?" on page 6). At the same time, the cost of new loans is significantly higher than in the days of zero and negative interest rates. The more old loans that have to be refinanced at high cost and the faster total debt increases, the more expensive it becomes for borrowers. When the costs exceed the borrower's ability to pay, things become dangerous. Even if there is not yet an acute crisis regarding government debt, the signal that debt is rising seemingly without limits is already having an effect. The prospect of a potential crisis of confidence in paper money with the corresponding consequences is making real assets more attractive.

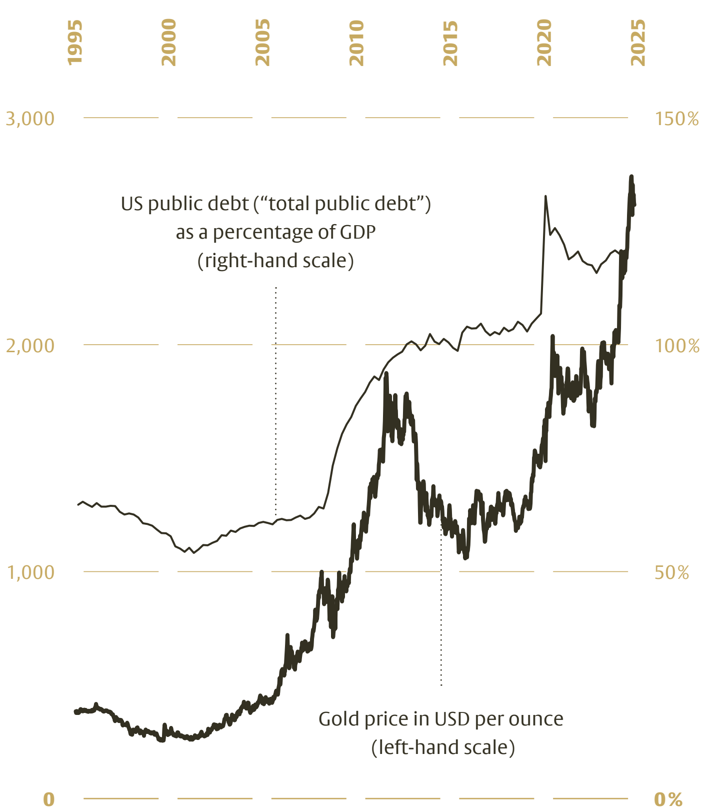



Figure 3
**Gold has no counterparty risk**
Development of the gold price and US public debt

**Past performance is not a reliable indicator of future performance.**
*Source: LSEG Datastream, Flossbach von Storch, data as at 31 December 2024*





Figure 4
**Partial de-dollarisation is helping the gold price**
China is reducing its US Treasury holdings

*Source: LSEG Datastream, Flossbach von Storch, Data as at 31 December 2024*


Added to this are political developments. The US dollar is regarded as the world's reserve currency. Anyone wishing to invest in the dollar generally buys interest-bearing, safe US Treasuries. China has recently reduced its holdings. The relevance of a currency is ultimately always a question of power. And the example of Russia shows that autocratic regimes must fear for the liquidity of their foreign investments in the event of conflict. This problem does not exist with gold. This makes it clear that increasing political conflicts can also influence demand.

The development of the gold price over the past few decades has been very impressive. Inflation, the devaluation of money, is not only reflected in the corresponding figures from the central banks. The following graph shows how much gold you could get for EUR 1,000 in the past and today.

25 years ago, you could get 10 times more gold for one euro than you can today. Within a generation, this massive devaluation of the common currency has caused many savers to increasingly question the common practice of parking their money in cash. Given the developments of recent decades (which are likely to continue), it is becoming increasingly clear that gold is the currency of last resort. ◆


Figure 5
**Gold versus fiat money**
How many grams of gold can you get for EUR 1,000?

**Past performance is not a reliable indicator of future performance.**
*Source: LSEG Datastream, Flossbach von Storch, data as at 31 December 2024*

Frank Lipowski


## The US dollar is the world's reserve currency, and US Treasuries are considered a safe haven among global investors. But doubts are beginning to surface – are there alternatives?

Times change. We can no longer rely on the things we once held as true. What we see in many areas of life at any given moment is also reflected in the investment landscape. Financial markets are always an indicator, a preview of what is to come. Sometimes they exaggerate; other times they fall short.

Good asset management always involves questioning long-held convictions, even more so in today's bond market. The only way to adequately reconcile opportunities and risks is to apply an active and flexible investment strategy.

Public debt is following an unprecedented trajectory, the consequences of which are evident in the markets. Securities that for generations have been considered safe havens, those that are risk-free in terms of default but offer low yields, are coming under scrutiny. US Treasuries and German Bunds are on a tightrope.

In the USA, the runaway budget deficit of recent years is coming up against a new president who is eager to spend. Unchecked debt dynamics in an era of rising interest rates are sparking fears. We are faced with a rapidly growing supply of government bonds, for which buyers will have to be found in the future.

A key risk indicator alarm has sounded in Germany (for the first time since the creation of the eurozone) – the Bund swap spread has dipped into negative territory, something that also indicates a loss of confidence in the issuer, the German government. It is likely to become more challenging to refinance bonds that are close to maturity, as well as new debt.

These two developments are causing investors to turn their attention to interest-bearing investments, which for generations have been considered undisputed anchors of stability.

How are investors reacting to these developments, which could feasibly be described as historical in the world of bonds? We would like to delve deeper into the subject by providing some explanations and pinpointing key takeaways for investors. →

The United States is regarded as the Land of Opportunity. This not only applies to innovation and economic power. The national debt is now also reaching gigantic proportions. By the end of the year, it could have risen to around 120 per cent of gross domestic product (GDP). This trend is rising rapidly. New debt recently grew by a good seven per cent of GDP (see Figure 1).

In addition to rising deficits and debt levels, the long-term increase in yields (despite the interest-rate turnaround announced by the US Federal Reserve) is increasing costs. An ever-increasing number of securities that were negotiated at the previous, significantly lower, interest rates need to be gradually extended with less favourable terms. This means that the mountain of debt (and the cost thereof) could continue to grow over time (see Figure 2).

Traditionally, Treasuries are considered a "safe haven" for investors. A default is considered highly unlikely. The US dollar is the world's reserve currency, and the USA is the world's most important and innovative economy. This makes US Treasuries popular with investors, particularly in times of crisis. Nevertheless, certain recent market movements are indicative of growing scepticism. For example, yields on government bonds rose shortly after the first Fed rate cut. Despite the interest-rate reversal, five-year bonds have risen by almost one percentage point since September and spreads on comparable European government bonds have also increased.

If creditors still expect higher yields in the face of falling monetary policy interest rates, this is an indication (in simple terms) that their confidence in the issuers has declined. Donald Trump's incoming government could make the budget (even) more expansionary. Falling taxes and high spending will increase the government deficit. Coupled with the increased cost of credit, the debt burden continues to rise.

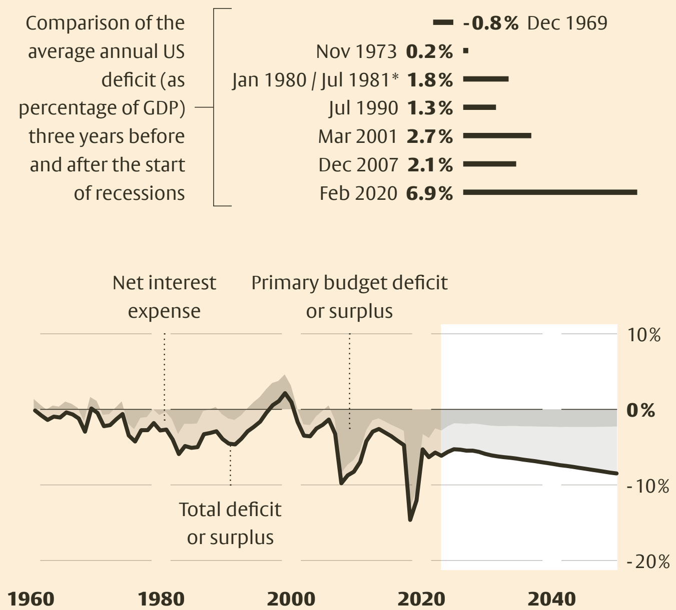



Figure 1
**US budget: significant increase in interest expenditure**
Supply outlook could weigh negatively on long-dated US Treasuries (as per cent of GDP)

**The scenario analysis is based on specific assumptions. Actual results may differ significantly from this.**
*Source: Bloomberg, Congressional Budget Office, Flossbach von Storch, data as at 31 December 2024*

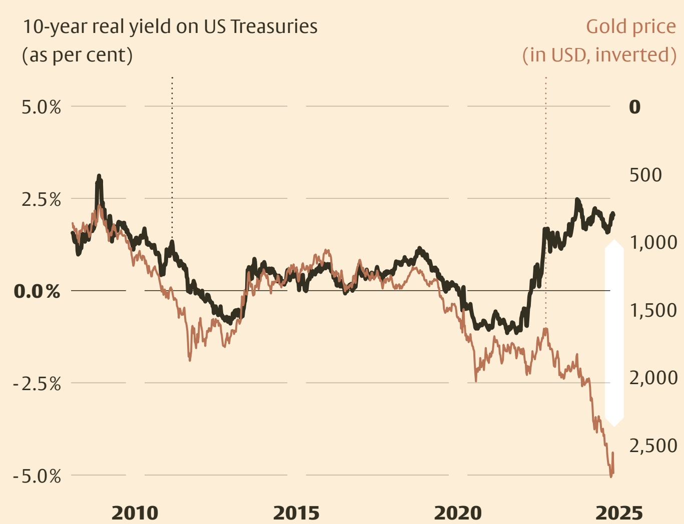



Figure 2
**Catch-up potential**
After the decoupling of the gold price, will we now see a catch-up effect for real yields?

**Past performance is not a reliable indicator of future performance.**
*Source: Bloomberg, Flossbach von Storch, data as at 31 December 2024*



The supply of promissory notes, however, can only increase if there is enough demand. Without lenders, there are no borrowers. Even if the central banks will always be there (albeit as a last resort), the prospect of a possible future oversupply can trigger price movements.

It remains to be seen whether (and to what extent) such fears will be realised in the future. Since none of us has a crystal ball, investors should never put all their eggs in one basket. There is a reason why diversification, i.e. the division of assets into different individual securities, is the basis of any professional investment. But what does this mean for US Treasuries? And do bond investors have any alternative to the globally sought-after Treasuries?

## REAL POSITIVE YIELDS PROVIDE PROTECTION FROM INFLATION

We quickly found what we were looking for in the US dollar area. In contrast to nominal US Treasuries, real yields can be locked in with US Treasury Inflation-Protected Securities (TIPS). Furthermore, the accumulated inflation is paid. At present, TIPS with a term of 10 years offer a real yield of more than two per cent. Real yields such as these were last seen during the aftermath of the global financial crisis well over 15 years ago. Real yields may have been at significantly higher levels during the 1990s and until the turn of the millennium, but debt levels were much lower (and less burdensome for the US budget) back then.

You only need look at the recent significant increase in the price of gold to recognise the attractive risk-reward potential of bonds that are protected against inflation. Historically, real yields have generally kept pace with the inverted gold price (see Figure 2 on the previous page). However, they are currently lagging significantly behind when compared with the rally in the gold price in recent years (see Figure 3). This could indicate an imminent catch-up effect.

It is also worth noting that at the end of last year the breakevens, i.e. the inflation expectations reflected in the difference between nominal and real yields, were still manageable at between 2.0 and 2.5 per cent. In an environment in which the Fed has shifted its monetary policy focus away from pure inflation control to a stable labour market at an early stage, there may still be some growth potential. This is bolstered by structural inflation drivers, such as demographics, restrictions on free world trade and the costs of energy transition, to name just a few examples. We believe that TIPS offer a good risk-reward ratio in terms of their valuation and also serve as a "buffer" against financial market turbulence.

## DOLLARS ARE ALSO TO BE FOUND DOWN UNDER

Although the US dollar is likely to remain the world's reserve currency for a very long time to come, the extended dollar zone also includes Australia and New Zealand, which both have dollar currencies. For investors eyeing currencies, regions and higher coupon yields than those available in Europe as a means of diversifying the safe portion of their bond portfolio, there are opportunities to be found Down Under. Yields on new issues are similarly attractive to those in the USA, and the costs of hedging currency fluctuations are lower (see Figure 4).

And it's not just the attractive yields that make New Zealand and Australian government bonds a good choice. The debt situation and debt dynamics look much better Down Under than in the USA. Projected debt based on economic performance is just over one third that of the USA. Both countries are also much more cautious when it comes to new debt (see Figure 5). Unlike in the USA, we do not envisage any concerns regarding an oversupply of Australian or New Zealand government bonds in the market.

In addition to the interest coupon, guaranteed to every investor who holds their securities until the end of the term, there are numerous other ways to increase the overall yield →

of the bond portfolio. This includes, for example, the roll-down effect, which allows investors to profit from early sales of their long-maturity bonds since the yields for shorter-term securities on the market can be significantly lower (see further explanation: How investors can benefit from the roll-down effect).

In Australia and New Zealand, the yield curves of government bonds are much steeper for medium-term bonds than for their US counterparts. Thanks to the roll-down effect, investors have a much greater profit potential if they do not hold their securities to maturity.

This example demonstrates that the bond market offers attractive alternatives to the globally sought-after US Treasuries. In addition to inflation-protected TIPS, New Zealand and Australian bonds are also worth a look. They can be used to diversify a traditional segment of the bond portfolio – with similar or even more attractive (real) yields that are also hedged against currency risks. It is also worth taking a "macro look" at the rapidly rising US debt and the future threat of a glut of government bonds. Technical effects also present opportunities, such as the more attractive roll-down effect.

For all the advantages, though, there are also disadvantages that should always be taken into account when making an investment decision. US Treasuries offer much greater liquidity. Should crises emerge Down Under, bonds will be more difficult to sell owing to the generally lower demand. If this scenario becomes a reality, prices may be marked down. This example demonstrates that there is no such thing as the best bond for all circumstances. The only way to balance potential opportunities and risks in the future is with a carefully diversified portfolio.

*Frank Lipowski is the Portfolio Manager of the Flossbach von Storch - Bond Opportunities Fund at Flossbach von Storch SE in Cologne.*

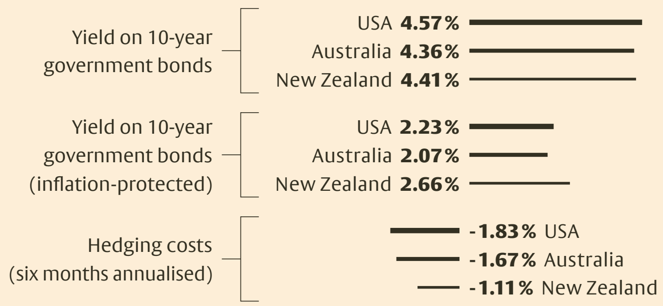



Figure 3
**US Treasury diversification: alternatives Down Under**
Attractive real yields and lower costs of hedging currency risks in Australia & New Zealand

**Past performance is not a reliable indicator of future performance.**
*Source: Bloomberg, Flossbach von Storch, data as at 9 January 2025*

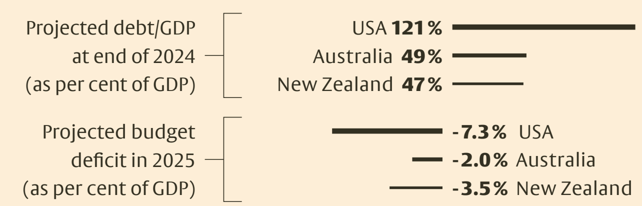



Figure 4
**US Treasury diversification: lower public debt**
Significantly better fiscal discipline and fewer concerns about an oversupply of government bonds speak in favour of Australian and New Zealand securities.

**The scenario analysis is based on specific assumptions.**
**Actual results may differ significantly from these.**
**Past performance is not a reliable indicator of future performance.**
*Source: Bloomberg, IMF, Flossbach von Storch, data as at 9 January 2025*

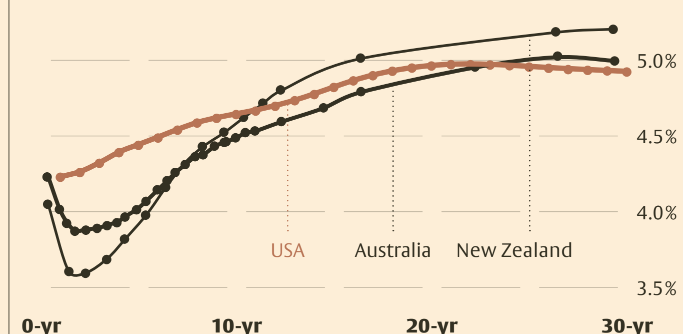



Figure 5
**More attractive roll-down effects**
Steeper yield curves in Australia and New Zealand increase earnings potential

**Past performance is not a reliable indicator of future performance.**
*Source: Bloomberg, Flossbach von Storch, data as at 9 January 2025*



FURTHER EXPLANATION:
## HOW INVESTORS CAN BENEFIT FROM THE ROLL-DOWN EFFECT

The roll-down effect describes how the price of a bond rises as it approaches maturity, provided that the yield curve follows a normal trajectory, i.e. that it increases in line with the length of the term. Depending on the term, bond yields fluctuate significantly in some cases. Long-term bonds typically offer higher yields than short-term ones. Bondholders are rewarded for relinquishing their money for longer. Likewise, the predictability of credit costs increases when bondholders know how high interest rates will be in a few years. Bonds are traded daily on the bond markets, regardless of maturity. Prices rise or fall in accordance with demand (which in turn depends on achievable yields for certain risk classes). Over time, a long-term bond will "slip" down the yield curve as its remaining term shortens. What exactly is behind this process? The price of the bond increases because it is more attractive than the short-term bonds being traded on the market thanks to its higher guaranteed coupon. The example of New Zealand government bonds shows how this works in practice. You buy a seven-year bond with a yield of 4.08 per cent (see Figure 6). After one year, it is then only a six-year bond, and the yield for this term on the market is only 3.93 per cent. The investor benefits from the higher yield of long-term bonds, which exceeds the rates for shorter-term bonds. The differences are reflected in the price gain. Ultimately, the roll-down effect is nothing more than a bonus that investors receive due to their bond gaining value over time as it "rolls down" the yield curve.

Ultimately, the roll-down effect is nothing more than a bonus.

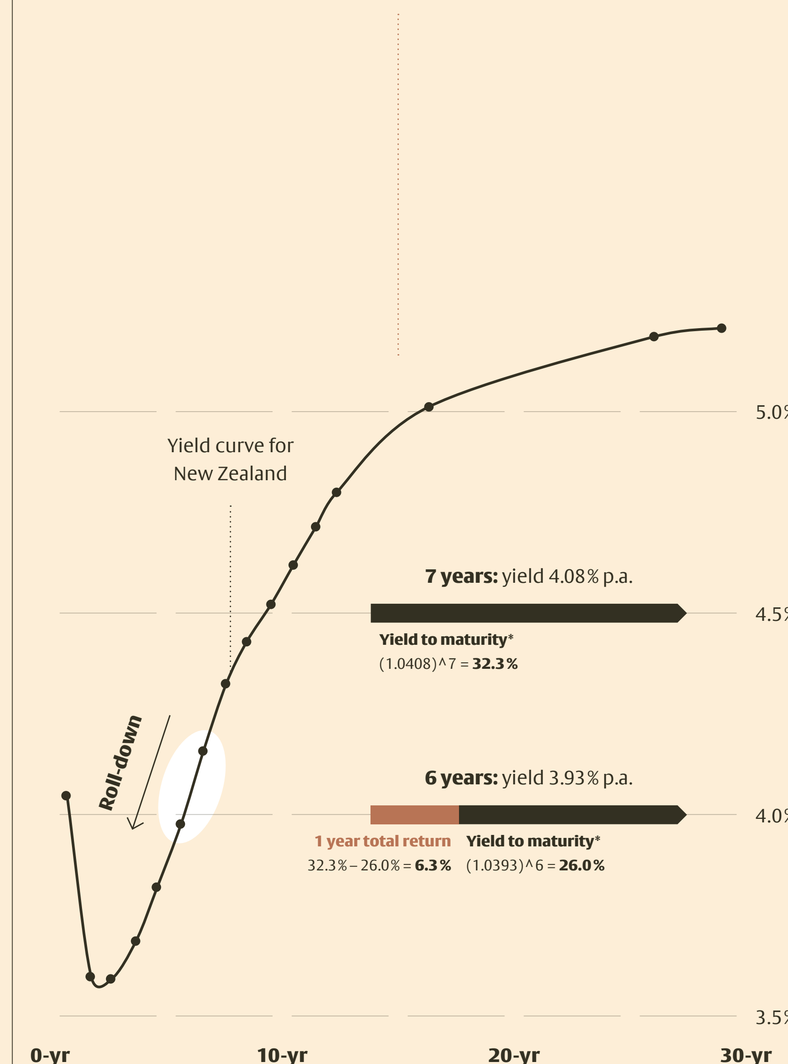



Figure 6
**Yield curve and earnings potential of New Zealand government bonds**
Steeper yield curves offer attractive potential returns for long-dated bonds.

* Total earnings until bond maturity.

**Past performance is not a reliable indicator of future performance.**
*Source: Bloomberg, Flossbach von Storch, data as at 9 January 2025*

# INFLATION HAS NOT BEEN DEFEATED

Prof. Gunther Schnabl, Head of the Flossbach von Storch Research Institute, explains that there are valid reasons why inflation could creep up again in the eurozone and perhaps in the USA too.

**Prof. Schnabl, there are currently numerous trouble spots around the world, but in terms of inflation, at least, calm seems to have been restored.**
It appears that way, yes. Consumer price increases, for instance, have fallen significantly since peaking at 10.6 per cent in the eurozone in October 2022 and 9.1 per cent in the USA in June 2022. In September 2024, inflation stood at 2.4 per cent in the USA and just 1.7 per cent in the eurozone. In Germany it was 1.8 per cent.

**The US Federal Reserve (Fed) also made its first rate cuts in September, and the European Central Bank (ECB) did so even earlier back in June. Would it be accurate to say that both central banks believe inflation has been defeated?**
It seems so, yes. Joachim Nagel, President of the Deutsche Bundesbank, has stated that the tide of inflation has started to turn. Philip Lane, Chief Economist at the ECB, has even expressed concern about inflation being chronically low. And Fed Chair Jerome Powell wants the focus of future policy to shift away from inflation and towards the labour markets.

**But you have your doubts about whether inflation is really defeated …**
Yes, I do – I think the central bankers could be wrong for several reasons.

**And what would those reasons be?**
First, consumer price indices do not cover all inflationary pressures; second, there's still a great deal of liquidity in the financial system; and third, global debt is extremely high.

**Let's start with your first point about consumer price indices not covering all inflationary pressures. Many people currently have the impression that despite inflation rates officially being lower, costs are increasing in many areas, such as grocery shopping and eating out. There's a lot of talk about "perceived inflation" – are the central banks underestimating this problem?**
Yes, lots of people believe that their purchasing power has been reduced dramatically, and not just in the USA and Germany. People are feeling the pinch from higher prices for food and services, such as in the hospitality sector. Perceived inflation in the eurozone in the second quarter of 2024 was well above the official measurement at 11.9 per cent. Moreover, further price rises – even by as little as two per cent per year – mean further losses in purchasing power.

**So, inflation rates are falling but people aren't feeling it in their pockets; the inflationary pressures remain.**
Exactly – or as Chair of IG Metall Christiane Benner put it: "The inflation rate may be falling, but prices at the

“Confidence in currencies is likely to continue decreasing rather than improve.”

supermarket checkout remain high for people”. And it’s unclear whether all losses in purchasing power have been captured by the official consumer price indices. In the eurozone, factors, such as price increases for owner-occupied real estate, cost increases for public goods, such as bridges, and asset inflation, such as with equities, aren’t taken into account when measuring prices. Furthermore, if the quality of industrial goods goes up – for example, if the equipment in a mid-range car is improved – the prices in the index come down. If the quality of services deteriorates, by contrast, this is not taken as an opportunity to reduce prices in the index.

**So, there’s uncertainty in how inflation is measured.How does perceived inflation affect the actual economy?**
The biggest impact it’s having is on wage demand. For example, there has been a lot of progress in collective bargaining in the chemical industry, in trade, in the railways, and most recently in the metal industry. Such demands are understandable from an employee perspective, but if wage costs rise, we see prices rise too. In December, for example, the price of services in the eurozone increased by a further 4.1 per cent. The central banks must not ignore this.

**Speaking of the central banks, that brings us to your second point, which is that you believe the considerable liquidity in the financial system could fuel inflation. What exactly do you mean by that?**
The huge number of bond purchases made and emergency loans issued by the ECB during the financial crises, the eurozone crisis, the sovereign debt crisis and the COVID-19 crisis means that commercial banks’ deposits into the Eurosystem increased dramatically, rising to almost EUR five trillion by 2023. The ECB started raising the interest rate on the banks’ deposit facility in 2022. Overall, it rose from -0.5 per cent to 4.0 per cent by September 2023, which gave banks considerable risk-free revenue.

**What happened next?**
In June 2024, the ECB began reducing the interest rate on the deposit facility again. By October, the rate had fallen to 3.0 per cent. Deposits have declined accordingly but still account for more than EUR three trillion.

**So, interest-rate cuts are making such investments less and less attractive for commercial banks?**
Exactly. The interest-rate cuts are causing commercial banks to lose a key source of income, which they could offset by increasing lending. And that would actually be desirable as it would stimulate growth. But despite interest rates falling, companies are not investing.

**Why not?**
The reasons for this are likely to be first and foremost the sharp rise in unit labour costs, erratic economic policy, increasing regulation and growing trade barriers. All of this is putting pressure on profits and consequently on our companies’ willingness to invest. The demand for real estate (loans) is also expected to remain subdued due to high prices and regulation in the construction industry, which is proving expensive.

**That doesn’t sound good, but how does it affect inflation? Ultimately, commercial banks are scaling back their deposits.**
It’s likely that if interest rates continue to fall, banks will export more capital abroad. Interest rates in Germany are significantly lower than in the USA, which makes US Treasuries more attractive. If capital outflows from the Eurosystem accelerate, the euro will depreciate – thus making imported goods, particularly commodities and energy, more expensive. This in turn would push up consumer prices still further in the eurozone.

**So, expectations around inflation could continue to stoke wages and consequently drive up production and service costs, and the lack of investment could prompt banks to make capital outflows that rock the value of the euro. And on top of that, there’s public debt.**
Exactly. Public debt is at an all-time high in many industrialised countries, and the eurozone is no exception – just look at France and Italy. Huge spending commitments for social security and ambitious green transformation plans are leaving governments little room for spending cuts. What’s more, with the Transmission Protection Instrument the ECB has made it possible to buy an unlimited number of bonds from heavily indebted eurozone countries. This will enable it to anticipate potential sovereign debt crises, but in all likelihood, it will also reduce the incentive for governments to consolidate public budgets.

**And the inflation problem?**
While the ECB in particular was very slow to react to the sharp rise in consumer price inflation from 2022 onwards, like the US Fed it eased monetary policy again before the inflation target had been met. This could indicate that Europe, which is averse to reform, and the USA, which is hungry for debt, still see inflation as the only politically viable solution to their uncontrollable spending promises. But perceived inflation being high signals that the confidence people have lost in currencies and in policy makers has yet to be restored. Confidence in currencies is therefore likely to continue decreasing rather than improve. Inflation rates went back up again in October, and asset prices are trending upwards too. The sharp rise in the price of gold and bitcoin is proof of this loss of confidence in the dollar and the euro as major currencies.

**Rising prices provided a tailwind for Donald Trump in the US elections. Surely now he’ll have to do everything possible to tackle inflation?**
Indeed, the issue of lower purchasing power is likely to have been crucial in the US presidential election. But now that Trump is actually in office, it’s unclear exactly what he intends to do. Fears of “Trumpflation” are already being vocalised!

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**But he promised voters stable prices!**

Well Trump was clearly opposed to a loose monetary policy even in his first campaign in 2016, though he reacted angrily when the Fed raised the key interest rate to 2.5 per cent during his tenure. He was “not thrilled”, saying that the Fed was “going wild” and that the rate increases were “ridiculous”. When the economy cooled in 2019 and the Fed didn’t reduce interest rates, Trump publicly speculated about whether Fed Chair Jerome Powell or Chinese President Xi Jinping was the bigger enemy of the USA. It wasn’t until the Fed slashed interest rates during the COVID-19 crisis that it garnered praise from the President. Thanks to the central bank, Trump was able to send US households cheques bearing his signature, which was a great publicity stunt.

**… though they are now being seen as contributing to inflation.**

Yes, inflation rose sharply from 2021 onwards, but that wasn’t until Trump’s successor, Joe Biden, took office. That meant Trump could blame high prices on his opponents during the 2024 election campaign. He saw inflation drivers in the Green New Deal and the inflation blinkers worn by the Democrats, who preferred to blame COVID-19 and Putin for the price rises. In September 2022, with inflation sitting at more than eight per cent, Trump called for the Fed to implement substantial interest-rate hikes.

**And interest-rate hikes did indeed follow.**

Yes, but too late for the Democrats. US voters saw inflation and prices as the most important issue in the election campaign. At a press conference in August 2024, Trump was pictured beside a table holding sausages, biscuits, bread and breakfast cereals, and loudly complained about the sharp rise in food prices by saying “bacon is through the roof”.

**And what do you think will happen with inflation under Trump?**

Future inflation depends on fiscal policy. The higher a government’s unfunded spending commitments, the greater the pressure on the central bank to buy government bonds. Trump has announced plans to cut taxes, modernise the army, better protect US borders against migration, and provide cheap loans to first-time real-estate buyers. The Committee for a Responsible Federal Budget has calculated an additional funding shortfall of USD 7.7 trillion, even though the US central government’s public debt is already over USD 36 trillion.

**So, will Trump fuel inflation?**

Not quickly; the party manifesto also includes planned spending cuts. Comprehensive deregulation, reduced immigration and an end to the war in Ukraine are expected to reduce spending. Furthermore, a new Department of Government Efficiency headed by Elon Musk is to scrutinise all government spending – and “cut wasteful expenditures”. Musk warns that “business as usual” will lead America into bankruptcy. If spending cuts and deregulation actually do materialise, public debt could stabilise, and inflationary pressures could ease. Treasury Secretary designate and former hedge fund manager Scott Bessent is tasked with pushing through the cuts, but Elon Musk has questioned his ability to do so. So, the signals that Donald Trump has sent about future inflation are contradictory.

**And what do you think will happen?**

Having a Republican majority in the Senate and the House of Representatives could eventually give rise to significantly more public debt. It’s likely that greater inflationary pressures would also see property prices rise, which would benefit real estate tycoon Trump. Nevertheless, the outcome is uncertain. Trump can’t afford to drive his voters away, which means he needs a successful anti-inflation policy.





**You mean in terms of spending cuts?**

In terms of spending cuts and deregulation, yes, but also in terms of his energy policy aimed at low prices. All three factors could put the brakes on inflation. Ultimately, a strident Donald Trump might actually be better suited to implementing structural reform than consensus-seeking Kamala Harris would have been.

**Germany is also in urgent need of structural reform, as you describe in your recent book “Deutschlands fette Jahre sind vorbei” (Germany’s years of plenty are over). What would be your most pressing advice for the next Chancellor?**

Germany has been living beyond its means for the last 20 years. An increasingly loose monetary policy from the European Central Bank has made it possible to take government spending commitments too far, especially in the social sphere, and to expand regulation enormously, particularly in terms of climate policy. All three factors are grinding down growth and prosperity, which is why we also need the kind of reform currently being considered in the USA. To create pressure for spending cuts and deregulation, the ECB would need to keep interest rates high.

**Is that likely to happen?**

The FDP at least has recently been giving this issue some thought. I see more of a business-as-usual attitude with the other parties, though there’s still time for more to happen with the CDU. If the reforms in the USA are successful, the pressure will probably intensify. If Germany and the EU were to remain inactive, the exodus of capital to the USA would accelerate and economic and political instability would continue to increase. I hope the next Chancellor will secure a majority that will prevent this scenario.

**Thank you for the interview.**

ABOUT THE PERSON

**Prof Gunther Schnabl** is Head of the Flossbach von Storch Research Institute. Since 2006, he has been Chair of Economic Policy and International Economic Relations at the University of Leipzig and Head of the Institute of Economic Policy. Prior to that, he worked as an advisor at the European Central Bank and was a visiting academic at Stanford University, the University of Tokyo, the Université Paris 1 Panthéon-Sorbonne and multiple central banks.

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Since 1925 there have been numerous occasions when the financial outlook appeared bleak for economies and companies. We explore how economic development has been stimulated in different ways over the years.

# A CENTURY OF VISIONARIES






## HENRY FORD
LEADING THE WORLD WITH THE ASSEMBLY LINE

Carl Benz had filed a patent application for the first car back in 1886, so at first glance there was nothing special about the Model T that Henry Ford started selling in 1908. The Model T was very simple and was essentially designed to be as easy to operate and repair as possible. Ford's aim was to build an automobile for the "common people". Cars were prohibitively expensive for most Americans at that time, but that changed with the introduction of the assembly line in Ford's factories. The trial period began in 1908, and by 1913 the time required to work on each car had been reduced from 12.5 hours to 93 minutes. Prices fell and sales grew rapidly as a result, and by 1927 the number of Model Ts produced in the US alone was 15 million, making it the world's best-selling vehicle. Renault, Citroen and Fiat were dominating the European market that same year. They too were early adopters of the assembly line, and in the 1920s the main manufacturers following this strategy in the German Reich were Opel and Hanomag.

## FRANKLIN D. ROOSEVELT
OFFERING HOPE DURING THE GREAT DEPRESSION

Between 1925 and 1929, prices on Wall Street tripled to more than 380 points on the Dow Jones Industrials equity index. Then on 24 October 1929 came a crash that ruined many people's lives. By 1932 the index had dropped to 43 points, plunging thousands of banks in the USA into insolvency and forcing shops and factories to close. Income from farming fell to half of what it had been before the crash, and one in four Americans were unemployed. That same year, Franklin D. Roosevelt won the presidential election with his New Deal. Numerous employment programmes to expand infrastructure took jobseekers off the streets. The minimum wage was implemented, and pension and unemployment insurance were introduced. This policy alleviated hardship but doubled the US debt ratio from 1933 to 1936, taking it to 40 per cent of the country's gross domestic product (GDP). But despite this, Roosevelt had strengthened ordinary people's confidence in politics. In the Weimar Republic, however, which had been severely affected by the global economic crisis since 1929, the NSDAP increased its vote share sevenfold in 1930 to became Germany's second-largest party.

## GENERAL MOTORS
THE WORLD'S MOST VALUABLE COMPANY IN 1927

General Motors was founded in 1908 and bought multiple car brands in the years that followed. From 1924 onwards, the company began offering different vehicles "for every purpose and purse". A design team was hired in 1927, and a sales system implemented to boost sales. These modern management methods enabled General Motors to push Ford into second place on the car manufacturer leaderboard by the end of the 1920s, and it become the world's most valuable company by 1927. In Germany, Deutsche Reichsbahn was the country's largest company in 1938, employing more than 700,000 staff. This state-owned enterprise united the regional railways that had been operating separately until 1919 and its profits were used to pay reparations. Becoming independent in 1924, it had a great capacity for innovation and even set a number of speed records. Germany's major cities were connected by ultra-fast railcars. In May 1933, one of them, the "Fliegende Hamburger" (Hamburg Flyer), travelled from Berlin Lehrter Bahnhof to Hamburg Hauptbahnhof in just 138 minutes – setting a world record that remained unbroken until the introduction of ICE trains 64 years later.

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## WINSTON CHURCHILL
NETWORKING FROM A DEFENSIVE POSITION FROM 1940

Winston Churchill became British Prime Minister in 1940 and quickly found himself embroiled in debates about the UK surrendering. The situation looked bleak, with Hitler's troops having advanced to Paris and the Soviet Union and Italy being on Nazi Germany's side. The UK was not ready for direct conflict. Churchill rejected Hitler's offer, giving his "blood, sweat and tears" speech – and began proactively forging alliances. Churchill gained US President Theodore Roosevelt as an ally. Military assistance was negotiated and, since the UK's resources were limited, Roosevelt allowed the British to "borrow" warships from the USA. Following Hitler's attack on the Soviet Union in the summer of 1941, Churchill offered Stalin a place in his alliance too. The USA entered the war after the attack on Pearl Harbour, and the Allies agreed to fight Germany first and foremost. The rest is history. Three months after the war ended, Churchill was voted out in spite of his success.

## FLEMING, FLOREY, MOYER
VITAL PENICILLIN DURING WARTIME

Scottish doctor Alexander Fleming discovered penicillin in 1928, but it was a while before the antibiotic could be used. After his discovery, Howard Florey and Ernst Boris Chain from Oxford University began developing the substance into a clinically effective product, but it was very difficult to achieve at first. Penicillin was not administered to a human being until 1941. With the outbreak of the Second World War, large quantities of penicillin were desperately needed. Research was in full swing, with Florey and Chain seeking help in the USA, where they met Andrew J. Moyer. Within six months, the British-American research team had achieved exponentially higher yields in the growing of penicillin strains. With assistance from the US government and companies such as MSD Sharp & Dohme, Pfizer, Squibb & Sons and the British firms Glaxo and ICI, mass production was rapidly achieved. Fleming, Florey and Chain were jointly awarded the Nobel Prize in 1945 in recognition of their work.

## HARRY S. TRUMAN
AND THE START OF THE ECONOMIC MIRACLE

After the Second World War, more than 60 per cent of the world's industrial goods were produced in the USA and 70 per cent of the world's gold reserves were located there. Across Europe, however, much of the housing and infrastructure and many production sites had been destroyed. After the Holocaust and the war, the Allied Control Council's industrial plan put a cap on the German commodities and manufacturing industry, limiting it to half its pre-war production level. Tensions rapidly began to emerge between the USA and the Soviet Union, however, as the USA wanted to prevent the expansion of communism. In March 1947, US President Harry S. Truman declared that "It must be the policy of the United States to support free people who are resisting attempted subjugation by armed minorities or by outside pressures". The division of Germany followed shortly afterwards, along with the Marshall Plan, which provided aid to those countries in Europe that agreed on a common economic system driven by competition. Some 16 European countries agreed to this, including West Germany.






## VOLKSWAGEN
HIGH-GROWTH COMPANY OF THE 1950S

Krupp was the largest company in the Federal Republic of Germany on the 1958 stock exchange list. But more generally, it was the automotive industry that embodied the German economic miracle of the 1950s and 1960s. While motorcycles and Italian Vespas dominated the streets in the early 1950s, cars soon become more popular – and 40 per cent of all vehicles in Germany during this decade were made by Volkswagen. The car of the moment was the VW Beetle, which people would affectionately call a "saloon". Development of the Beetle was ordered by the Nazi state in 1934, and series production began once the war was over. According to figures in the "History" section of the VW website, the number of vehicles produced between 1950 and 1960 rose from just under 90,000 to 890,000, and sales increased from 411 million to 3.9 billion marks. The German government wanted citizens to have a piece of this high-growth company, and so approximately 60 per cent of VW shares were transferred to private ownership in July 1961. By 1965, however, the majority of small-scale investors had already sold their shares again.

## THE US FEDERAL RESERVE
AND THE DEBT MIRACLE OF THE 1960S

By 1946, the debt ratio in the USA had risen to 106 per cent of its gross domestic product due to the high cost of the war. Furthermore, the government's military contracts, which had previously provided for high growth, were now no longer required. This meant that the US economy was at a low level in the years immediately after the war. The economy did not pick up again until the 1950s, and from there it developed dynamically until the end of the 1960s. The Truman administration insisted that the Fed maintain the bond cap introduced during the Second World War. Yields on short- and long-term US Treasuries consequently stayed below annual growth rates until 1965. As a result, the real interest rate remained low during this period, and in many years it was even negative. Savings and credit rates were likewise controlled by the state, and it was not possible to invest money abroad either. This caused the US debt ratio to reach 53 per cent in 1955, and then fall to below 30 per cent by 1969.

## IBM
THE WORLD'S MOST VALUABLE COMPANY IN 1967

When Herman Hollerith collected the results of a survey for the US Census Office in 1879, he found the counting to be a frustrating experience, so he invented an electric counting machine for the US agency to use. He founded a company but sold it to Charles Flint, who then merged it with two other technology companies and christened the conglomerate the "International Business Machine Company" in 1924. This is how IBM was born. Initially, the company grew not only by virtue of its counting machines but also, first and foremost, due to its watches, measuring instruments and scales. From 1924 onwards, electric typewriters and then increasingly office equipment were added to the range. Punch cards were introduced in 1928, and IBM finally launched its first mainframe computers in the 1960s. The company sold hardware, software and service contracts from a single source, meaning it had close ties with business customers. And so, in 1967, at the dawn of the computer age, IBM became the world's most valuable company.

**PAUL VOLCKER**
OR THE END OF STAGFLATION IN THE LATE 1970S

The Organization of Arab Petroleum Exporting Countries (OAPEC) curtailed production volumes in 1973, causing the price of oil to multiply. This price increase fuelled existing inflation in the USA and put pressure on wages. The economy began to stagnate. At around the same time, the gold standard agreed at Bretton Woods, linking Western world currencies to the US dollar, was terminated, which increased the pressure on the external value of the US dollar. Paul Volcker became Chair of the US Federal Reserve in August 1979. Inflation had climbed to 13.3 per cent by the end of the year. At the start of 1980, Volcker raised key interest rates in the USA to 20 per cent. Inflation began to fall dramatically until the USA slipped into a double-dip recession in 1980-1981 and unemployment started spiralling. President Ronald Reagan, elected in 1981, nevertheless supported the approach adopted by the central bank with an austerity programme and reforms that focused on deregulation and tax relief. His plan worked, and the USA entered one of the longest periods of economic growth since the Second World War.

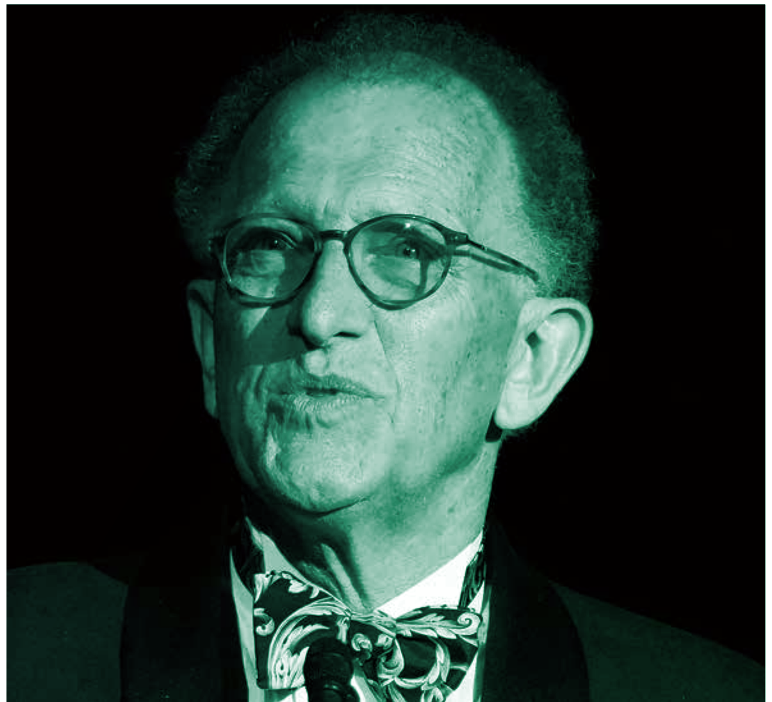
**ALAN GREENSPAN**
AND THE "GREENSPAN PUT"

On 19 October 1987, Wall Street fell by 23 per cent. The reason why was unclear, and panic began to spread. Alan Greenspan, Chair of the US Federal Reserve, responded by increasing the money supply and injecting liquidity. His method worked and was then deployed several more times during periods of sluggishness on the stock market. The "Greenspan put" was born, which served as a promise that investors could rely on the Fed when things got tough. The 1990s got off to an optimistic start with former Soviet countries opening up to Western trade and finance. The Cold War was over; consumption increased and arms spending was cut. The economy was growing. Technology stocks also reached dizzying heights – until the wind suddenly changed at the turn of the millennium. Growth expectations were greatly exaggerated, US interest rates began to rise, and a crash soon followed. When the terrorist attack of 11 September 2001 sent the stock markets into a tailspin again, the "Greenspan put" came to the rescue once more. From the first quarter of 2002, the US economy was back on a dynamic growth trajectory. Fast forward a few years, however, and the success had been overshadowed by financial scandals.

**"EMERGING MARKETS"**
THE NEW GROWTH MARKETS

For a long time, the West underestimated the economic potential of many economies beyond Europe, Japan and the USA. Countries deemed "third world" used to find it difficult to attract investors. Antoine van Agtmael launched the first Third-World Equity Fund in 1981. His idea was well received, but the term "third world" continued to deter potential investors, so Van Agtmael came up with the name "emerging markets". More products soon followed, and from 1990 onwards the fall of the Berlin Wall increased the West's appetite for globalisation. Economic development then began gaining momentum, particularly in China following the country's accession to the World Trade Organization (WTO) at the end of 2001. Jim O'Neill, Chief Economist at Goldman Sachs, hypothesised that the BRIC countries (Brazil, Russia, India and China) would quickly overtake developed economies. Only China has delivered on these expectations, with GDP increasing approximately 47-fold since 1988. As of the end of 2024, however, the Hang Seng China Enterprises equity index has only doubled once since its launch in 1993.





**APPLE**
BECOMING THE WORLD'S MOST VALUABLE COMPANY IN 2011

In 2001, Apple CEO Steve Jobs pioneered the iPod, which would go on to revolutionise the music market. In 2007, the launch of the iPhone marked the start of the smartphone era. By 2011, Apple was valued at USD 340 million, making it the world's most valuable company. Apple continues to fight Nvidia and Microsoft for the top spot to this day with a stock market value of more than USD three trillion. Apple's foundations were unstable in the late 1990s. Jobs founded Apple together with Steve Wozniak and Ron Wayne in 1976 and launched the Macintosh, one of the first personal computers (PC) with a graphical user interface, in 1984. After an internal power struggle, he left the successful company in 1985, only to return again at the start of 1996 when Apple ran into trouble and was on the verge of insolvency. The development of the iMac, a PC with an innovative new operating system, returned the ailing company to profitability in 1998. But it was not until the iPod, iPad and iPhone that a new chapter in Apple's success story began. Sadly, Jobs died in 2011 aged just 56.

**MARIO DRAGHI**
SAVIOUR OF THE EURO

The eurozone crisis began in 2009 when several eurozone countries had to put together aid packages for banks during the global financial crisis. Some had been living beyond their means for years. A bailout package was provided by the European Financial Stability Facility (EFSF), established in 2010, and the European Stability Mechanism (ESM), and the ECB purchased bonds from ailing eurozone countries. This was not sufficient to save Greece, which was on the verge of bankruptcy, and the euro was bordering on collapse. In November 2011, in the midst of the crisis, Mario Draghi became president of the European Central Bank (ECB). Even as early as July 2012, he had achieved something that aid programmes and agreements had previously been unable to do – he had reassured the financial markets with his words: "the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough". Under his tenure, however, interest rates unfortunately remained at their lowest levels even during years of growth. Furthermore, he was not afraid to flood the financial markets with increasing amounts of money.

**BIONTECH**
THE COVID VACCINE FROM MAINZ

In February 2020, the COVID-19 pandemic spread from China to Europe. More and more countries had to impose lockdowns; the economy – and life in general – stood still. Only the emergence of a vaccine against the virus ended the pandemic and lifted the lockdowns. The first COVID-19 vaccine was developed primarily by Mainz-based company BioNTech, which most Germans had never heard of until then. BioNTech was founded in 2008 by Ugur Sahin, his wife Özlem Türeci and doctor Christoph Huber. The company specialised in the development of mRNA molecules and started developing a vaccine against COVID-19 immediately after the pandemic broke out, bringing US pharmaceutical company Pfizer on board at an early stage. In November 2020, a trial showed that their COVID-19 vaccine was effective and production in collaboration with Pfizer began at the Marburg plant. BioNTech generated a healthy profit in those years, which has been invested mostly in developing new cancer treatments. This could be a project for the future.

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# "How Business People do It"

Are equities currently expensive – or not? There is no single right answer to this question, but in any case, it's not a key consideration for long-term investors.

**Is now the time to be fully invested in equities?**
VORNDRAN: No, you don't need to go all in at the moment.

**But European equities are quite reasonably valued – you could almost say cheap …**
LEHR: Cheap doesn't necessarily mean "favourable". And there are reasons for the valuation differences – good reasons.
VORNDRAN: In fact, that brings us to one of our favourite pieces of advice, doesn't it?
LEHR: Granted, it has become rather overused …

**And that is?**
VORNDRAN: Don't think in terms of regions or sectors, but first and foremost in terms of companies!
LEHR: And it's also worth noting that with some of the very good companies, those that are very interesting from an investor's point of view, the quality has already been priced in – perhaps too much so.

**Are you referring to some of the key AI players?**
VORNDRAN: Yes, that's one example. Looking ahead, not too much can go wrong with the valuations – despite the quality of the underlying business models.

**A good company is still a good company though …**
LEHR: That is true, without a doubt. But it may not necessarily be a good investment in the long term if you pay too much for it, possibly even far too much.

**Since you have cautioned against going all in, what would you recommend right now?**
VORNDRAN: Firstly, don't fall into the trap of black-and-white thinking. When we say that we would err on the side of caution at the moment, that doesn't mean liquidating all equity positions as soon as possible – on the contrary. Our message is simply that liquidity does no harm, indeed quite the opposite.
LEHR: It gives us the flexibility to take advantage of investment opportunities as they arise. So, there is nothing wrong with temporarily holding a little more cash.

**Warren Buffett is often criticised for his high cash holdings …**
VORNDRAN: That doesn't invalidate our arguments though. The great Warren Buffett is certainly not the worst possible example to follow …
LEHR: Part of the criticism is usually the suggestion, or rather the conjecture, that Buffett – unlike in the past – is no longer finding attractive investments. The assertion is that this is because he is no longer fully up to speed and potentially doesn't fully grasp the significance of AI.
VORNDRAN: Which is, of course, complete nonsense! Buffett is simply doing what he always has done.

**Which is?**
VORNDRAN: He takes his time. And waits. This is exactly what long-term investors do. Just as good business people do. Wait for opportunities, identify them and then take advantage of them.
LEHR: The profit lies not least in the procurement, as the saying goes. In this respect, our advice should be regarded as a plea to always consider cash as a separate asset class in asset allocation. Or to put it another way, cash is an indirect driver of returns for long-term investors.

"Wait for opportunities, identify them and then take advantage of them."

**Strategist & Strategist**
*Philipp Vorndran (right) and Thomas Lehr (left) are Capital Market Strategists at Flossbach von Storch SE.*

# Glossary

## Economic terms in brief

**Asset class** – Financial products with similar characteristics can be allocated to different groups. Traditional asset classes include, for example, equities, bonds, real estate and precious metals.

**Bonds** – Securities that an issuer can use to borrow in the capital market. Bonds can be issued in different currencies and can have different maturities and coupon rates.

**DAX 40 Index** – Equity index that tracks the performance of the 40 largest and strongest (with the highest turnover) German stocks in terms of market capitalisation. The criteria for the weighting of the shares in the DAX are the stock-exchange turnover and the market capitalisation of the free float. The DAX is calculated as a price and performance index.

**Diversification** – The allocation of assets across various investment classes, individual securities, regions, sectors and currency zones – with the aim of reducing potential risks in investments by distributing investments widely.

**Duration** – The duration reflects the average period during which the capital of an investment is invested in a fixed-rate security and is consequently the weighted average of the dates at which the investor receives payments from a security.

**Equity index** – An equity index is an indicator of the average price development of the share basket of a country, a region or even individual sectors. It tracks the price level of the selected shares.

**Gross domestic product (GDP)** – The value of all goods and services produced in an economy during a year.

**Inflation** – A general increase in the price of goods that is accompanied by a loss in the purchasing power of money.

**Liquidity** – Liquidity means the "money proximity" of assets, i.e. their potential to generate immediate or short-term cash inflows. The liquidity of a market must be distinguished from the liquidity of assets. This is the case when the difference between the bid and ask price is low and larger volumes can be traded without substantially influencing the market price.

**MSCI World Index** – The MSCI World equity index shows the performance of stock markets in the industrialised countries. It is based on more than 1,600 equities in 23 countries.

**Portfolio** – A collection of investment securities.

**Share** – A share is a security that makes its holder a co-owner of a public limited company. When a share is purchased, the shareholder acquires a portion of the company's share capital. There are common shares and preferred shares. Common shares give their holders voting rights in general meetings. Holders of preferred shares do not have voting rights, but instead receive a preferred dividend that is generally larger.

**S&P 500 Index** – An equity index that shows the performance of the broad stock market in the USA and includes the 500 largest listed companies in the USA.

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A comprehensive glossary of topics and terms (in German) can also be found at www.flossbachvonstorch.com/glossar/.



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