

# POSITION

Thought-provoking issues for investors

“The environment demands  
**DISCIPLINE**”

**Interview with Bert Flossbach**

**ANALYSIS**

How much does Germany really work?

**PORTFOLIO**

Digital diversification

**BONDS**

Protection and opportunity



The stock market is currently sending mixed signals to investors. On the one hand, there are the large US technology companies, which now represent more than 40 per cent of the US equity market and are driving advances in artificial intelligence through annual investments running into the hundreds of billions of US dollars. The associated expectations for growth are high, and equity valuations are, in some cases, elevated, leaving little room for disappointment. Whether these vast investments will ultimately pay off remains uncertain.

On the other hand, there is a large number of solidly positioned companies whose shares are more moderately valued. Many of them operate in rather defensive sectors – consumer goods manufacturers and health care companies, for example. Their growth potential may be unspectacular, but so are the underlying risks. Investors in these companies get predictable business at a fairly favourable price.

In such an environment, discipline is essential. Realistic return expectations, a level-headed assessment of individual valuations, and a well-balanced portfolio structure are more important than ever.

## Flossbach von Storch POSITION 1/2026

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

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### IN A WORD

Another year of political turbulence lies behind us. The trade war led by Donald Trump may have largely faded from memory; the bloody war in Ukraine, in the heart of Europe, has not – despite the US President’s grandiose announcements and self-proclaimed role as a peacemaker.

Europe is at a crossroads. Not solely because of the Russian threat. Public debt continues to grow at an ever-increasing rate. The population is ageing, while there is a lack of young people. Growth and innovation are flourishing elsewhere these days.

Major reforms are needed to make the “old” continent competitive again – and thus fit for the future. Whether governments – not least having to contend with populist forces – will summon the necessary courage, and whether voters will show sufficient patience, remains to be seen.

As entrepreneurs and investors, we find ourselves caught between two conflicting priorities. On the one hand, we must act pragmatically and must never recklessly abandon our entrepreneurial optimism. On the other, it would be negligent to simply ignore political missteps and risks.

Over the past few years, we have taken a number of measures to position ourselves sustainably for the future. We have not only expanded the Executive Board, but we have also made it considerably younger. Dr Tobias Schafföner, Dr Till Schmidt and Marcus Stollenwerk were the first to be appointed two years ago. With the appointments of Christian Schlosser and Dr Tobias Hirsch this January, the Executive Board is now complete. These two colleagues represent the areas of fund distribution as well as IT and data.

In addition, we have also changed our legal form – from a German stock corporation (AG) to a European one, a “Societas Europaea” (SE).

Our mission is to establish the company as an independent, long-term, cross-generational institution. We remain fully committed to acting solely in your interests and those of our clients. Your trust is both a source of motivation and a responsibility we take seriously. Thank you!

We hope you find this issue interesting!

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

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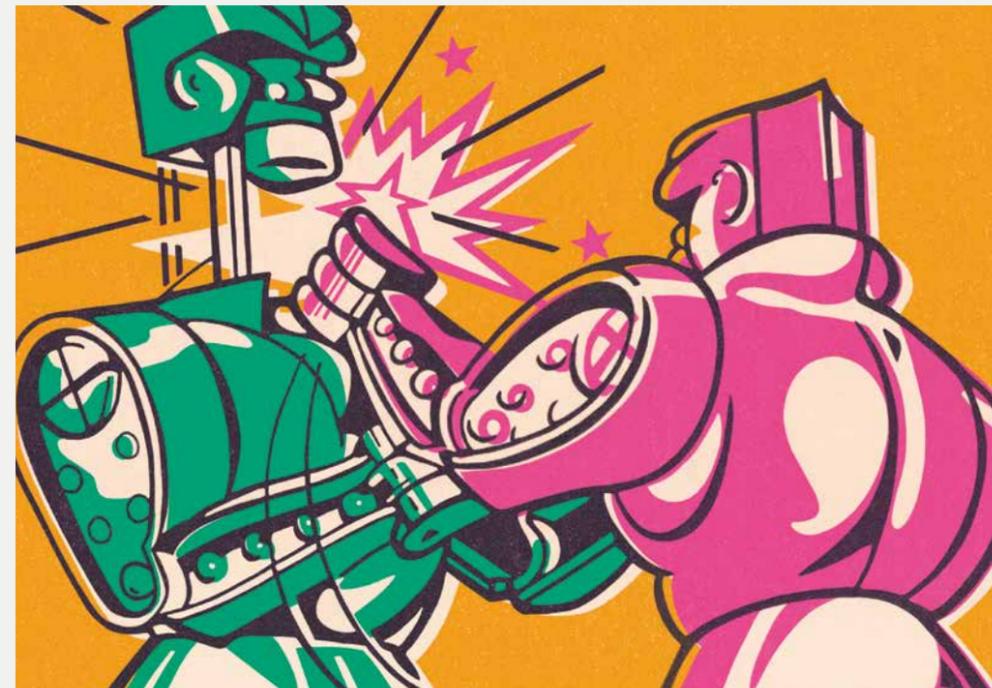


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## DIGGING DEEPER

In our new section, we explore topics that we encounter repeatedly in everyday life or in the media. In an increasingly polarised world, we want to provide hard facts on topics that matter to many people. This time, we turn our attention to the question:

?

# How Much Does Germany Work?

By Julian Marx

Nowhere else is as little work done as in Germany.  
At least, that's what the OECD figures state.  
What's the truth behind the myth of lazy Germans?

Germany is facing a severe shortage of skilled workers. There is hardly a sector of the economy that is not desperately seeking personnel. There is a shortage of workers in electrical engineering, childcare and IT, not to mention catering, skilled trades and public transport (to name just a few examples). According to estimates by the German Economic Institute, there could be a total shortage of 768,000 skilled workers in this country by 2028. This inevitably raises the question of how this gap can be closed.

German Chancellor Friedrich Merz provided the seemingly simple answer to this question in May 2025: "We need to work more and, above all, more efficiently in this country," the politician exhorted. He went on to say: "We will not be able to maintain the prosperity of this country with a four-day week and work-life balance."

Merz's second statement in particular suggests that many Germans may have become too comfortable in their working lives. But how much truth is there to this claim? Are people in Germany not working hard enough?

## GERMANY AT THE TAIL END

Figures from the Organisation for Economic Co-operation and Development (OECD) paint a stark picture of working hours in Germany. Among all 38 OECD countries, Germany recorded the lowest average annual working time. In 2024, an employed person in Germany worked just 1,331 hours, which is a full 405 hours less than the OECD average.

Apart from Germany, Denmark is the only OECD country where employees worked less than 1,400 hours on average. Mexicans worked the most, with around 2,200 hours. Within Europe, Greece topped the ranking with just under 1,900 hours worked, even surpassing the United States, where employees averaged around 1,800 hours annually (see Figure 1).

Seen in this light, the average working hours in Germany send out an alarming signal, especially with regard to international competitiveness. One partial explanation for the

lower number of hours worked – at least in comparison with countries outside Europe, such as the USA – may be the more generous holiday entitlements. While German employees had an average of 31 days 'off' in 2024, their US counterparts were entitled to just 10 to 20 days, depending on their length of service. In the case of front-runner Mexico, the high number of hours worked also reflects the fact that the working week there regularly comprises six days instead of the five days that are customary in Germany. In addition, however, a statistical peculiarity also distorts the significance of the annual average working time.

## A QUESTION OF PART-TIME WORK

In the small print, the OECD already points out pitfalls in interpreting the annual averages for working hours. One aspect that weighs on working hours from a German perspective is the above-average proportion of part-time employees compared to other countries. Among employed persons aged 15 to 64 in Germany, 29 per cent were recently working part-time. In a European comparison, only the Netherlands and Switzerland have significantly higher part-time rates of around 40 per cent. In contrast, the EU average and the US part-time rate is less than 20 per cent.

The reason for the high part-time rate in Germany actually has a very positive origin. It correlates strongly with high employment among women, almost 50 per cent of whom were in part-time employment. In the first quarter of 2025, just over 74 per cent of women aged 15 to 64 were in employment. While Germany ranks last in terms of average annual working hours, it is one of the frontrunners when it comes to female employment. The OECD average for female employment was a full 10 percentage points below the German figure, at just under 64 per cent (see Figure 1).

The comparison with Italy further underlines the fact that average annual working hours do not tell the whole story. In Italy, an employed person worked an average of just over 1,700 hours per year. In Italy, only 54 per cent of women →

Figure 1  
Germany brings up the rear or is in the front ranks

— Average annual working hours per employee in 2024  
— Share of women employed in the 15–64 age group

Source: OECD, Flossbach von Storch, data as at September 2025

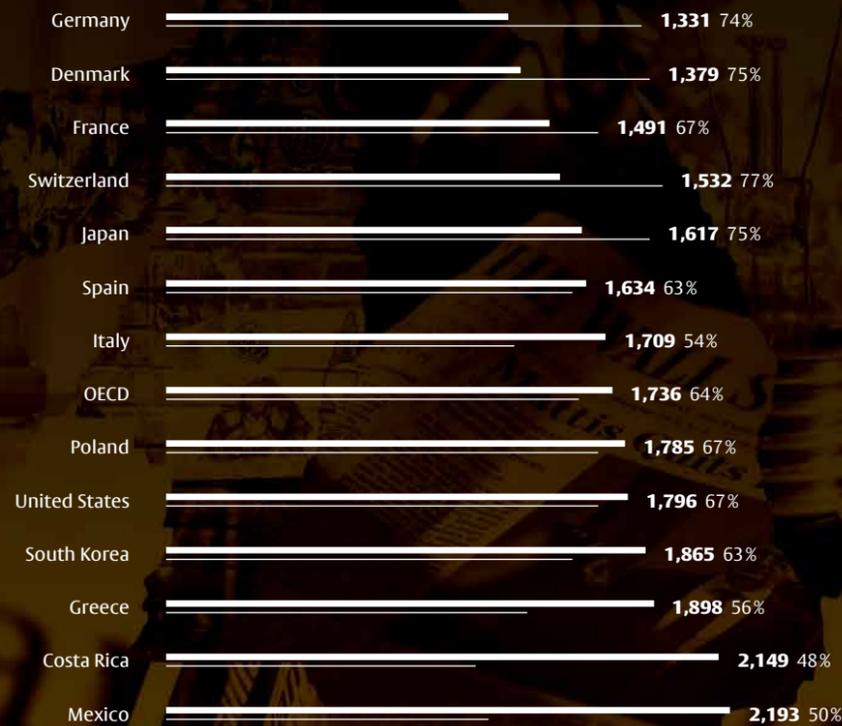
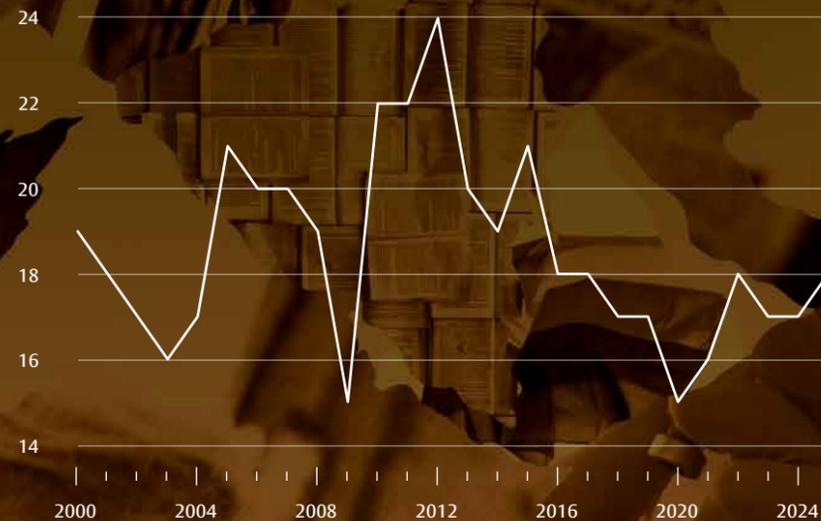


Figure 2  
In the “Top 20”  
Germany’s GDP per capita (in USD) compared with 195 countries

Germany’s ranking in the global GDP per capita comparison

Source: LSEG Datastream, Flossbach von Storch, data as at 31 December 2025



between the ages of 15 and 64 were employed in the first quarter of last year. In other words, the labour force participation rate of German women is almost 40 per cent higher than that of Italian women. “Mamma Mia” is likely to be the thought that crosses the mind of many observers.

There are also significant differences in employment among men. While around 80 per cent of men aged 15 to 64 were employed in Germany, the OECD average was slightly lower at 77 per cent, and in Italy it was only 71 per cent.

This shows that looking at the average annual working hours in isolation is only of limited value. The proportion or number of people in (part-time) employment is just as relevant when considering the total volume of work in society as a whole. And in this context, it is positive from a German perspective that an above-average number of people in this country are in gainful employment.

**QUANTITY VERSUS QUALITY**

In Germany, the total volume of work has been distributed across an increasing number of shoulders in recent years, which is due in particular to a noticeable increase in the participation of women in the labour market. In this context, the average working time per employed person has fallen by around 13 per cent since 1994, which is just as much as in Switzerland. However, if we look at the total number of hours worked, these have still risen slightly over the past 30 years, as an evaluation by Germany’s Institute for Employment Research shows: from 58,119 million hours in 1994 to 61,364 million hours in 2024. This represents an increase of just under six per cent.

Accordingly, a lower average working time has been more than offset by higher labour market participation. This is encouraging insofar as the working-age population (20 to 64 years) has shrunk by around five per cent over the past 30 years, meaning that the potential labour supply was already under pressure.

**WORK AND INCOME**

However, caution is advised when attempting to measure work performance solely on the basis of hours worked. After all, in progressive societies, work performance has increasingly become a question of human capital or the (efficient) use of capital. The differences in the annual economic performance of individual countries are correspondingly large. Measured in terms of per capita gross domestic product (per capita GDP) in US dollars, Switzerland, for example, has been among the absolute leaders among all nations worldwide for decades – despite an average annual working time that is 200 hours below the OECD average and despite a leading part-time employment rate among working women aged 20 to 64 of more than 60 per cent. Last year, Switzerland’s per capita GDP once again exceeded the USD 100,000 mark. The only other countries to achieve this were Ireland and Luxembourg, both of which have smaller populations and are likely to have benefited from their status as “EU tax havens”.

This means that Switzerland’s per capita GDP was around eight times higher than that of Mexico, the “OECD hour champion”. Germany also ranks among the top countries in terms of performance, most recently generating a per capita GDP of around USD 60,000. Among the 195 countries surveyed, Germany is thus stable in the “top 20” – most recently in 18th place. Seen in this light, not much has changed in the Federal Republic in this millennium (see Figure 2), and Germany is also scratching the surface of the top third in the OECD comparison.

Of course, it should be noted that per capita GDP measured in US dollars is only an approximate indicator of the performance and strength of an economy. It is subject to currency fluctuations, which are often only loosely related to actual economic performance. It should also be borne in mind that many of the economies ranked above Germany in this list are relatively small and benefit from special factors. For example, Qatar and Norway, with

populations of just under three and six million, respectively, benefit from their wealth of natural resources and the associated gas and oil exports.

A closer look at the facts shows that simply looking at the number of hours worked is only of limited value when it comes to assessing the “quality of work”. Against this backdrop, the question of Germans’ work performance could also be rephrased. Instead of “How much does Germany work?”, the question could also be: “How well does Germany work?”.

In relative terms, looking at per capita GDP, it can be said that Germans still do not fare too badly in international comparison.

#### ANOTHER PERSPECTIVE

The issue of working hours becomes even more complex when viewed from a less short-term economic perspective. For example, expected working life plays an increasingly important role in ageing societies. Here, too, Germany is doing quite well, with Eurostat data currently putting the expected working life at around 40 years. This is significantly higher than the EU average of 37 years. Only Denmark, the Netherlands, Sweden and Switzerland have significantly higher working lives of just under 43 to 44 years.

Unpaid work is less relevant from an economic point of view, but all the more important from a social perspective. This includes raising one’s own children, caring for relatives, but also voluntary work. According to the latest time use survey by Germany’s Federal Statistical Office, the average person aged 18 and above spent almost two hours a week on unpaid voluntary work. Admittedly, these two hours per week are extremely unevenly distributed: “only” 37 per cent of the population aged 10 and over were involved in voluntary work.

However, further figures show just how important this contribution is. According to the German Olympic Sports Confederation, more than 500,000 people in Germany hold

a coaching licence and perform around 10.8 million hours of voluntary work every month. Among other things, they offer millions of children and young people an inexpensive form of social participation. Its relevance is underlined by a study conducted in 2023, which was funded by the Federal Ministry for Family Affairs, Senior Citizens, Women and Youth. According to the study, children and young people who are regularly active in sports have a significantly better general state of health than children who do not engage in regular physical activity. Physical exercise plays just as important a role as social connection. In this respect, voluntary work also makes a significant economic contribution: ultimately, society as a whole benefits when children and young people grow up to be healthy and therefore productive adults.

Voluntary work is also significant outside the field of sport. At the end of 2022, there were over 1,000,000 firefighters in Germany’s volunteer fire brigades. In an emergency, firefighters not only take physical risks, but are also regularly confronted with psychological stress – especially operations involving human lives can be emotionally stressful.

Numerous other examples of unpaid but socially highly relevant work could be cited. Combined with a working life that is above average compared to the EU, this underscores the challenges of obtaining a complete picture of the hours worked.

#### WHO’S LAZY HERE?

Chancellor Friedrich Merz caused controversy last May with his call for “more and, above all, more efficient work”. His statement that “we cannot maintain the country’s prosperity with a four-day week and work-life balance” also caused a stir. There is much to suggest that his choice of words – perhaps deliberately so in the context of an economy in crisis – was too pointed in order to fuel the debate on maintaining prosperity in an ageing society.

After all, long-term data does not initially show any clear evidence that the work ethic in Germany has noticeably

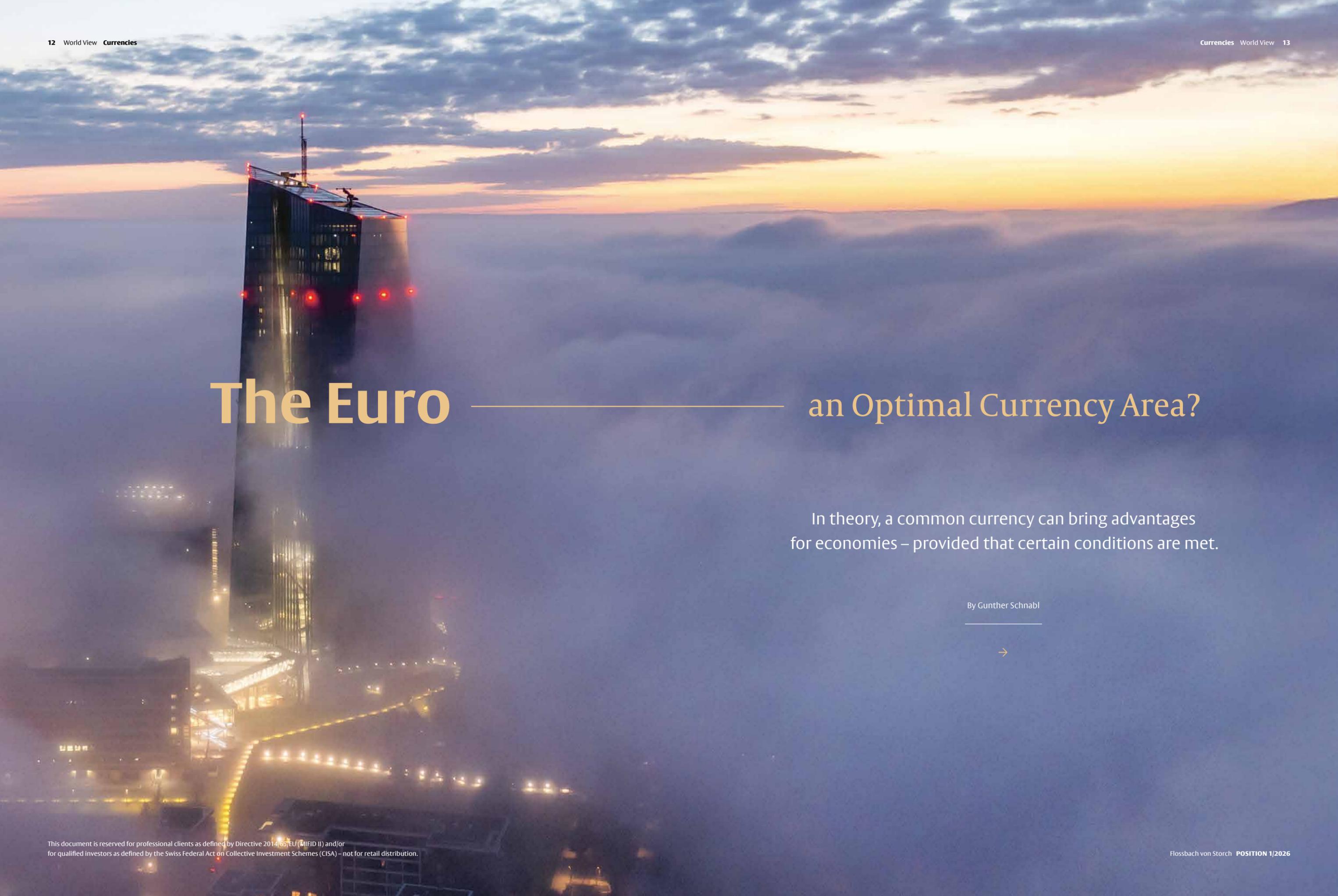
declined. Overall, Germans are probably not “lazy” or “lazier than before”. After all, the total volume of work has actually increased slightly in recent decades. If we also take into account that the number of people of working age between 20 and 64 has declined slightly during this period, the only moderate increase in the volume of work looks even better.

The fact that the average working time per employed person has decreased can also be explained by changes in the labour market. In particular, many more women are participating in the German labour market today. Particularly with regard to the compatibility of work and family life, the four-day week “rejected” by the Chancellor may therefore be a necessary prerequisite for both parents to be able to pursue employment in a modern society. Only a few countries, such as Denmark, the Netherlands and Switzerland, are more advanced in this development than Germany – and all three of these countries are even more competitive in terms of per capita GDP. Against this background, the average annual working hours reported by the OECD should be treated with caution and placed in a broader context.

Based on the available data, it is therefore hardly justifiable to denigrate Germans as “lazy”, especially in an international comparison. Conversely, this also applies to numerous less productive economies. When women and men in rural areas of Africa have to walk kilometres to fill their water canisters with clean drinking water, these people may be less productive in economic terms – but that does not make them lazy. This example shows that in a politicised world where debates are increasingly defined by extremes, a nuanced view of things remains essential. At least if one wants to identify and solve the relevant problems. ♦

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

**In a politicised world  
where debates are increasingly  
defined by extremes,  
a nuanced view of things  
remains essential.**



# The Euro ————— an Optimal Currency Area?

In theory, a common currency can bring advantages for economies – provided that certain conditions are met.

By Gunther Schnabl

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Since 1 January 2026, Bulgaria has been the 21st member of the euro area. Christine Lagarde, President of the European Central Bank (ECB), has assured Bulgarians that the euro will bring “prosperity and security”. Since Bulgaria’s economic cycle is closely linked to the eurozone, the euro is a “natural fit” for Bulgaria.

Lagarde is thus seamlessly continuing the tradition of grandiose predictions at ceremonies of this kind: when the euro was introduced in 1999, the then French President Jacques Chirac promised the French people that the euro would become “a pole of stability in Europe”. German Chancellor Gerhard Schröder even predicted “better times than under the Deutschmark” when euro cash was introduced in January 2002.

**IS SENTIMENT WORSE THAN REALITY?**

Yet such statements give many of us pause for thought. After all, the mood today is clearly subdued. The euro economy is stagnating, inequality between member states has risen sharply, the purchasing power of the euro has fallen, and perceived inflation, at around 10 per cent, is well above the officially measured figure of some two per cent.

So is the euro an optimal currency area for Europeans, or is it not? According to Robert Mundell, who won the Nobel Prize for this theory in 1999, a currency area is optimal when all member countries follow the same economic cycle. If, on the other hand, one part of the region is in recession

and the other is not, the common central bank cannot set an optimal interest rate. If it lowers the interest rate to help the part of the region in crisis, it fuels inflation in the other part. If it raises the interest rate to curb inflation in the booming part of the region, it exacerbates the crisis in the other.

**FLEXIBLE LABOUR MARKETS WOULD HELP ...**

If the probability of different economic cycles is high, then flexible exchange rates are better. Unless, that is, the labour markets are flexible enough to compensate for the economic differences. For the crisis region, this means that prices and wages there would fall rapidly and the unemployed would have to migrate to the part of the region with the better economy.

Partly because Europe’s labour markets were anything but flexible even back then, many people advised against a monetary union in heterogeneous Western Europe in the 1990s. The euro came into being nonetheless – but with a design flaw that former German Chancellor Angela Merkel pointed out at the height of the euro crisis: “The eurozone does not have a common financial and social policy that can automatically align different economic cycles.”

**... OR A COMMON FINANCIAL AND SOCIAL POLICY**

If, for example, France were in boom and Germany in crisis in a political union, the French would pay more taxes to the common finance ministry in Brussels. This would offset declining tax revenues from Germany. More social security contributions from France would enable more social security payments in Germany, which would stabilise the economy there. However, a common financial and social policy was not on the horizon for the EU at that time (and still isn’t today).

Instead, the European Commission argued in 1990 that the elimination of exchange rate fluctuations would likely lead to a convergence of economic cycles because trade relations between eurozone countries would intensify. In later work, Mundell also showed that economic cycles can converge in a monetary union through greater integration of capital markets. If German and French banks operate in Germany and France, respectively, higher credit defaults in one country are offset by lower defaults in the other when economic conditions differ.

From this perspective, the single market completed in 1992 had created an important prerequisite for the functioning of monetary union. However, the hoped-for convergence failed to materialise. Because other regions of the world grew faster than Europe, trade among the euro countries declined as a share of their total trade. The Maastricht criteria, which were actually intended to ensure convergence in the euro area, had the effect, via the financial markets, of causing economic cycles to drift even further apart soon after the introduction of the euro.

**ECONOMIC CYCLES DRIFT FURTHER AND FURTHER APART**

The southern eurozone countries, which had to lower their inflation rates and interest rates to German levels in order to join the euro, encountered an economic upturn in their countries. In Germany, conversely, reunification had driven up public debt, forcing the country to make savings in order to comply with the Maastricht debt limits. Austerity measures prompted German banks to increase lending to the southern eurozone, where they fuelled excessive government spending and property market speculation, aided by irrevocably fixed exchange rates.



Figure 1  
**Significant loss in value since the euro’s introduction ...**  
Purchasing power trend

Source: ECB and own calculations based on the Harmonised Index of Consumer Prices (HICP), data in December 2025

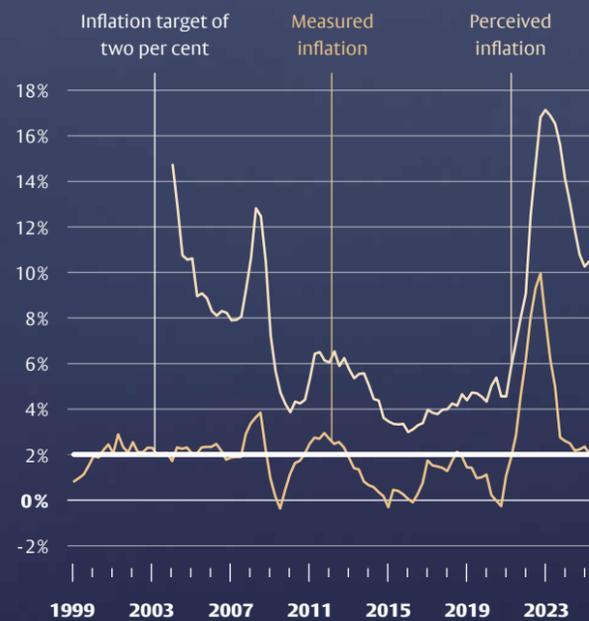


Figure 2  
**... creates little confidence in the single currency**  
Officially measured and perceived inflation in the euro area (as a per cent)

Source: Oxford Economics and European Commission. Perceived inflation as median, data in December 2025

Growing trade deficits and external debt on the periphery of the currency area ultimately led to the euro crisis in 2008, which resulted in a reversal of economic cycles. While the crisis continued to smoulder in the south for a long time, the ECB's euro rescue policy fuelled sharp rises in government spending and property prices in Germany. Despite stable nominal exchange rates, prices and wages within the eurozone often diverged, leading to considerable fluctuations in real exchange rates.

**EURO ENLARGEMENTS EXACERBATED DIFFERENCES**

With the enlargement to include more and more Central and Eastern European countries with lower

per capita incomes than the euro average, the monetary union became even more heterogeneous.

The differing inflation and growth rates meant that the key interest rate set uniformly in Frankfurt had varying effects on the individual eurozone countries. The fiscal policies of the eurozone countries should have balanced out the economic differences, but the national governments were primarily committed to their own goals. Since the euro crisis, at the latest, it has therefore become clear that the euro cannot survive without government support.

Initially, large fiscal aid packages were put together for the crisis-hit countries of southern Europe and Ireland. In May 2010, the German Bundestag

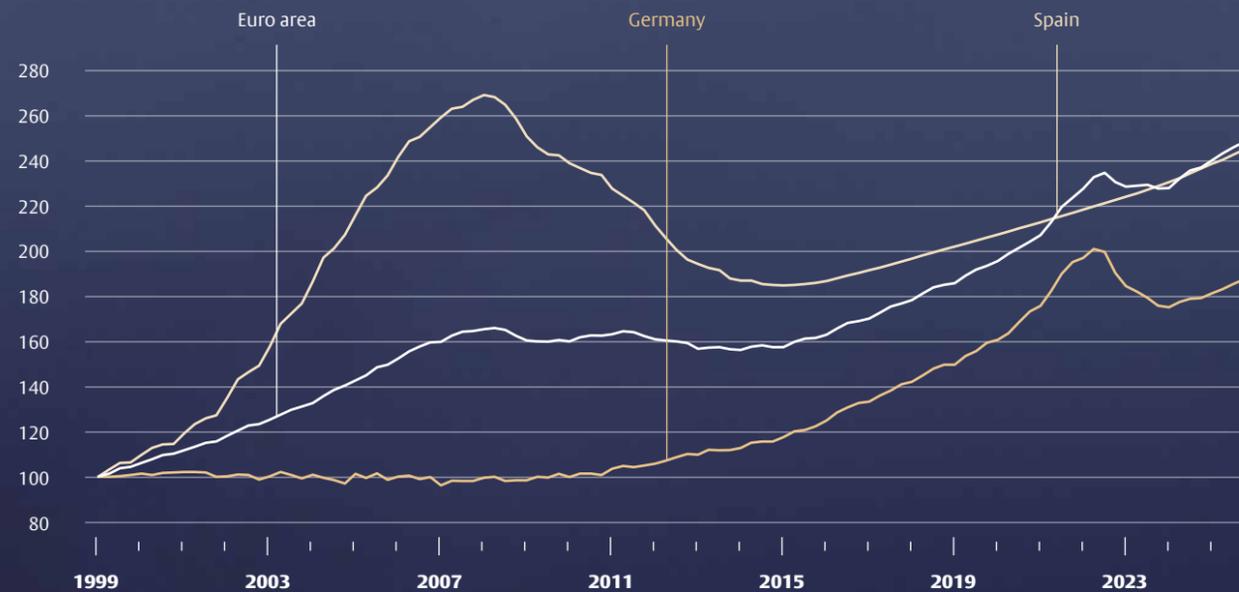


Figure 3 **Rising real estate prices**  
Price trends in Spain, Germany and the eurozone since 1999 (Index: 1999=100)

Past performance is not a reliable indicator of future performance.  
Source: Oxford Economics, data in December 2025

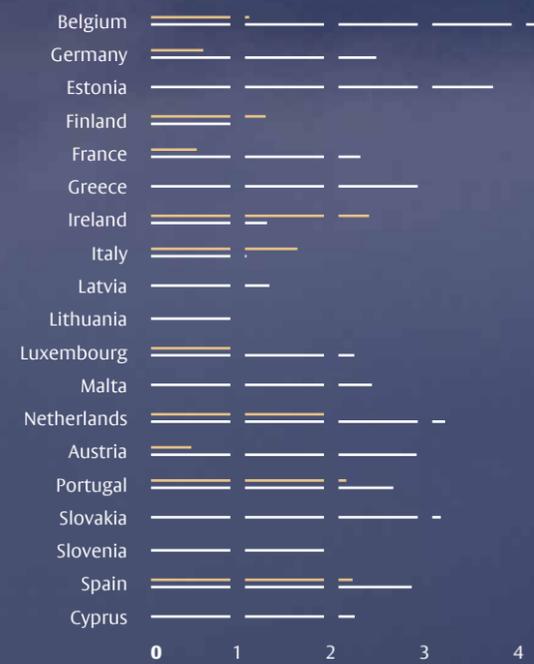


Figure 4 **Heterogeneous currency area**  
Inflation rates in eurozone countries in 1999 and 2024

Source: ECB. No entry for countries that were not founding members of the monetary union in 1999, data in December 2025

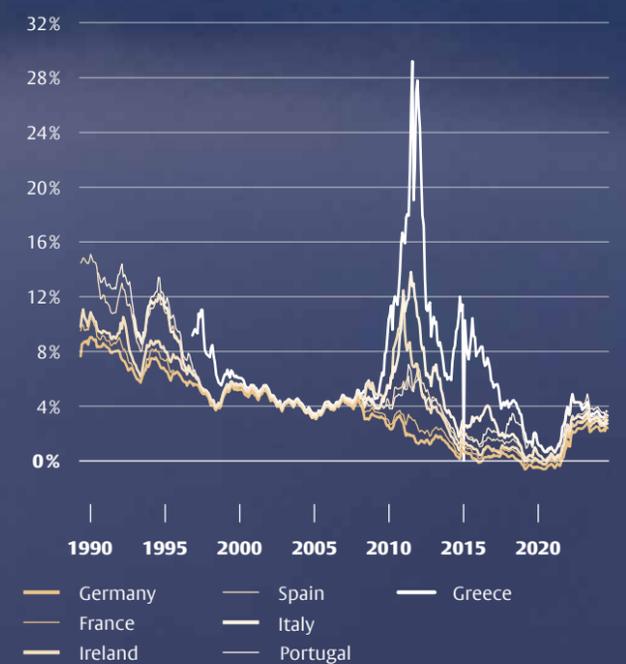


Figure 5 **Aid programmes are holding the euro together**  
Development of long-term interest rates in the euro area

Source: IMF, data in December 2025

paved the way for the first EUR 110 billion for Greece with the "Monetary Union Financial Stability Act". Angela Merkel had campaigned with the slogan "If the euro fails, Europe fails." This was followed by the European Financial Stabilisation Mechanism (EUR 60 billion) and the European Financial Stability Facility (credit volume EUR 440 billion), which in 2012 merged into the European Stability Mechanism (ESM) with a capital base of EUR 700 billion.

Yet these democratically legitimised financial aid programmes proved insufficient. When interest rates on government bonds in Greece, Italy, Ireland, Portugal and Spain rose alarmingly, only ECB President Mario Draghi was able to save the euro in July 2012 with his legendary "whatever it takes"

statement. In the wake of the numerous rescue programmes that followed, the Eurosystem's balance sheet grew from EUR 1.3 trillion in December 2007 to EUR 8.8 trillion in June 2022. Approximately half of this was accounted for by the purchase of government bonds. Even though the balance sheet has since shrunk back to around EUR six trillion, the Eurosystem intends to hold government bonds structurally in the future.

**THE ECB'S ROLE HAS CHANGED**

Until the crisis, the ECB had set a uniform key interest rate for all players in the eurozone according to the motto "one size fits all" – or "one monetary policy for all". With the onset of the crisis, the Eurosystem was able to focus on the crisis countries →

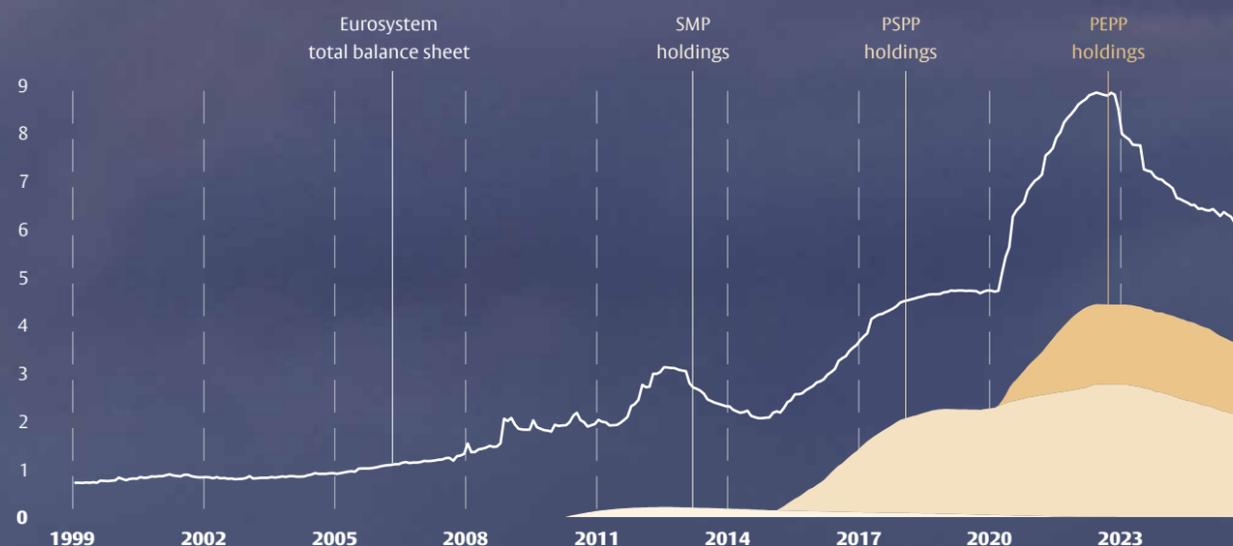


Figure 6  
**Costly rescue programmes for the euro**  
 Balance sheet total of the Eurosystem and holdings  
 of government bonds  
 (in EUR trillions)

Source: ECB. SMP, PSPP and PEPP are bond purchase programmes run by the ECB, data in December 2023

when accumulating assets on its balance sheet. After government bond purchases were initially aligned with the capital key of the individual eurozone countries at the ECB, the weight shifted in favour of the southern European crisis countries. The so-called targeted longer-term refinancing operations (TLTROs) focused on the crisis countries from the outset. With the introduction of the Transmission Protection Instrument in 2022, the ECB also created the option to purchase bonds from crisis countries on a preferential basis “in an emergency”.

The Coronavirus crisis brought the EU closer to a regional financial equalisation mechanism that can balance out different economic cycles in the monetary union. The NextGenerationEU

recovery programme will distribute grants and loans totalling around EUR 800 billion between 2021 and 2026, with priority given to the problem countries Italy, Spain and Greece, which will receive EUR 194 billion, EUR 163 billion and EUR 36 billion, respectively. Unsurprisingly, positive economic news has since been coming increasingly from the once hard-hit southern countries, including Spain.

#### A NEW FINANCIAL EQUALISATION – WITH DRAWBACKS

If this form of financial equalisation were to become permanent, the burden of maintaining the cohesion of the monetary union would be lifted from the ECB’s shoulders. However, this is only

at first glance, as NextGenerationEU is financed through EU bonds (Eurobonds). These are already on the ECB’s list of eligible securities. Some of the bonds issued by the EU to date are likely to already be held by the Eurosystem as supranational bonds. The EU is therefore closer to a central bank-financed common fiscal policy than many people think.

Even though the much-heralded “euro crash” has not materialised, the euro is still not an optimal currency area. Nevertheless, the ECB’s inflation record is acceptable when measured against the official harmonised consumer price index. And the ECB’s power is growing. It is now responsible not only for rescuing the euro, but also for financial stability and climate protection. With a digital euro, it even wants to break the dominance of the US dollar as the international reserve currency in the future.

Unfortunately, the euro has lost significant value against gold and, since 2008, against the US dollar as well. The high perceived inflation also points to a loss of confidence. The recent government budget crisis in France has made it clear once and for all that the attempt to secure the stability of the euro by limiting government debt in the eurozone has failed.

Nevertheless, the euro will remain because the ECB has virtually unlimited scope to rescue it. However, the resulting – partly hidden – inflation is slowing growth and increasing inequality. In addition, Germany’s power to hold the eurozone together with transfers is waning because German industry has lost competitiveness under the soft euro. The burden of the euro is therefore likely to become increasingly noticeable for everyone in the eurozone. ◆



#### ABOUT THE AUTHOR

**Prof Gunther Schnabl**  
 is Head of the Flossbach von Storch  
 Research Institute and is a  
 Professor at the University of Leipzig.  
 He has worked as an advisor at the  
 European Central Bank and  
 has conducted research at the  
 universities of Paris 1 Panthéon-Sorbonne,  
 Stanford, Tokyo, Leuven and Tübingen.  
 He has been a visiting scholar  
 at the Deutsche Bundesbank, the  
 European Central Bank, the Bank  
 of Japan and the Federal Reserve Bank  
 of New York.



# THE SPANISH BOOM

While Germany's economy has been stagnating for six years, Spain has experienced enviable economic growth. The reasons behind this development.

By Pablo Duarte

From the second quarter of 2019 to the present day, Germany's gross domestic product (GDP) has grown by zero per cent. The situation differs in other eurozone economies; Spain in particular has experienced enviable economic growth.

Adjusted for inflation, its GDP is still 11 per cent higher than before the Coronavirus crisis. Although the US economy grew slightly faster, the eurozone and Germany lagged significantly behind Spain (see Figure 1).

So, what makes Spain more economically successful than Germany? At first glance, the development seems like the fulfilment of an old euro promise: the living standards of the countries in the monetary union are converging. Fact is the difference in per capita income between Germany and Spain has shrunk significantly. While Spaniards earned an average of EUR 18,000 less per year in 2020, the figure is currently around EUR 15,000 less. But this is likely to be a consequence rather than a cause of the recent boom.

So has there been a Spanish productivity miracle? Hardly: labour productivity, measured as GDP per person em-

ployed, has risen only slightly more in Spain since 2012 (three per cent) than in Germany (two per cent). In the USA, conversely, productivity swelled by 19 per cent over the same period.

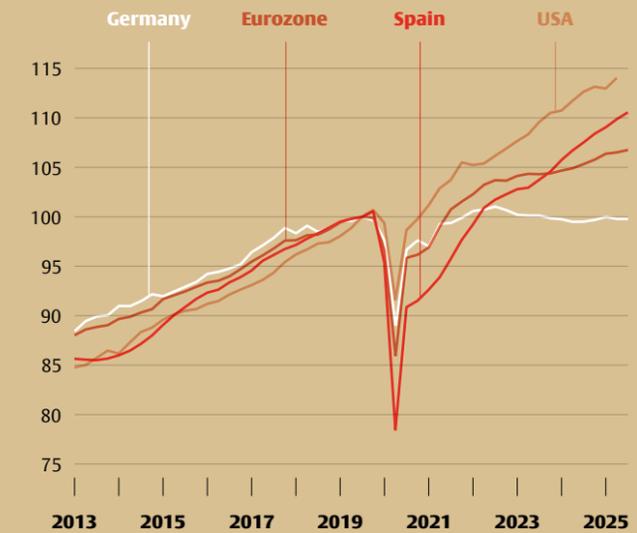


Figure 1  
**Spain outpaces Germany**  
Comparison of real GDP  
(indexed: Q2 2019 = 100)

Source: Flossbach von Storch Research Institute, Macrobond, Destatis, INE, Eurostat, BEA, data as at third quarter 2025.

## ADVANTAGES MAINLY DUE TO SUCCESSFUL IMMIGRATION ...

However, the number of people in employment has risen much more sharply in Spain than in Germany. Whereas the average birth rate per woman in Spain is 1.12, in Germany it is slightly higher at 1.35.

Nevertheless, Spain's working-age population, i.e. all persons between the ages of 15 and 64, has expanded by a total of 1.2 million since 2021; the number of people in employment even rose by 2.4 million to 22 million. In Germany, the labour force grew by around 800,000 people over the same period.

The latter occurred abruptly after the outbreak of war in Ukraine in 2022. The number of people in employment rose by 1.6 million to 46 million in Germany. The increase in the number of people in employment since 2021 was therefore around 12 per cent in Spain, compared with only four per cent in Germany. →

Although the proportion of foreign nationals in the total population is higher in Germany (14.7 per cent) than in Spain (13.8 per cent), the proportion of foreign nationals in the labour force is higher in Spain (16.1 per cent) than in Germany (15.3 per cent). The cultural and linguistic proximity to Latin America, where the majority of immigrants come from, also helps to minimise friction losses during integration.

This is especially true given that Germany's generous social welfare system delays the integration of immigrants into the labour market. In Spain, significantly less social assistance is offered. In return, work on the informal labour market is tolerated and after two years, there is even the prospect of legalisation.

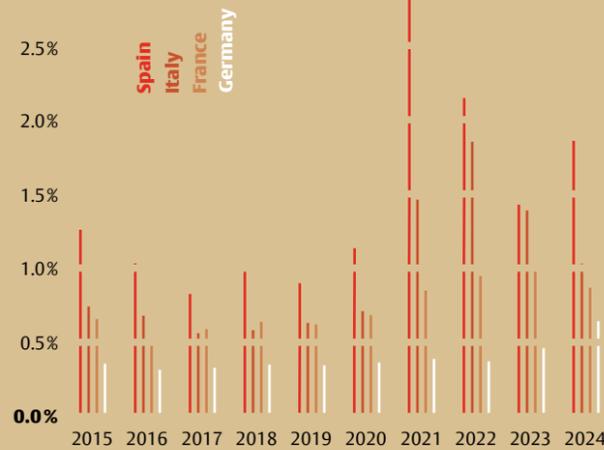


Figure 2  
High EU transfers to Spain  
EU payments as a percentage of recipient countries' GDP

Source: Flossbach von Storch Research Institute, Macrobond, European Commission, data from 2024

**... AND TRANSFER PAYMENTS FROM THE EU**

A second factor behind Spain's boom is money from Brussels. Government spending in Spain is receiving a massive lift from transfers from the European Union (EU). Before the Coronavirus crisis, these amounted to one per cent of GDP. Even then, they were higher for Spain than for Germany, where they reached 0.3 to 0.4 per cent at the time. But that changed

after Covid-19 and the EU's Recovery and Resilience Facility (RRF), which was launched in February 2021, and the subsequent NextGenerationEU recovery plan. The programme alone provides grants and loans for Spain amounting to EUR 163 billion. As a result, inflows from Brussels to Madrid

added up to two per cent of Spanish GDP in 2024, while Germany received an injection of only 0.6 per cent.

If we add the government deficit of 2.8 per cent in both countries to the EU transfer, the Spanish economy received a fiscal stimulus totalling almost five per cent of GDP in 2024. In Germany, however, the stimulus remained notably lower. Part of Spain's growth is therefore imported demand, financed by European transfers.

So, while Spain is booming, Germany remains mired in crisis. On the one hand, Spain's economic miracle is based on substantial financial injections from the European Union. On the other,

it is also supported by the successful integration of migrants into the labour market. Tolerance of informal work and the prospect of legalisation apparently offer migrants a stronger incentive to participate in the labour market. ♦

Pablo Duarte is a Research Analyst at the Flossbach von Storch Research Institute.



**While Spain is booming, Germany is mired in crisis.**

By Shenwei Li



# MAIL FROM S H A N G H A I

Economic engine, superpower, party dictatorship. Anyone interested in global trends looks to China. Analyst Shenwei Li provides a subjective report on her experiences from the perspective of a Chinese citizen. This time, she discusses the consequences of falling prices for property owners.

In China, anyone wishing to buy an apartment normally needs a bank loan. Increasingly, however, it is now the sellers who are seeking financing. After three years of price corrections in our property market, depending on the region, prices are now back to 2018 or 2016 levels – even in Shanghai. Many people who want to sell their flats are now finding that the realisable sales proceeds are not sufficient to pay off outstanding mortgages. Those who still want or need to go through with the sale usually need a loan to cover the remaining liabilities.

Those most affected are buyers who purchased apartments at the peak of the property boom between 2020 and 2023 and financed them with mortgage loans. According to national statistics office figures, a square metre of newly built living space cost an average of 12,497 renminbi in mid-2023, compared to 8,307 renminbi at the start of 2018 – an increase of 50 per cent. With an equity ratio of 30 per cent in each case, buyers have had to take out increasingly higher mortgages for the same square metre footage.

## GROWING PRESSURE

However, because the economic situation in our country has also deteriorated, many mortgage borrowers have had to accept salary cuts or have even lost their jobs. Against this backdrop, interest-rate cuts – from as much as six per cent in 2023 to around four per cent on existing loans – have brought little relief.

Some borrowers are particularly hard hit by the realisation that the sales proceeds currently achievable are lower than the remaining mortgages. Although it is extremely difficult for some to continue servicing their loans, they are refraining from selling and continuing to make repayments with enormous effort. Others are going through with the sale with the help of banks. Some are supported by family or friends. The probability that sellers will quickly get back on their feet financially is usually high, especially since the basic rent in metropolitan areas amounts to a maximum of one to two per cent of the purchase price; in so-called “low-tier cities” – with fewer inhabitants and lower average incomes – it is slightly higher.

## DEFAULT RATE HIGHER THAN EXPECTED?

How large has the problem become by now? A Bank of China Research Institute report, which has since been deleted, estimates the proportion of mortgages that are no longer being serviced due to borrower insolvency (NPL ratio) to be 3.7 per cent for 2025. In some low-tier cities, the figure is said to be five per cent. By way of comparison, commercial banks officially put the NPL ratio at no more than two percentage points.

In any case, the pressure on banks to record as few defaults as possible in their balance sheets appears to be high. They therefore remain cautious with reminders and other measures. As a result, more and more mortgage holders are withholding payments even without financial hardship. In the worst case, financial institutions blacklist such borrowers

for late payments, and those affected can no longer book first-class tickets or five-star hotels when travelling, for example – drawbacks that seem bearable.

## SOME BANKS ARE INCREASING PRESSURE ON PRICES

In addition, smaller banks from low-tier cities have been increasingly trying to get rid of properties pledged to them by borrowers. Unfortunately, our banking law then stipulates that they must be sold within two years. As a result, the listing price is often 20 to 30 per cent lower than the market price, which has consequences in an already weak market: potential buyers delay purchases, while potential sellers often feel compelled to price their own properties even cheaper.

Those who suffer are borrowers who have to sell due to severe financial pressure – and receive considerably less from sales than planned. Because banks have a perpetual right of recourse to the remaining private assets, these borrowers must continue to pay off expensive mortgage loans (without refinancing options) even in the most difficult situations and with all their efforts. For many, personal bankruptcy would probably be of help. They could then apply for foreclosure and, after three to five years of severe restrictions, make a fresh start in life. However, to date, there are no nationwide personal bankruptcy proceedings in China. Pilot projects are running only in Shenzhen and Xiamen.

At least these mortgage borrowers have one advantage: if a property is put up for auction by the courts due to insolvency and the borrower is deprived of ownership, they are allowed to continue living in the domicile. In practice, our courts do not support eviction, at least not if the residence is the borrower's only accommodation. ♦

Shenwei Li is an Analyst in Shanghai.

# “There Have Rarely Been so Many **Attractively Valued Stocks**”

Bert Flossbach on the hype surrounding artificial intelligence (AI), the two faces of the stock market and a rally in precious metals.



### **Before we look ahead, how would you describe 2025 in a nutshell?**

A turbulent year on the capital markets, dominated by two forces that could hardly be more contrasting – US President Donald Trump and artificial intelligence (AI).

### **What surprised you most?**

The real performance stars were not the often-mentioned tech giants, but banking and defence stocks, or more precisely, European banking and defence stocks. With a gain of 91 per cent, banking stocks, including gross dividends, recorded an historically unique investment year! However, bank profits in 2025 rose by only around eight per cent compared to the previous year.

### **How does that fit together?**

The extreme price development is primarily due to the notable rise in the valuation of bank shares, which reflects increased confidence in the quality of bank balance sheets. The ratio of market capitalisation to balance sheet equity climbed from 0.8 to 1.36 over the course of the year, reaching its highest level since early 2008!

### **Does that mean the price potential has been exhausted?**

I am not in a position to judge that. However, we have always been cautious about bank shares, precisely because it is very difficult to assess the quality of balance sheets and long-term earnings potential with any degree of reliability. We accept that this means we are not involved in rally phases.

### **By far the most attention has been paid to artificial intelligence and the shares of the companies that profit most from it – how do you assess the hype?**

The word “supposedly” should actually be added at the beginning.

### **What do you mean?**

“Supposedly” profit. No one knows yet whether the companies that everyone currently believes will be the big winners in the investment race will actually be so in the long term. History has taught us that scepticism is warranted. There is no doubt, however, that the seemingly enormous potential of a fascinating topic – and an almost clerical belief in a new saviour – provide fertile ground for a stock-market bubble.

### **Would you say that we are already in a new stock-market bubble?**

We have to distinguish between technological innovation on the one hand and the investment behaviour of companies and investors on the other.

### **You'll have to explain that.**

The development of artificial intelligence is not a bubble, just as the Internet was not a bubble. On the contrary, rarely has the long-term potential of an innovation been so underestimated as was the case with the Internet at the turn of the millennium. When people talk about the dotcom bubble today, they are not referring to overly high expectations of the Internet, but rather to the economic success of companies. At that time, loud-mouthed analysts and investor relations departments fuelled the greed of naive investors and catapulted questionable companies without sustainable business models to the top of the stock market for a short time. The real winners of the Internet had often not even been founded at that point.

### **Which companies come to mind?**

Take Alphabet, Meta, Uber or Spotify. Others had completely different business models, Apple or Netflix, for example. By the time these companies began their triumphant rise, most of the icons of the dotcom boom had already vanished from the scene or were mere shadows of their former selves. It took almost three years for the specu-

lative bubble to burst on the Nasdaq technology exchange. However, it is not necessarily the often-cited greed that creates an investment boom and a speculative bubble.

### **What do you mean by that?**

The fear of company bosses that their own highly profitable business will be disrupted by another company or a new technology can also trigger a wave of investment. That is exactly what is happening right now. It makes sense for the top dogs to protect their highly profitable businesses and the many trillions of US dollars in market value by offering AI services themselves or operating gigantic data centres for third parties. The motto is: better to invest too much than to be run over by the AI train. Mark Zuckerberg, the head of Meta, summed it up when he commented: wasting a couple of hundred billion dollars would certainly be painful. But the real risk is in being too cautious and not investing at all.

### **So, the huge investments are not least a protective wall against unwelcome competition?**

That's right. And yet, investments of several hundred billion dollars in data centres and chips inevitably fuel speculation on the stock market.

### **Which stocks are particularly prone to speculation?**

Probably chip manufacturers. They are considered the main beneficiaries of the investment wave. Leading the way is Nvidia, currently the world's most valuable company with a market capitalisation of USD 4.5 trillion. Its share in the MSCI World Index is now more than five per cent! Even Broadcom, the number two chip company, has a market capitalisation of USD 1.7 trillion.

### **Has the end of the line been reached?**

Not necessarily. The more and the longer prices rise, the greater the pain investors feel about not being invested – and the stronger the fear of miss-

ing out. This situation is a recipe for bubbles in the financial markets, which are ultimately nothing more than irrationally high valuations. When the shares of the stock market heavyweights are affected, they pull the entire market with them – first upwards, then downwards. This can lead to painful surprises for investors who invest in a broad index fund in order to spread the risk.

### **Do you see parallels with the dotcom bubble?**

Every bubble has its own script.

### **Then the differences are ...**

Unlike the dotcom bubble, the current AI boom is better founded economically. However, it would be a first in financial history if an investment boom such as the one we are currently experiencing were to come to a gentle and silent end without collateral damage. Stock-market bubbles burst when investors' high expectations prove to be exaggerated. The bursting of a bubble can be painful and expensive. But so can premature exit, because euphoric investors drive prices even higher.

### **Looking ahead, what can investors expect from the stock market in this environment?**

A year ago, we predicted a decade of modesty, with realistic return expectations of five to a maximum of eight per cent per annum. By 2025, corporate profits had risen by around 10 per cent, and valuations had increased from 21 times earnings to 22.5 times. The US dollar was the spoilsport, falling by around 12 per cent. The bottom line was a 6.8 per cent gain for the MSCI World Index, calculated in euros, which was in line with our long-term expectations. The potential is likely to be similarly high in the coming years.

### **What will be particularly important in 2026?**

After the devaluation of the US dollar had a major impact on performance in 2025, corporate

earnings are likely to be decisive in 2026. Based on analysts' estimates, corporate earnings are expected to rise by almost 12 per cent for companies in the S&P 500 Index. Whether this is realistic depends primarily on the business performance of the large technology companies, which account for a good 40 per cent of the index. The second factor is the valuation or earnings multiple. For the US market, this currently stands at just under 23 based on expected earnings. Based on corporate earnings over the past 12 months, the price-to-earnings ratio is as high as 25. This means that the US stock market currently stands at an historically high valuation, which can only be justified by the prospect of strong long-term earnings growth.

#### **What happens if these high expectations are not met?**

Then valuations would fall. And if they were to fall along with earnings, a drastic correction cannot be ruled out. When considering future earnings growth, we should not forget that a massive wave of write-downs is rolling towards the four tech giants Alphabet, Amazon, Meta and Microsoft. Based on the capital expenditure expected by the market until 2030, this means additional write-downs of around USD 400 to 500 billion per year from 2030 onwards. That is roughly equivalent to these companies' current profits and corresponds to about 15 per cent of the operating profits of all S&P 500 companies! This does not yet take into account expenses in the form of long-term payments for leased data centres.

#### **However, this calculation fails to take into account the fact that the investments also "generate" income ...**

That's right, but these must equally be enormous, which is by no means certain. However, we should not underestimate the adaptability of the companies mentioned.

#### **What do you mean?**

Alphabet, Amazon, Meta and Microsoft have the financial strength to quickly reduce or reprioritise their spending. These are highly profitable companies with dominant market positions and established business models, whose core business generates significant cash flows even without maximum AI expansion. AI investments are therefore not an all-or-nothing game for them but offer strategic optionality. The core business would remain intact even in the event of potential bad investments. However, this does not apply to all players in the AI value chain.

#### **But that doesn't sound like a bubble risk, does it?**

The problem is that many investors ignore valuation issues when it comes to AI and focus instead on visions. This even applies to investors who, on the one hand, do not trust the investment boom, but on the other hand want to take advantage of the momentum and dance as long as the music plays.

#### **To put it another way: where do you see investment opportunities as an investor?**

The paradox of today's market environment is that, after several strong years for equities and with indices at record highs, there have rarely been as many attractively valued stocks as at the turn of the year 2025/2026. The very good performance of AI, banking and defence stocks has masked the weak price performance of other sectors or stocks. This even applies to technology stocks, such as established providers of enterprise software, which had recently suffered from the AI boom.

#### **Can you give some examples?**

In defensive sectors, such as consumer staples, health care, financials and IT services, valuations have fallen markedly in some cases. The risk-reward ratio has improved, meaning that stocks have become more attractive. We have defined a basket

of companies that have shown continuous profit growth of a good seven per cent over the past few years and are currently trading at their lowest price-to-earnings ratio in more than 10 years. The growth potential of these companies is unspectacular, as are the risks. Investors get predictable business performance at a relatively favourable price.

#### **The price of gold has also climbed sharply recently – how do you assess this increase?**

There is a temptation to view it as a potential speculative bubble, particularly when it comes to silver.

#### **But?**

The silver market is the smaller, more speculative brother of the gold market. The daily trading volume is only a fraction of that of gold, which is why the silver price can be moved more easily with less capital investment. In upward phases, it rises disproportionately, and in corrections, it falls more sharply than gold. This pattern was also observed in the late 1970s and during the commodity boom of 2011. It is likely that a possible setback in the silver euphoria could also temporarily weigh on the gold price, especially as the pace of the gold price rise has been very brisk recently. However, the investment motives that speak in favour of gold remain intact.

#### **What do you mean?**

Rising government debt, high budget deficits, question marks over the independence of the US Federal Reserve and confiscation risks in the USA – all this makes gold appear to be a safe alternative to US Treasuries, and not just for foreign central banks.

#### **Thank you for the interview.**

**This document does not constitute an offer to sell, purchase or subscribe to securities or other instruments. The information contained herein does not constitute investment advice or any other recommendation.**

*“It would be unprecedented in financial history if an investment boom, such as the one we are currently experiencing, were to come to a gentle and quiet end without any collateral damage.”*

# Conviction is Not a Strategy

In the wake of the ongoing rally around artificial intelligence (AI), tried-and-tested investment principles are coming under fire. Caution is advised!

By Thomas Lehr



**Comment sections are filled with often loudly expressed convictions that are frequently based on hasty judgements and limited knowledge.**

“Diversification is all well and good – but anyone who still spreads their investments widely today has failed to understand the market. Artificial intelligence (AI) is where the action is, Herr Lehr. Why are you so critical?”

We hear statements like these with increasing frequency. They are usually delivered with great conviction, and the markets seem to prove the questioners right. At least, a heavy focus on technology has almost never been wrong in recent years – quite the opposite, in fact: the performance has been impressive, especially this year. And for the time being, there is little to suggest that the AI rally will come to an end any time soon. A broadly diversified portfolio, conversely, currently appears unspectacular. It is lagging behind in terms of performance. As is so often the case in such phases.

The fact remains, however, that equity markets in the USA and globally are being driven by a small group of large-cap US technology companies. These companies are expected to use AI to avoid economic uncertainties on the one hand and, on the other, to generate high returns on their enormous capital expenditures in the future. For example, two-thirds of the gains in the US S&P 500 equity index last month were attributable to just a handful of technology stocks out of 500 individual stocks whose performance is supposed to reflect the benchmark.

#### THE RISK OF SMALL NUMBERS

In addition, there are close mutual shareholdings and business relationships between these companies. At the end of November, Anthropic’s valuation rose significantly after it was announced that Microsoft and Nvidia would each be investing billions. While Anthropic’s AI models are to be integrated into Microsoft’s Copilot products in the future, the start-up has committed to extensive cloud and infrastructure purchases. This includes spending tens of billions on computing capacity at Microsoft and the use of Nvidia chips in the expansion of its own AI infrastructure.

Such mutual investments may be strategically understandable for the companies involved. But they are not isolated cases. Back in September, a joint contract and investment arrangement between Nvidia, OpenAI and Oracle caused sharp share price movements. This gives pause for thought. Could growth expectations be artificially propped up here, similar to the keiretsu structures in the Japanese bubble? All of this may end up being profitable for those involved. However, there are once again increased risks in the cluster risk.

So is focusing on supposedly successful technology companies in the portfolio the better long-term approach? At a technology conference in Italy, Jeff Bezos, founder of US online retailer and cloud operator Amazon, provided another argument against this. He called the current enthusiasm surrounding AI a ‘good bubble’. Unlike ‘bad bubbles’, which burst and leave nothing behind except destroyed capital, lost trust and economic damage, in a ‘good bubble’ capital flows into new ideas, many of which will fail, but society as a whole will still benefit. So even if the share prices of many AI-driven companies are likely to collapse at some point, the structures, innovations and advances will remain, as was the case with the dotcom bubble.

#### THE POINT OF DIVERSIFICATION

Not even today’s industry leaders can know who tomorrow’s winners will be. For us, this demonstrates the sense and logic of diversification: we are currently invested in large US technology companies, but only to a certain extent. We also see opportunities in other areas, such as certain consumer companies that are currently being overlooked by the market. In our view, there are quality companies available here at what we consider to be favourable valuations.

These are two different areas where we see opportunities for completely different reasons. And because not every single investment in the portfolio will realise its potential, our portfolio is also broadly diversified in terms of individual

stocks. The interaction between these factors creates stable, sustainable benefits. Anyone who recognises that this balance is advantageous in the long term understands why diversification cannot be a relic of the past.

#### CONVICTION IS NOT EVERYTHING

“One of the fundamental evils of our time is that the stupid are so sure of themselves, while the intelligent are full of doubt,” wrote British philosopher Bertrand Russell. Around a hundred years ago, he was not seeking to pass judgement on intelligence, but on attitude – in other words, on the difference between self-assurance and prudence.

Today, this statement seems more apt than ever. Whether in politics, in companies, on talk shows and, above all, on social media: the comment sections are full of statements expressing convictions that are usually voiced very loudly, but are often based on quick judgements and limited knowledge. In such a world, the more cautious among us have a hard time.

But those who believe they have found the one trend that will drive up prices on the financial markets may be rewarded in the short term. In the long term, however, those who are aware of the risks fare much better than those who ignore them. Even on the capital markets, conviction alone is no guarantee of correctness – and certainly no strategy.

And perhaps this is where the true value of diversification lies: it is less an expression of uncertainty than of experience; the experience that certainty is rarely permanent. ♦

*Thomas Lehr is a Partner at Flossbach von Storch SE in Cologne.*



# THE HANGOVER AT THE END

By Kurt von Storch

The topic of artificial intelligence is driving the stock markets higher. Many investors, particularly those with longer memories, feel reminded of the internet hype at the turn of the millennium. But is this comparison justified?

History does not repeat itself – but it sometimes rhymes, as they say. The promises of artificial intelligence (AI), the vast sums being invested in it, the boom in tech stocks – all this brings back memories of the dotcom bubble some 25 years ago. And of how it eventually burst ...

Technical progress has always moved people. It changes the way we work. It changes our consumption habits. Yes, it changes all our lives. It creates new jobs, but threatens others. It promises growth, but not for all industries, not for all sectors.

The stock market reflects these perspectives. Companies believed to be among the beneficiaries of the current wave of innovation are showered with premature praise. Their share prices rise from one record high to the next.

Conversely, shares in companies that do not benefit directly from technological innovations are ignored – far too boring!

That's exactly how it is these days. Shares in large US tech companies are dominating the indices, while shares in more “defensive” sectors, such as consumer goods or pharmaceuticals, are trading close to their 10-year lows. The big question is: how long will the AI enthusiasm on the stock markets last?

I don't know.

New areas of significant growth are naturally a magnet for investors. However, there is no boom that does not eventually end in excess and ultimately in tears. This was also the case with the Internet euphoria at the turn of the millennium, although even the most ambitious expectations were far exceeded in the following decades. Many of the supposed beneficiaries have fallen by the wayside, while new ones have emerged. And even the companies that are still “in the race” today

have lost up to 90 per cent of their market value in the meantime. Cisco shares, for example, one of the major beneficiaries of the Internet, recently reached their 2000 peak again after 25 years, albeit without dividends.

## NOT EVERYONE CAN WIN

This basically answers the question we are often asked by our clients and investors these days: why are you rather cautious with your investments in the tech industry? A specific company is usually mentioned. Why not Nvidia?

Because we simply do not feel confident in assessing its long-term earnings prospects with any degree of certainty. Yes, Nvidia is undoubtedly an excellent company with excellent management. The latest company figures were also impressive – once again. However, in our opinion, there are more scenarios in which the share price could halve than in which it could double again.

No sector is as disruptive as the tech sector. Nowhere else do today's winners so quickly become tomorrow's losers. This does not have to apply to Nvidia, but it could.

The tech giants' massive investments in AI are proof of how concerned their management is about falling behind in the race for future business areas (the profitability of which no one really knows today). One thing is certain: there cannot be only winners. There will not be only winners!

We are acutely aware of this. The Internet hype at the turn of the millennium, the enormous expectations at the time and the painful end of the boom, the hangover at the end – this phase was immensely important for us as investors and for the entire Flossbach von Storch company, which was still very young at the time. We learned how important it is not to build castles in the air. Not →

to deceive ourselves or our clients. To remain true to ourselves. To have a clear investment philosophy.

Anyone who invests money on the stock market, especially on behalf of others, must be humble – and remain so. They should not simply dance to the tune, even if that means lagging behind the dancing market at times. Such phases have occurred repeatedly in the past, and they will continue to occur in the future. We accept that.

### THE FUTURE CANNOT BE PREDICTED

We do not think in terms of calendar years, but rather in much longer time frames. We think like businesspeople. Our implicit value proposition is to preserve wealth and generate adequate returns for our clients and investors over time. To let them sleep soundly, even when storms rage outside.

We do this by diversifying assets as broadly as possible.

Diversification reflects the investor's understanding that the future cannot be predicted, but that one can nevertheless prepare for it as best one can. However, diversification does not just mean spreading assets across different asset classes and individual securities. That would be far too short-sighted. Diversifying assets sensibly also means spreading them across different currency areas. An investor from the eurozone, for example, would be well advised not to keep all their money in their home currency, but also to invest in "more robust" currencies – broadly speaking, in currency areas that are less indebted.

However, currencies have another component. It is not only the currency in which a bond or share is denominated that matters, but also the currencies in which the underlying company generates the bulk of its revenues. Currency developments

are very important for the profit prospects of a eurozone group that generates most of its revenue in the US dollar area (and settles its accounts in that currency). Investors must also take this into account when making investment decisions.

But even after doing all this – dividing assets across different asset classes, individual securities and currencies – investors still need to put the individual building blocks together in a meaningful way. How high should the equity allocation be? What does this mean for the proportion of bonds, which are intended to stabilise the portfolio's performance? And how high should the proportion of gold be (also in relation to the other asset classes) in order for the precious metal to fulfil its insurance function? The composition of a portfolio is derived from the capital market environment – and it should be possible to adjust it flexibly over time.

### QUALITY IS WHAT COUNTS

Another essential feature of a robust investment strategy should be the quality of the investments in which an investor invests. Betting on short-term trends and fads on the stock market is often a gamble. It is much more important to look at the substance of an investment, the amount of return it generates in the long term and, above all, its predictability. Investors should therefore always ask themselves how robust a company's business model and the returns it generates are.

Quality prevails in the long term – this also applies to financial investments. In times of crisis, this is even more true. Investors should therefore focus on companies that are capable of weathering even major crises largely unscathed and, ideally, emerging from them stronger.

Flexibility is also important. Only those who have a liquidity buffer are in a position to take advantage of investment opportunities when they arise.

Sooner or later, that is exactly what will happen. But that alone is not enough. The concepts of flexibility and liquidity should be interpreted much more broadly. Any investment that may be of interest to an investor must be examined, before it is acquired, in terms of how easily it can be sold if necessary. What use is an otherwise very interesting investment if there is no market for it in an emergency?

Investors should also pay attention to solvency. Their own solvency, but also the solvency of those whose shares or bonds they are buying. Solvency is a prerequisite for independence and the ability to act; high debts, conversely, are the most common cause of bankruptcy and loss of wealth. This becomes all the more evident in times of crisis.

The price is what you pay – the value is what you get in return. Just as good businesspeople do when buying and selling their goods, investors should carefully examine the value of the companies they want to invest in. Is the price possibly much higher than the potential investment is worth? Or is the price reasonable, or even lower than the actual value? Investors should never be guided by stock-market excesses, but should always try to focus on the true value of an investment.

Diversification, Quality, Flexibility, Solvency and Value – we formulated these five principles for ourselves in the early 2000s and combined them to form our Flossbach von Storch Pentagram. Five guiding principles against which all our investment decisions must be measured.

Now and in the future! ♦

The Internet hype around the turn of the millennium, the enormous expectations it fuelled, and the painful collapse of the boom – the hangover at the end – proved to be a formative period for us as investors and for Flossbach von Storch, which was still in its infancy.

# Just Like Humans, Only Better

Artificial intelligence (AI) has been the dominant topic in the financial markets for some time now. In an interview with Ulrich Stockheim, Professor Feiyu Xu explains the background and success factors for companies.

**Professor Xu, many people are currently talking about artificial intelligence (AI), but for most of us, the topic still feels very new. You have been working intensively in this field for many years.**

**How did you become an AI expert?**

I came to Germany from China in 1991 because I wanted to study here. I was very good at mathematics and quite good at languages. That's how I came to study Computer Science and Computational Linguistics. I was very lucky that the German Research Center for Artificial Intelligence (DFKI) was already in Saarbrücken at the time. Back then, Computational Linguistics was still very specialised. There were at most 30 students in a lecture, and fewer than 10 graduated. Now there are more than 300 students in AI lectures.

**You have since received several awards for your many years of research and gained practical experience as Head of AI Lab at Lenovo in China and Global Head of AI at SAP in Germany. You have advised the German government on this topic and have also founded a start-up. Did you foresee this development in AI?**

No. I didn't expect AI to develop so quickly and become part of everyday life. The pace has been particularly rapid over the past five years.

**But because most of us are still unsure about AI terminology – what is so special about AI? Can you define it for us?**

Gladly. AI simulates and extends human perception and cognition. Perception includes language, hearing, seeing and even smelling. Cognition encompasses everything related to thinking, planning and analysing. However, many AI systems are often more powerful than humans. For example, AI can translate more than 100 languages, recognise 100,000 faces or identify millions of plants and animals at a glance. And it can do this 24 hours a day, seven days a week. AI can even transform us creatively. With the help of AI, we can have a

picture painted like Picasso. But above all, AI makes the interaction between us humans and machines more natural. We can now talk and interact with software and hardware in the same way as we do with humans.

**In the business world, AI is primarily intended to make processes more efficient and products better, right?**

It's not quite that simple. Before either of these things can work, companies first need to define a clear AI strategy. That sounds simple enough, but in practice it often doesn't happen. The first question is: can the company use AI to make its products more intelligent? In the automotive industry, the answer is obvious – without AI, there would be no autonomous driving. AI is also giving rise to completely new products, for example, in aviation: drones would be unthinkable without AI.

**Now, many companies want to use AI to optimise processes, don't they?**

That's right. Many companies are starting with AI in the area of process optimisation – especially in the mechanical engineering industry, where AI makes manufacturing steps more precise and efficient. Then there are business processes: SAP plays an important role in intelligent processes, particularly in this area. However, I wouldn't start with processes that involve direct customer contact, so that mistakes made in the first AI experiments don't damage valuable customer relationships. And then there is a third, very important point: as soon as you start working with data and digitalisation, there is almost always an opportunity to develop a new business model – for services, for data-based solutions, for completely new offerings. AI is therefore not only about optimisation, but also a real driver of innovation.

**Can you explain that in more detail?**

Most traditional German companies still work with very linear business models. They sell machines, e.g. cars – often as a one-off transaction. Many car manufacturers and machine →

builders have now realised that additional service packages can be worthwhile because they generate continuous and recurring revenue. But in comparison, there are American and Chinese companies, such as Google, Amazon, Tencent and Alibaba that have built platforms and entire ecosystems. They are so successful today because they use exponential business models. I believe it is crucial for German companies to develop precisely such new business models in order to remain competitive in the long term.

**Now we are here with an asset manager and should don our investor's glasses. In your opinion, what should one look for when investing? Would you be more likely to select companies that use AI particularly well in traditional industries and thus become more efficient? Or would your focus be on what are known as AI companies?**

I need to back up a little here. The AI ecosystem basically starts at the bottom, with computer chips. At the top are chip designers and manufacturers, such as Nvidia and TSMC. The big cloud companies – Google, Amazon and Microsoft – build on this with their platforms. These companies are currently investing heavily. And the big players in China, such as Tencent and Baidu, are acting similarly strongly.

Most companies in Germany, conversely, are on a different level: they develop applications or use AI applications in their products and processes. This is extremely important for the European economy, because our industry in particular thrives on technologically strong applications. That's why digitalisation is so crucial at this point – and mere continuous improvement will not be enough. Incidentally, digitalisation also includes the electrification of industry. I think that we in Europe and Germany need to develop much more ambition. We should clearly show that we want to be number one in a key industry of the future. This is not easy for the automotive industry at the moment, but I see certainly great opportunities in other areas.

**Now, one could say that we have to be number one in this area. But AI has long since arrived elsewhere. And there is a huge infrastructure behind it. That is, the language models and data centres, each of which costs tens of billions. In addition, these data centres have high energy costs. And that brings us back to the next issue in Germany. At the end of the day, one wonders: hasn't the train already left the station?**

I don't think the train has ever left the station. What I find lacking in Europe is passion – and the ambition to really create something new. I sit on the Supervisory Board at Airbus, and I think we can be very proud of this company. I often hear people say they are afraid to fly on planes made by our competitor Boeing. But let's remember when Airbus was founded in the early 1970s, one could just as well have said then that the train had long since left the station in aircraft construction. And yet it has become one of Europe's greatest success stories. Even "Made in Germany" did not originally start out as a seal of quality. It was the English who wanted to use it to mark the origin of German products – in the firm belief that German goods were inferior. And yet it later became a global seal of quality. Time and again throughout history, there have been moments when Germans or Europeans were initially considered the underdogs – and yet they still achieved outstanding things. We need to rekindle this ambition in Germany and Europe. And to do that, we need a clear plan for how we can really win in the wake of digitalisation and new technologies.

**So, from your point of view, it's not just about improving existing industry, but also about catching up with AI companies in the narrower sense?**

Of course. Look at the "Magnificent Seven". They represent a huge industry, a huge market that we shouldn't just leave to the USA and China. Especially since we're not short of ideas either. →



i

**Prof Feiyu Xu** holds a professorship in Industrial AI. Her research has received numerous awards. In addition, she served as Global Head of AI at SAP from 2020 to 2023 and led Lenovo's AI Lab from 2017 to 2020. Feiyu serves on multiple supervisory boards, including Siemens Energy, ZF Group and Airbus.

**AI is currently a topic of discussion at almost all companies. In many cases, it has already been implemented in some form. But some people think this is a little exaggerated. And so, an AI team is half-heartedly set up, consisting of a few young people who are then supposed to try it out. Is that enough?**

Absolutely not. If a company is seriously interested in artificial intelligence, then the topic belongs under the responsibility of the supervisory board, board of directors or executive board – and it must be an integral part of the corporate strategy. I have experienced many companies up close: first at Lenovo, where I developed the AI strategy and built the central AI team, and later in a similar role at SAP. Almost all of the projects were very successful – but only because they were backed by a clear, comprehensive strategy. Without such a holistic AI strategy, investments are often misguided or plans fail to address the actual priorities. Recently, a large US telecommunications company asked me to evaluate an AI application in the field of human resources. My first question was: why should a telecommunications group invest in this area of all places? After all, this industry is primarily concerned with network stability, network optimisation and service quality. There was no convincing answer to this question – and that is precisely what reveals the strategic gap. That is why every company that takes AI seriously needs a holistic AI strategy and a clearly formulated North Star to guide all initiatives.

**What would such a North Star be?**

Let's take the automotive industry, BMW or Mercedes, for example. That could be the development of the self-driving car. And once you agree on a goal like that, you have a very clear investment path. For a mechanical engineering company, on the other hand, it's often about improving the manufacturing process, for example, optimising the supply chain in the face of geopolitical challenges.

**Let's come back to Germany as a business location. Are there any areas where you would say the government needs to provide a better framework? For example, on the issue of energy costs, or is this issue being overestimated?**

No, it is not being overestimated. The USA and China have significantly lower electricity prices than Germany. We urgently need to invest in the energy sector here – and in AI technologies at the same time. The demand is enormous, not least due to the massive electrification of our industry. At the same time, the EU has taken an important step with the so-called AI Gigafactory initiative. And I think Germany should have acted strategically here in a similar way to France – or even better: we should have seized the opportunity to take joint action. After all, there were at least six applications from German companies. This is precisely where the state needs to play an active role: it must identify our strengths in an AI Gigafactory – location, energy, technology, cloud, applications – and how we can expand these through targeted investments. This cannot be left to individual companies. We have great companies in Germany: Siemens is excellently positioned in the field of AI industry; SAP is a global leader in business processes; and Siemens Energy in the energy sector. Bringing these competencies together would have been a very strong strategic configuration for Germany and Europe.

**You talk about business models. But isn't one of the problems that, when it comes to AI, the public debate here tends to focus more on warnings than on simply letting companies get on with it?**

I completely agree with you. If we want to win and really be Number One, then we need ambition, and we need resilience. That is something that would have to change fundamentally in our society. I even see this in the family environment: we often try to read our children's every wish from their eyes, show a lot of compassion – sometimes perhaps

too much. But in the end, if you're not resilient and don't learn to take responsibility for yourself and the community, you'll have a hard time later on – both as an individual and as part of a team. Success requires inner strength, perseverance, and the will to take responsibility.

**You mentioned earlier what AI can do and what none of us here in the audience can do. Why does AI take so long to get a driving licence? So why does a human being usually need up to 20 driving lessons, while the development of autonomous driving takes years?**

A human being brings a lifetime of experience to driving – we understand road traffic intuitively, read body language, and recognise risks. AI, on the other hand, starts from scratch and has to learn millions of special cases that we take for granted. Technologically, autonomous driving already works in many scenarios today. What is missing are clear rules, liability issues and social acceptance. We tolerate mistakes made by humans, but we expect perfection from AI – and that is precisely why it takes longer.

**Even companies that work with AI usually have to live with a margin of error because AI cannot cover everything as yet. How do companies deal with this?**

Yes, many companies use AI for chatbots in customer service, for example. However, this often does not work in escalated situations. A smart company will therefore ensure that AI and humans work together: AI may answer 90 per cent of the most frequently asked questions, while employees take care of troubleshooting and de-escalation. Nevertheless, the use of AI can also lead to significant savings here – resulting in clear efficiency gains.

**Thank you for the interview.**

*“We tolerate mistakes from humans, but we expect perfection from AI.”*

# Digital Diversification

By Dirk Seel

**Why we focus on investing as broadly as possible in the technology sector.**

Amid the current hype surrounding artificial intelligence (AI), the market is rapidly generating narratives of winners and losers. This is fuelling extreme market movements in technology stocks. The question of which companies will be able to develop solid long-term business models from this technology and which will come under pressure remains far from answered. In order to benefit from these developments without taking on too much risk, we advocate a diversified positioning.

Technology is a broad field. In theory, the Global Industry Classification Standard (GICS) from index provider MSCI clearly divides companies into 11 sectors, one of which is Information Technology. In practice, however, it is far less clear-cut: online retailer Amazon, for example, is classified as a “cyclical consumer” company, even though it is also one of the leading service providers in the cloud business. Alphabet, which is not just Google’s parent company, and Meta, which is not just focused on social networks, are also considered “communication services,” even though their business model is more about selling advertising. Because technology permeates many industries, we prefer to view current developments against the backdrop of the entire digital value chain.

This includes software used by consumers or businesses and software behind so-called financial information companies. Added to this is the hardware

installed in and around data centres. All four areas are currently influenced primarily by developments in AI and dominated by certain market narratives.

## CONSUMER SOFTWARE: CAN THERE BE ONLY ONE?

Whether travel platforms, streaming services, ride-hailing services or social networks: they all work best with as many users as possible due to the network effect. With this type of software from everyday consumer life, our credo has therefore been that the big players are getting bigger and bigger. However, the question now is whether the rise of AI chatbots (also known as assistants or agents) such as ChatGPT and Perplexity will change this.

This is supported by the fact that, ultimately, all companies are vying for the attention of customers, but they only have 24 hours in a day. Increased usage of one app therefore typically comes at the expense of another. This has led to the narrative that ChatGPT and search engines cannot coexist, but that the better option will prevail among customers. At Meta and Netflix, conversely, the market seemed rather carefree in our view. ChatGPT is characterised by creativity, which could be used in the future to expand into areas such as social media and video production.

Which existing companies could come under pressure from chatbots in the fu-

ture depends heavily on the details of their business models and the specific capabilities of the chatbots. If, for example, chatbots prove to be particularly good at finding specific and rare information, this would put considerable pressure on certain providers, even if they have been the top dogs up to now. Instead of following the broad narratives that “the market” sometimes tends to adopt, business models, disruption risks and AI developments must be closely monitored. It is not advisable to prematurely classify companies as AI winners and losers.

## ENTERPRISE SOFTWARE: DO BUSINESSES NEED MORE OR LESS SOFTWARE?

The enterprise software sector has been characterised by a high degree of predictability for many years, as changing providers usually involves a great deal of effort for business customers. Now, however, there is also discussion here as to whether AI will lead to disruption and how the pricing power of providers could change. Three aspects are being discussed in particular.

Firstly, enterprise software is becoming increasingly effective due to the addition of AI functions, meaning that companies could reduce their workforce in the future and consequently have less need for software licences for their smaller workforce. On the other hand, there is the argument that AI makes employees more productive and that →

the resulting efficiency gains are shared between the software provider and the customer. We tend to agree with this view in the case of some companies.

Secondly, sceptics argue that enterprise software providers offering new AI features will be forced to adopt a different pricing policy. Historically, they are said to have earned excessive margins by relying on bundled offerings – selling multiple applications only as a package – and on long-term subscription models. This could now become a disadvantage. Some companies argue that adding AI features would justify price increases and that usage-based components could be incorporated so that frequent users could be asked to pay more in the future. However, there is currently no evidence that customers of established software are willing to pay for additional AI features. In our view, the shift in pricing models away from subscription models towards usage-based payment is also likely to present challenges.

Thirdly, it is assumed that the business of software providers could be at risk if tasks are no longer performed by humans but by AI in the future. However, we still consider this scenario to be premature for most areas. Start-ups that build agents are dependent on data. And we have been observing for some time that the top dogs among software providers are blocking access to this data. This allows providers to buy time to incorporate agent func-

tions into their own products. Services that rely heavily on current data may therefore feel less pressure from AI.

#### FINANCIAL INFORMATION SOFTWARE: WILL DATA PROVIDERS BECOME REDUNDANT?

Credit card providers, stock exchange operators and data and analytics companies, such as S&P Global, all benefit not only from the network effect, but also monetise data directly and indirectly.

Credit card providers process billions of transactions every day. This generates granular data – who bought what, where, when and via which device – which is monetised, for example, by selling risk tools for the early detection of fraud anomalies. Stock exchange operators also sell not only trading data, but also analysis tools for risk control.

Will AI make such transactions more difficult in the future? This concern has been driving the market since at least mid-September. At that time, quarterly results from US financial data company FactSet triggered a wave of selling among financial information stocks. The management there had announced that it would invest and that margins would decline slightly in the coming year without the prospect of a corresponding increase in revenue. One broker wrote: “Even if this is not a complete disruption by AI, the costs of doing business are clearly rising.”

This may be true for companies in this sector that only have a relatively small amount of their own data. However, in our view, this is by no means true for the entire industry. We therefore go into detail with each of the companies with further questions such as: Is the data difficult to replicate? Is it embedded in a workflow? Is it enriched by company input? Is it protected by regulation? Does it represent legitimacy and credibility for customers? Where the answer is yes, we often see potential.

#### HARDWARE: WHO WILL PREVAIL?

The fourth and final part of our digital value chain, hardware, can be divided into three areas:

- (1) chips that are installed in a data centre;
- (2) the data centre itself; and
- (3) everything needed to keep the data centre running.

All of these areas have experienced a structural boost in recent years due to AI demand. Nevertheless, we also see risks.

In the chip sector, these were visible to Intel shareholders by mid-September, as the company lost massive market share. Even in the semiconductor sector, the tide does not lift all boats. However, there are very few ships to watch: among chip designers, there are basically only three significant companies:

Nvidia, Broadcom and AMD; in design software, there are two: Cadence and Synopsys; among chip manufacturers, there are also two: TSMC and Samsung; and among equipment suppliers, there are five: ASML, Applied Materials, LAM Research, KLA and Tokyo Electron.

The oligopolistic nature also applies to the second area, cloud infrastructure. The three providers AWS (Amazon), Azure (Microsoft) and GCP (Alphabet) currently have a market share of more than 90 per cent. However, their largest supplier, Nvidia, is keen to reduce their bargaining power and prefers to supply new providers (so-called Neoclouds) such as Oracle, CoreWeave and Nebius with its high-performance chips. This is intended to put pressure on the three dominant providers. However, Oracle shareholders have learned that such attempts have their pitfalls. After the share price had risen sharply following the announcement of the cooperation with Nvidia from September 2025, it subsequently lost around 40 per cent at times – the market is weighing up exactly how profitable each planned data centre is.

Things are quieter in the third hardware area, the so-called Enablers. Companies such as connector manufacturer Amphenol, Siemens and Schneider Electric ensure that power is reliably supplied to and distributed within the data centre. These companies are just as indifferent to which consumer, business or financial information software prevails as they are to the question of which chip

is used. In addition, the AI trend, together with automation, accounts for only about 50 per cent of sales. These companies are therefore benefiting from the current demand for AI data centres without being dependent on it.

#### FOR DIVERSIFIED, BALANCED INVESTMENTS

The digital value chain thus spans many industries, each with its own particular advantages and disadvantages in terms of AI progress. Although common market narratives often cause price movements, we do not believe they are always justified. For example, we consider the expectations of disruption to be exaggerated for some software companies in the enterprise sector. On the one hand, changes in this area do not usually happen very quickly, as demonstrated by the ongoing migration of enterprise data to the cloud, which has been going on for years. On the other hand, AI can also be an opportunity for market leaders.

We therefore focus on carefully analysing companies and investing in a balanced and diversified manner along the value chain. In this way, we aim to take advantage of the opportunities presented by these extraordinary developments without taking excessive risks. ♦

Dirk Seel is a Fund Manager at Flossbach von Storch SE in Cologne.

We therefore focus on carefully analysing companies and investing in a balanced and diversified manner along the value chain.

# INNOVATION Required



**Public debt levels are rising across many Western industrialised nations worldwide. The (short-term) risks appear manageable. However, demographic burdens harbour dangers.**

Debt rather than reform continues to dominate much of Europe, while the United States is running a budget deficit of around seven per cent. Indeed, some European countries and the USA have long since passed the magic threshold of 100 per cent of gross domestic product (GDP) in terms of the government debt ratio.

Nevertheless, painting a bleak picture is unwarranted. As described above, risks must be viewed much more on a timeline; in the short term, the insolvency of a Western industrialised nation is a scenario that is hard to imagine. Rather, the inherent instability caused by high public debt is likely to be stabilised by the shared interests of government creditors, pensioners, entrepreneurs and civil servants. None of these players has any interest in a disorderly sovereign default and its unforeseeable consequences. In the medium to long term, there is therefore still much to suggest that central banks will guarantee the financing of government budgets with low real interest rates. In this regard, the monetary guardians are likely to be assured the blessing of market participants.

However, from a public finance perspective, increasing demographic burdens will complicate matters in the coming decades – a problem that affects the world's largest economic areas equally, albeit to varying degrees. For the eurozone, United Nations population models assume that in 2040 there will be 57 persons aged 65 and over for every 100 of working age (20 to 64). The current figure is 40. The development in China is all the more striking. By 2040, there are likely to be around 43 persons aged 65 and over for every 100 of working age (see graph), compared with 23 at present. During the 2050s, the ratio of young to old people in China is likely to become even less favourable than in the eurozone.

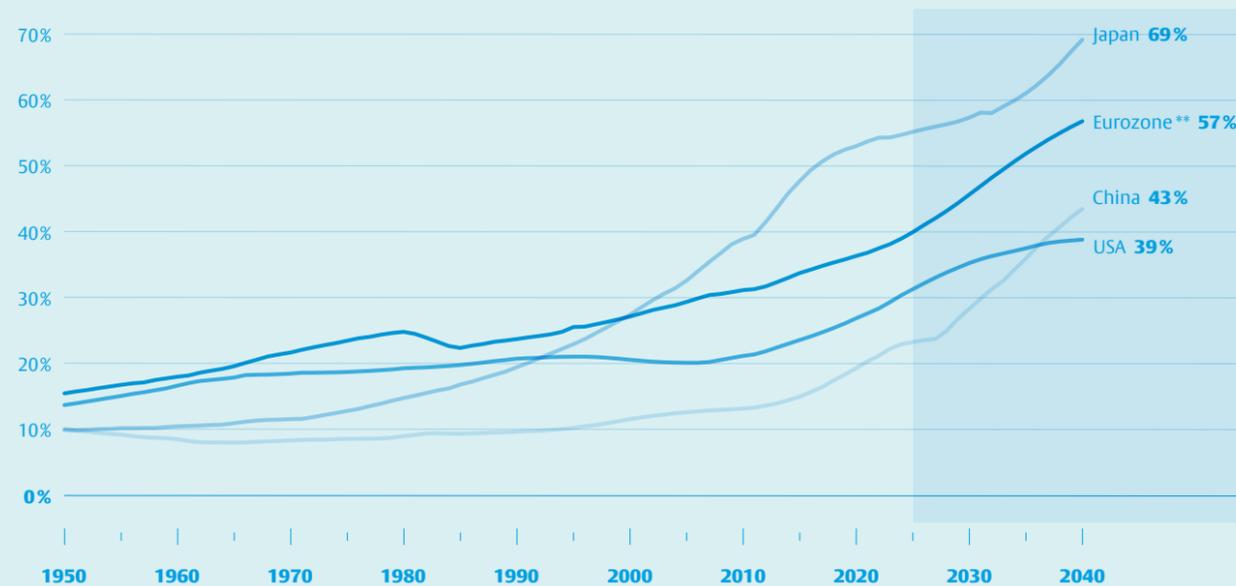
## DEMOGRAPHICS AS A TICKING TIME BOMB

Demographics are thus becoming a ticking time bomb for social security systems. It is not only the ageing population that should be causing concern. At the same time, population growth in industrialised countries is falling below the “replacement rate” of 2.1 children per woman. Social security systems are therefore dependent on skilled immigration in order to ensure their financial self-preservation in the face of latent reform fatigue among the population.

From an investment strategy perspective, it is crucial that the demographic slowdown primarily affects those economies that have high purchasing power in international comparison.

This means that companies that have benefited from the combination of a growing population and increasing prosperity are losing at least some of their momentum. Although these pressures do not necessarily have to result in a decline in business performance, the companies affected will face greater challenges in

**An additional complicating factor in the coming decades will be rising demographic burdens – a problem that affects the world's largest economic areas equally.**



Graph

#### The world is getting older

Old-age dependency ratio\* is rising across the globe

\* Number of persons aged 65 and over in relation to those of working age (20 to 64); estimates from 2025 onwards.

\*\* Selected were the four most populous economies in the eurozone: Germany, France, Italy and Spain.

Source: LSEG Datastream, Flossbach von Storch, data as at 31 December 2025

the future in terms of driving growth on their own – for example, through greater innovation or differentiation of their product ranges.

#### INNOVATION AS A REMEDY

In addition, there is a stronger focus on efficient production, as demographic change not only puts pressure on sales, but also leads to a stagnating or even declining labour supply. Efficiency gains are thus becoming a key source of growth. However, productivity gains rarely come about without friction – they require hard work and sometimes demand creative destruction, which meets with resistance, especially in an ageing population. For this reason, the greatest hopes of our time are pinned on two letters that have become synonymous with the next productivity upheaval: AI. ◆

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

# HEALTH CARE

## An Important Portfolio Component

By Eugen Uretzki

Pharmaceutical stocks have lost some of their shine. However, there are good reasons why this sector – like other segments of the health care market – offers attractive opportunities in the long term.

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Following the outbreak of the Coronavirus pandemic in February 2020, the world was searching for a vaccine – and biopharmaceutical stocks experienced a rally that reached all the way to Mainz-based BioNTech. However, since advances in artificial intelligence (AI) have been driving up the share prices of major indices, the performance of the health care sector has lagged behind. Yet it is likely that medicine in particular will benefit permanently and massively from AI developments. Above all, however, the Trump administration's measures and plans are causing a great deal of uncertainty – and causing many investors to overlook structural growth drivers in the segment.

In our portfolios, we would not want to forego companies in a sector that is known for its cyclically independent business development and thus promises a high degree of predictability in terms of earnings growth – especially since the health care market offers structural growth drivers that make it an attractive investment vista stretching even beyond exceptional trend spells such as pandemics.

#### **DEMOGRAPHICS AND INNOVATION AS GROWTH DRIVERS**

Global demographic changes are increasing the demand for medicines and medical care. The world population is expected to rise from around eight billion today to an estimated 10 billion by the end of the 2050s. As a result, the average age of the population is also increasing, particularly in many so-called developed economies, which means that

the incidence of many chronic diseases is statistically on the rise. Meanwhile, the strengthening purchasing power of a growing middle class in many emerging markets is enabling access to modern medical care and thus opening up disproportionately high sales potential.

In addition, existing medical solutions for most diseases are not (yet) optimal, which is why medical innovations are

in demand. The pace of innovation has increased enormously in recent decades. Successful drug developments therefore often open up immediate commercial opportunities. Here are a few examples:

→ Cancer remains one of the most common causes of death worldwide. Although mortality rates have improved significantly since the 1970s, there are still types of cancer that are difficult to diagnose and treat. Thanks to modern oncology drugs, cancer treatment is becoming increasingly precise and personalised. For example, drugs with a chemotherapeutic effect or radiation now act directly on the affected tumour cells without damaging the surrounding tissue, which reduces

side effects. Other modern cancer drugs target specific genetic changes in the tumour. The mRNA technology used in Covid-19 vaccine development even promises to tailor therapy to individual patients.

→ In medical technology, surgical robotics is also finding its way into operating theatres. It enables minimally invasive procedures, which reduces the risk of complications and takes the strain off doctors operating the equipment.

**Existing medical solutions leave many patient needs unmet. Successful drug developments therefore often open up immediate commercial opportunities.**

→ At the same time, there are fundamental innovations in equipment for research and development and for the production of new classes of drugs. The new precision tools shorten the development time for new drugs and enable their cost-efficient production.

These are historic opportunities, not only for pharmaceutical companies, but also for less prominent segments of the health care market. The areas differ in some specifics of their business models and the associated opportunities and risks.

Traditional pharmaceutical companies benefit from patents on their drugs, which secure high margins for them – but only for the limited duration of the patents. After that, cheaper generic products come onto the market and companies have to develop new drugs to generate new sales and profits. However, research and development of new active ingredients is naturally subject to increased risk. Larger pharmaceutical companies are diversified in this regard through a broad research pipeline. Meanwhile, advances in AI applications promise to shorten the development times for new drugs in the future. However, as the supply of drugs is the focus of political attention, the sector is subject to increased political risk. Regulatory intervention and forced price reductions in the USA in particular are currently deterring many investors.

#### **LOW POLITICAL RISK IN MEDICAL TECHNOLOGY AND LIFE SCIENCE TOOLS**

Other sub-segments of the health care sector are much less in focus: medical technology, for example, which roughly speaking refers to equipment and consumables for hospitals. Examples include operating theatre systems and surgical instruments, or products that are used directly on patients, such as pacemakers, artificial joints and incontinence products. Other examples include life science tools and suppliers of biopharmaceutical research and development equipment.

In addition to a comparatively low regulatory risk, medical technology also benefits from shorter innovation cycles than biopharmaceuticals and, at the same time, lower development risks, as product innovations are often incremental in nature. However, the use of these products on sick patients also results in increased product liability and litigation risks for manufacturers.

The life sciences sector does not supply patients or doctors, but rather pharmaceutical companies and other institutional research players who develop the products for the end customer. It thus benefits from the macro trends mentioned above without bearing the development risk of individual drugs. In addition, product liability risks play a lesser role in this business. These companies are often characterised by the so-called “razor-and-blades” business model: the installation of a specific research and production instrument (the razor) leads to recurring purchases of exclusively specified consumables (the razor blades).

A number of structural growth drivers are therefore opening up attractive opportunities in the health care market. However, as in any industry, in-depth analysis and targeted selection of individual stocks form the basis for promising investments. ♦

*Eugen Uretzki is an Investment Analyst at Flossbach von Storch SE in Cologne.*

# Protection and Opportunity

Investing in bonds is attractive again.  
One example shows how returns and risks  
can be balanced in practice.

By Lars Conrad

Interest rates are back. Bonds are making a comeback – or so we keep hearing (and reading). And indeed, there's currently a lot to be said for this asset class, which is gradually shaking off its wallflower image after many years of zero and negative interest rates and an historic interest-rate turnaround.

In addition to adequate coupons (even for top credit ratings), i.e. the guaranteed returns that investors receive annually until the end of the term, there are numerous other sources of return. Bonds are traded daily on a free market. This opens up price opportunities if the price that buyers are willing to pay is higher than the original purchase price.

Perseverance is also rewarded: yield curves are rising steeply. Long maturities are once again yielding significantly better returns than short ones. After a positive bond year in 2025, in which active and balanced funds were able to achieve returns of a good four per cent p.a., we also see good opportunities for 2026.

The problem is that the bond market is highly complex. Each individual security must be subjected to a careful risk-reward

analysis. Is the issuer solvent and does this justify the price of the bond? Are there exaggerations in the markets from which flexible investors can benefit? Have currency risks also been taken into account? Last but not least, is the portfolio sufficiently diversified? Active bond portfolios can quickly consist of 200 to 300 individual securities, which must be precisely tailored to the fund's strategy. In more turbulent bond years, the entire portfolio may be restructured two or three times.

But how can opportunities in the market be identified? Using a specific example, we would like to illustrate how selected securities earn their place in a bond portfolio. It is important to note that we do not, of course, make any recommendations to buy. In any case, we strongly advise private investors against bond picking: investments only make sense in combination, i.e. in a diversified portfolio.

## AFFORDABLE PROTECTION AGAINST INFLATION

So-called "inflation linkers" contain an insurance function, covering the actual inflation incurred. In contrast to a pure →

Figure 1  
Insurance premium  
favourable against inflation

Breakeven inflation in the USA  
and the eurozone at central bank  
target levels

Fed & ECB target

Past performance is not a reliable  
indicator of future performance.

Source: Bloomberg,  
Data as at 9 January 2026

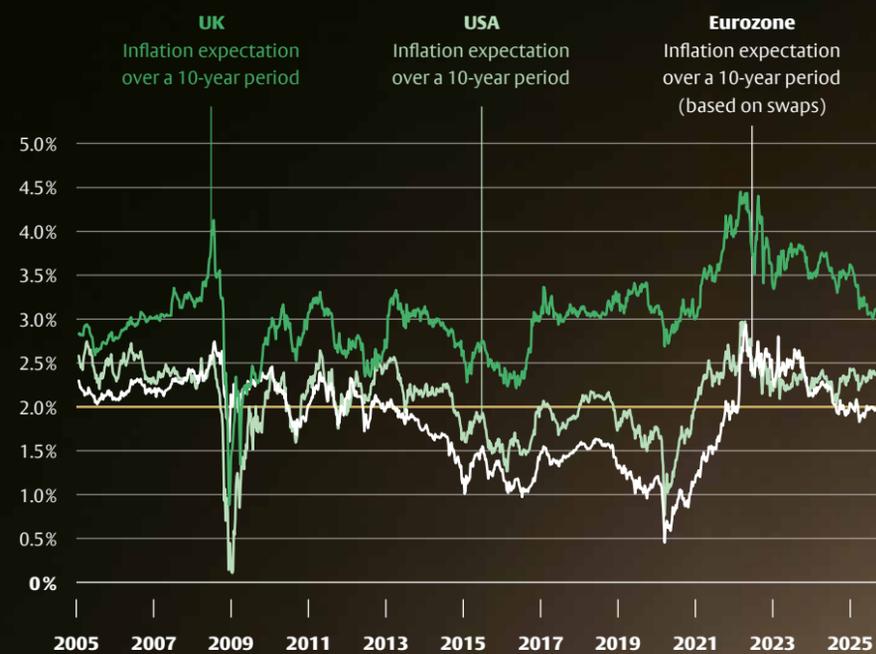


Figure 2  
(Real) yields at attractive levels

Offensive portfolio duration –  
Linkers as a strategic component

Past performance is not a reliable  
indicator of future performance.

Source: Bloomberg,  
Data as at 9 January 2026



risk protection policy, however, they also offer a real return – the real yield, which is currently at an historic high. Unlike nominal government bonds (which have a fixed coupon), the returns on inflation-linked bonds derive from two components: a lower coupon rate (the “real coupon”) plus compensation for the actual inflation incurred (measured by a fixed price index).

The difference in yield (excluding inflation) between a linker and a nominal bond with the same maturity is the market’s expected “implicit inflation expectation” (also known as the “breakeven”). If investors assume that actual inflation over the remaining term will be higher than that priced in by the market, they are better off with the linker (hence breakeven).

We are currently seeing in the major markets that inflation expectations (for 10 years) in the USA, for example, are only moderately above the central bank’s target of two per cent. For the eurozone, they are even slightly below that (see Figure 1). In other words, the insurance premium for unexpectedly high inflation is currently relatively inexpensive.

This is particularly true in view of global debt dynamics. Government debt levels have been rising rapidly for many years, and the pace has accelerated further of late. All of this has to be financed, especially in times of rising interest rates. Inflation is a welcome aid in this regard: when prices rise, so do (tax) revenues for the state coffers. Governments (and central banks) may therefore be inclined in the long term to allow (slightly) higher structural inflation in order to keep the mountains of debt in check – or even reduce them.

In addition to its protective function against inflation, there is a second point that makes inflation-linked bonds interesting. Real yields have recently been at historic highs. In the United States (and other Anglo-Saxon countries) in particular, yields on long-term government bonds were two to three per cent above expected inflation. The last time such rates were seen was more than 15 years ago, during the Global Financial Crisis (see Figure 2).

At that time, however, government debt ratios were significantly lower than they are today. Other debt indicators are

also deteriorating. For example, the interest burden on many countries has risen significantly, while growth prospects are declining (especially in the eurozone). Against this backdrop, critical observers may consider real yields to be too high.

In short, inflation-linked bonds offer investors opportunities if real yields were to fall again in the future (especially for longer maturities, which reflect market movements more strongly in their prices). They also offer investors protection – buffering movements in a portfolio if inflation could pick up again in the future in view of structural government debt problems.

As part of the bigger picture, we believe that linkers (especially TIPS from the USA, supplemented by securities from eurozone countries with good credit ratings) can add value to a portfolio. Experienced portfolio managers should use them carefully. Their share in the portfolio should be appropriate to the return and risk targets. The duration structure should also be appropriate. If nominal and real yields fall in unison, for example, investors who tend to favour longer

maturities in linkers will benefit disproportionately. With a shorter duration, the portfolio will instead prove more robust when yields rise due to increasing inflation fears. This ‘skew’ can be advantageous for investors.

As mentioned, linkers are just one example of many bonds in a portfolio. They only fulfil their purpose when combined with other securities in the right way. Investing money is comparable to many decisions that have to be made in life. Ultimately, it is always a question of complexity. Bold decisions deserve respect – especially when they do not rule out all other possible opportunities. ♦

Lars Conrad is Portfolio Director Fixed Income  
at Flossbach von Storch SE in Cologne.

# National Debt and the Financing of War

How military conflicts can plunge states into severe financial difficulty is examined through an historical lens by guest contributor Professor Werner Plumpe.



Reasonableness  
is hardly to be  
expected in the  
foreseeable future.

The planned rearmament of Europe's highly indebted countries is causing concern. History shows that wars have repeatedly caused great financial hardship, even when states were not as heavily indebted as they are today.

Even in the 16th century, waging war was extremely expensive. And after the discovery of America, tons of silver ended up in the Spanish crown's coffers. Nevertheless, Spain was only able to finance wars against the Netherlands, Great Britain and France in the 16th and 17th centuries by taking on ever more debt, which was raised not least by the major Upper German financial houses, such as the Fuggers and Welser. This enabled Spain to prolong the war for a long time, but ultimately it was of no use in the struggle for supremacy in Europe.

Instead of triumphing, the Spanish crown was forced to declare insolvency six times between 1557 and 1647, with each state bankruptcy having devastating consequences for its creditors.

The Netherlands, long Spain's main adversary, already had a fairly modern tax and banking system, generated high revenues and was consistently liquid. Amsterdam became the European financial centre, where investors from all parts of the continent brought their money to safety. Despite the burden of the war with Spain, the interest rate that the Dutch States General had to pay remained low. However, this early establishment of modern financial market structures was the exception.

The major European states continued to run up debts. The War of the Spanish Succession between 1701 and 1714 was financed by France, Great Britain and the Habsburgs with debts that brought the states to the brink of insolvency after the end of the war. Attempts by France and Great Britain to reduce their debts led to two of the first major European financial and speculative crises.

#### – 1718 TO 1720 –

##### DEBT-DRIVEN SPECULATIVE BUBBLES IN PARIS AND LONDON

In essence, it went like this: the state granted private "entrepreneurs" privileges in certain areas of colonial trade, namely in southern North America and the Caribbean, and also allowed the establishment of relevant joint-stock companies to exploit these opportunities. Their share prices skyrocketed due to the expected profits (the so-called South Sea Bubble), enabling these merchants to take on a large portion of the state debt in return for the privileges. In France, the privileges also included the right to establish a bank with note-issuing authority (the "Banque Royale" of entrepreneur John Law), which also quickly gained popularity among the population. The initial successes were phenomenal. Law was revered as a "magician". At the same time, dozens of joint-stock companies were founded in London that did not even specify the purpose of their activities; but the public nevertheless snapped up the shares from the issuers.

The inevitable happened. As soon as it became clear that expectations in the colonies were not being met, share prices collapsed, first in Paris, where a large part of the public was dispossessed in a matter of days when their securities became worthless. Law had to flee Paris. Those who could attempt to transfer their capital to the London market, but this too soon collapsed. Once again, the public was left empty-handed. The government in London responded with the Bubble Act, which effectively banned the establishment of joint-stock companies in future, but this was little consolation for the masses of dispossessed investors.

#### – POST 1815 –

##### STRICT AUSTERITY MEASURES IN RESPONSE TO POST-WATERLOO DEBT

However, the French and British governments continued to finance their ongoing conflicts in the 18th century with debt; at the end of the Napoleonic Wars in June 1815, both states were heavily indebted. This time, however, there was no mass expropriation.

The result was an extremely restrictive fiscal policy. France, which had been experimenting with paper money inflation since the 1790s, gradually emerged from debt through currency reform and restrictive monetary policy. The situation was similar in England, where the years after Napoleon saw heated debate about the constitution

of the financial market; a dispute that ended with the introduction of the gold standard and strict rules for the Bank of England, which were intended to put a stop to paper money experiments.

The restrictive monetary policy was accompanied by extremely austere fiscal policy, which was also pursued in the over-indebted states of Austria and Prussia. In modern terms, the public spending ratio, which had been more than half of total economic output during the strife, declined dramatically after the end of the Napoleonic Wars. In Prussia, the state accounted for barely 10 per cent of domestic product by the middle of the century; the situation was similar in the other states. What later became known as Manchester capitalism and the "night-watchman state" were, in this sense, born out of necessity. Without such retrenchment, the high levels of public debt could never have been overcome.

Contrary to what is often assumed today, the state's retreat in the 19th century did not lead to economic paralysis in the economies involved. On the contrary: the phrase of "Enrich yourselves!", attributed to French King Louis Philippe, but probably coined by his finance minister François Guizot – intended as an invitation to the bourgeoisie to do business and thereby gain wealth – struck a chord with the spirit of the times, which is remembered as the heyday of the Industrial Revolution.

#### – FIRST WORLD WAR –

##### MASSIVE DEBT ENDS IN INFLATION

The absence of major military conflicts favoured the "lean state," whose hour, however, came with the outbreak of war in 1914. While military expenditure rose enormously in the years that followed, the supply of civilian goods declined at an ever-increasing rate. The gold standard was suspended, enormous war loans were mobilised, and paper money inflation set in, initially insidiously, but later more and more blatantly. The Weimar Republic also financed the return to a peacetime economy on credit. After a brief period of apparent prosperity, inflation finally reached unprecedented levels, culminating in the Rentenmark currency reform of November 1923, which resulted in the complete expropriation of financial assets and the total devaluation of government bonds. As after the War of the Spanish Succession, this time too, at least in the German case, the public paid with the complete loss of their financial assets.

The Allied powers of Great Britain, France and Russia were also heavily in debt. They hoped for German reparations payments, but these were hardly sufficient to cover the consequences of the war, especially since Soviet Russia, one of the main debtors from the pre-war and war periods, refused to recognise the debts from the Tsarist era.

Great Britain was still in a comparatively good position. Its foreign assets →

had been large before the war and, as the world's most important financial centre at the time, it had itself granted loans to the Allies, but the way out, namely to get the remaining obligations under control through controlled inflation of Pound sterling, was blocked. This would have undermined its position as the anchor of the gold standard and guarantor of the importance of London as a financial centre. So the country pursued a restrictive monetary policy that was highly controversial at the time. The old gold standard returned in a modified form, but London lost its lustre.

Germany paid its reparations with American loans, while France and Great Britain used these payments, at least in part, to settle their war debts to the USA, and US banks immediately lent the money back to Germany: given the high interest rates in Germany, this was a lucrative business that was bound to collapse as soon as the flow of money from the USA dried up. This is exactly what happened in the economic crisis of 1929, plunging the global economy into the abyss.

#### – SECOND WORLD WAR –

##### DEBT BINGE, CURRENCY REFORM AND CONSOLIDATION

The Second World War, too, could only be financed through debt – in the hope that the burden could be imposed on the loser. Germany was particularly dynamic and inventive in its borrowing, but this did not change

the situation of complete over-indebtedness at the end of the war. Once again, the debts were repaid by completely expropriating the money-holding public: the currency reform of 1948, in which all domestic assets and liabilities were drastically devalued to the tune of 100 Reichsmark (RM) to 6.5 Deutsche Mark (DM).

Foreign debt was settled by the London Agreement, which granted the Federal Republic generous payment terms in addition to waiving outstanding interest payments, enabling the country to gradually meet its obligations. The fact that the country was relatively free of debt, combined with an extremely cautious government fiscal policy and the Bundesbank's efforts to maintain stability, are likely to have proved key pillars of the economic miracle.

#### – SINCE THE LATE 1960s –

##### EVER NEW REASONS FOR GOVERNMENT DEBT

Since the end of the 1960s, however, the link between government debt and war financing has been lost. In the wake of Keynesianism and expansion of the welfare state, the nature of debt changed, becoming a common, even desirable instrument of government financing. In this context, financial historian Hans-Peter Ullmann speaks of the “debt complex” that emerged in the late 1960s in the hope that debt could be used to modernise the economy (and society), which in turn would more than compensate for the

debt through its successes. The success failed to materialise, as expected, and the debt remained.

Since then, there has been a co-evolution of debt expansion and government economic and fiscal policy that is now breath-taking. Since then, rising tax revenues (it should be noted) have no longer been sufficient to keep the state functioning in line with the political mainstream, with the result that every challenge or crisis is met with new debt, which was only temporarily reduced in the 1980s. The financing of German reunification, the challenges of the dotcom crisis, the global financial crisis, the refugee crisis, the Coronavirus crisis and, finally, the war in Ukraine were the most important stages in this accumulation of debt, which is being radicalised once again by the current debt policy.

#### – POST 1990 –

##### DECOUPLING OF DEBT GROWTH AND PRODUCTIVITY GROWTH

What is fatal is that since the 1990s, debt has not been covered by increasing productivity, as had been hoped in the debt complex of the 1970s. On the contrary. Since the 1990s, productivity gains have declined significantly, and productivity levels are currently even falling. It is foreseeable that even a country like Germany will reach the limits of its debt sustainability. The German economy is already unable to generate the revenue needed to

cover the state's expenditure. Debt is no longer merely a crisis intervention measure, even if it is sold as such. It is an expression of the fact that the state is living beyond its means and would no longer be able to function without constantly taking on new debt.

And now? Historically, debt crises have mostly been “overcome” by expropriating the money-holding public, i.e. through state bankruptcies, inflation or currency reforms. Alternatives were and are financial repression, as practised in the USA after 1945, which, of course, only worked to a certain extent due to favourable economic conditions and was by no means without negative consequences. Alternatively, the state could take a step back, reduce its expenditure and thereby increase the scope for action by the economy, albeit at the cost of a significant reduction or non-emergence of a functioning welfare state. This was possible after 1815 in France, Great Britain and Prussia, as there were no mass democratic structures in place at that time. Today, such an approach is virtually inconceivable; in France, despite serious debt problems, there has been no success whatsoever in reducing social spending even slightly, although it would only be reasonable to act before the debt crisis becomes uncontrollable.

But reasonableness is unlikely to prevail in the foreseeable future. ♦



#### ABOUT THE AUTHOR

**Professor emeritus Werner Plumpe** is a distinguished historian. He was Chair of Economic and Social History at the University of Frankfurt am Main from 1999 to 2022. The author of several books, he received the Ludwig Ehrhard Prize for Economic Journalism in 2014. His latest work is entitled “Gefährliche Rivalitäten. Wirtschaftskriege – von den Anfängen der Globalisierung bis zu Trumps Deal-Politik” and was published by Rowohlt in 2025 (available in German language only). ISBN: 978-3-7371-0216-2.

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## 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.

**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.

**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.

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

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

**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.

**Nikkei 225 Index** – The Nikkei 225 is the leading index for the Japanese equity market. It tracks the performance of 225 of Japan’s largest listed companies. The Nikkei 225 is a price-weighted equity index.

**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.

**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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[info@fvsinvest.lu](mailto:info@fvsinvest.lu), [www.fvsinvest.lu](http://www.fvsinvest.lu)

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Flossbach von Storch Invest S.A.  
2, rue Jean Monnet, 2180 Luxembourg, Luxembourg  
[www.flossbachvonstorch.lu](http://www.flossbachvonstorch.lu)



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