

# POSITION

Thought-provoking issues for investors



The  
Wrong  
Hero

**CURRENCIES**

The two faces of the dollar

**BONDS**

Stay flexible



**Did you recognise the “hero” on the cover of this issue? No?**

**Let’s put an end to the suspense: it is meant to be Pac-Man, the iconic character created by Namco and a star of the early 1980s video game era. In our case, however, he is more of a tragic hero. His silhouette resembles the pie chart shown on page 24. The pie chart illustrates the primary source of retirement income in Germany today: the state pension system. For an ageing society like ours, this certainly does not bode well for the future ...**

**A more desirable picture would resemble the Mercedes-Benz star. A balanced mix of retirement income sources would benefit not only tomorrow’s retirees but also the state, which has been forced to subsidise the public pension system for years.**

Flossbach von Storch  
**POSITION 2/2026**

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**

It always starts with a realisation – the realisation that we will not be able to afford the social welfare state we have come to cherish for much longer. Instead, we will have to reform it fundamentally in order to preserve it. It will be painful, yes, but there is no other way.

I am not a politician. Nor would I want to trade places with one; that’s why I don’t wish to come across as a know-it-all or a habitual critic – quite the opposite. But as a father, this issue is weighing heavily on my mind.

By now, it should be clear to everyone that the state pension will not be sufficient for future generations. The impact this will have on many households here in Germany and elsewhere in Europe is likely still to be massively underestimated. Given the state of public finances, governments cannot continue to prop up pension systems indefinitely with ever

larger sums of taxpayers’ money. Especially as the need for investment elsewhere is enormous – defence spending being just one example.

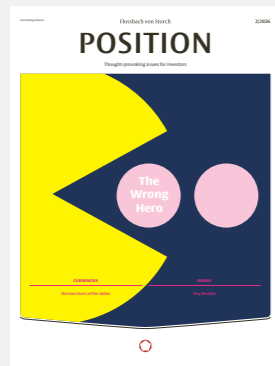
The world has become a harsher place. We are seeing this currently in Iran and still in Ukraine, not least in Europe’s growing estrangement from the United States under Trump. Future governments will have to devote far greater attention – and therefore far greater financial resources – to geopolitics than their predecessors ever did.

As is so often the case, everything is connected to everything else.

With this in mind, this issue of the Position focuses on the topic of retirement provision, as well as future monetary policy in the USA and Europe.

We wish you an interesting read!

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



Flossbach von Storch  
**POSITION**  
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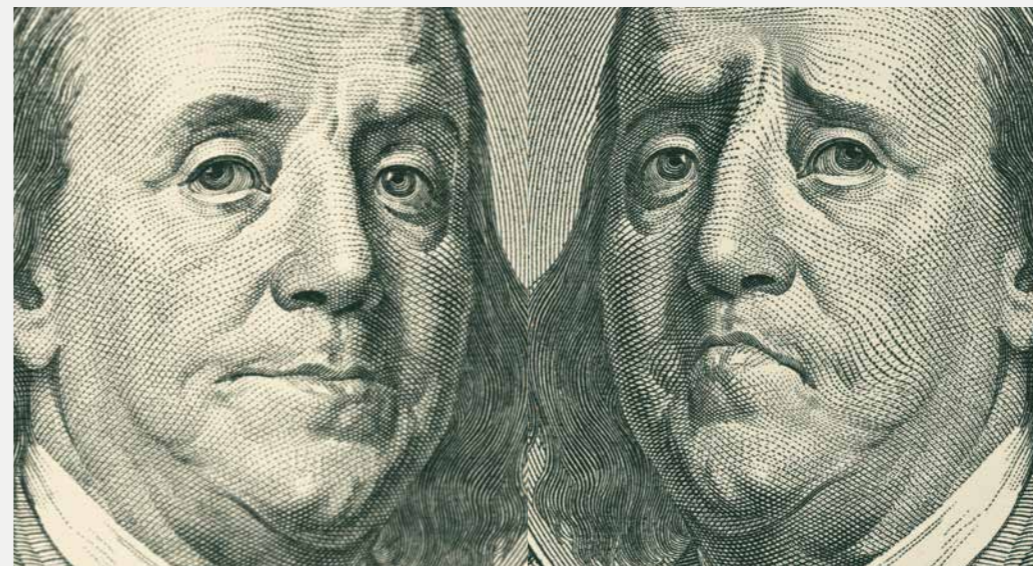


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## DIGGING DEEPER

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 address the question:

?

# How Much DEBT Can We Afford?

By Julian Marx

The world is groaning under the weight of an ever-increasing mountain of debt. Global debt now stands at more than USD 250 trillion – a record high. Is it time to rethink our approach?

In public discourse, debt now plays a defining role – although, in truth, it has done so for a very long time. This is because debt is a vital tool for shaping the present and the future: it makes it possible to undertake immense expenditure that could otherwise not be financed at all (or only with considerable effort). History offers countless examples of this.

At the level of nation states, it was primarily crises and wars in the past that repeatedly caused government debt to skyrocket. Entire books could be filled with the history of Britain's debt. For instance, during the 18th century alone, it was embroiled in five major wars: The War of the Spanish Succession (1701–1714); The War of the Austrian Succession (1740–1748); The Seven Years' War (1756–1763); The American War of Independence (1775–1783); and The French Revolutionary and Napoleonic Wars (1792–1815). In each of these wars, the British government ran deficits that peaked at up to 11 per cent of gross domestic product (GDP). The result was a steady rise in debt – from 22 per cent of GDP at the start of the 18th century to 155 per cent on the eve of the Napoleonic Wars.

Yet it was not only governments that relied on debt to shoulder immense burdens. Companies, too, knew how to make use of external funds. One historical example was the rise of the railway companies in the United States. After the US Civil War ended in 1865, railway

construction experienced a veritable boom between 1866 and 1873. During this period, 35,000 miles of new track were laid across the country. The size of the railway network had doubled within a few years, and the railway companies rose to become the country's largest non-agricultural employers.

Banks and other industries invested their money in new railway lines; along with the concession, they were usually also allocated many acres of land. Some investors were undoubtedly driven by speculation: if people settled along the newly built lines and towns emerged, the value of previously undeveloped land could rise dramatically. If successful, the profits promised to be substantial.

Within a very short period of time, vast sums of money were thus pumped into an industry that yielded no immediate profits – with devastating consequences. Costs spiralled out of control. For too long, railway construction burned through more money than the sections of track already completed were bringing in. Numerous investors had overextended themselves. This included the prestigious banking house Jay Cooke and Company, which co-financed the USA's second transcontinental railway line, the Northern Pacific, and unexpectedly closed its doors on 18 September 1873.

Almost overnight, euphoria turned into panic. A deep depression followed.

Of the country's 364 railway companies, 89 went bankrupt in the aftermath. A total of 18,000 companies filed for insolvency in just two years. The unemployment rate climbed to 14 per cent by 1876. It was not until the late 1870s that the US economy began to recover slowly.

Although the economic collapse, which lasted several years, did not undermine the long-term success of the railways – trains still play a vital role in the transport of goods and passengers today – this was of little comfort to the people whose lives in the 1870s were marked by mass unemployment and social tensions.

This example shows that debt is not an end in itself; it requires responsible management. Against this backdrop, reports of ever-new debt records appear all the more worrying.

## STARTING POINT: GOVERNMENT DEBT

Year after year, governments raise colossal sums on the capital markets to finance their spending. The USA alone had accumulated a mountain of debt amounting to USD 38 trillion by the end of last year. In relation to economic output, US government debt recently stood at a record-breaking 124 per cent of GDP. Only during the Second World War did the United States reach comparable levels of debt.



However, the USA is by no means alone in setting such debt records. Rather, a mania for government debt is spreading across the globe. Rules such as the European Maastricht criteria, which here actually stipulate an upper limit on government debt of 60 per cent of GDP, have little to do with living reality.

Among the Asian countries, China, the world's second-largest economy, has seen one of the most dramatic rises in debt in recent history. In absolute terms, China's government debt has increased tenfold over the past 15 years, from almost 14 to 139 trillion yuan. At the same time, China's public debt-to-GDP ratio has also skyrocketed, from 33 to 99 per cent of GDP. However, the Middle Kingdom still has a long way to go before it can catch up with Japan, the global debt champion. Japan boasts an unrivalled public debt-to-GDP ratio of 207 per cent (see: The Debt Atlas, p. 14).

But it is not only Asia that is racking up public debt. Brazil, the largest economy in South America, stands at 93 per cent of GDP. In North America, Canada complements the USA well, with a public debt-to-GDP ratio of 114 per cent. In Europe, too, public debt ratios exceeding the 100 per cent mark are the norm. Most recently, Belgium, France, Greece, Italy, Spain and the United Kingdom belonged to this select group.

At present, there is no sign that this debt trend will reverse in the near future. On

the contrary, the mountains of debt continue to grow steadily. In the USA, trillion-dollar deficits are expected to follow one after another in the coming years. According to estimates by the International Monetary Fund (IMF), the annual US budget deficit will average just under USD 2.6 trillion between 2026 and 2030. This means the existing debt mountain could grow by a further USD 13.1 trillion in just five years. Yet euro area countries are hardly exercising restraint either. Rising social and defence spending is likely to contribute to the eurozone countries accumulating more than EUR three trillion in new debt by 2030 (see Figure 1). Is the debt bucket about to overflow?

**STABILITY FROM INSTABILITY**

An overflowing debt bucket implies that the burdens resulting from government debt have exceeded the bucket's maximum capacity. Debt sustainability would therefore no longer be assured. Yet this is precisely where a fundamental problem in debt analysis lies. For presumably no one can specify the exact maximum capacity of the government debt bucket. The influencing factors are simply too complex.

A relevant aspect in this context is that the vast majority of the population is unlikely to have any interest whatsoever in questioning the creditworthiness of the US government or the German federal government. Not only because a default would have an immediate

negative impact on investors' wallets. Far more problematic would be the scarcely foreseeable consequences of a sovereign default.

In the USA, a large proportion of the 70 million or so people receiving old-age, survivors' or disability pensions could suddenly find themselves without an income. In Germany, around 23 million pensioners and public sector retirees could face the same fate. Furthermore, system-critical expenditure on teachers, police officers or public infrastructure could come under threat, to name just a few examples. A deep economic crisis would then likely be inevitable – a nightmare scenario in which there would be few, if any, winners.

The crux of the matter regarding government debt is that everyone – whether government creditors, pensioners, office workers or schoolchildren – relies on a functioning state apparatus if the objective is to maintain the orderly coexistence of millions of people in peace and prosperity. In this respect, the ability of states to act and pay their debts is a top priority for the cohesion of entire societies.

There is also a positive side to this, however. By implication, the inherent instability associated with high levels of government debt is partially offset by the deep entanglement of countless economic and financial actors with the state itself. Quite simply, nobody can afford – or wishes – to see a sovereign →

Figure 1  
**No end in sight**  
Projected cumulative budget deficits in the USA and the euro area from 2026 onwards \*

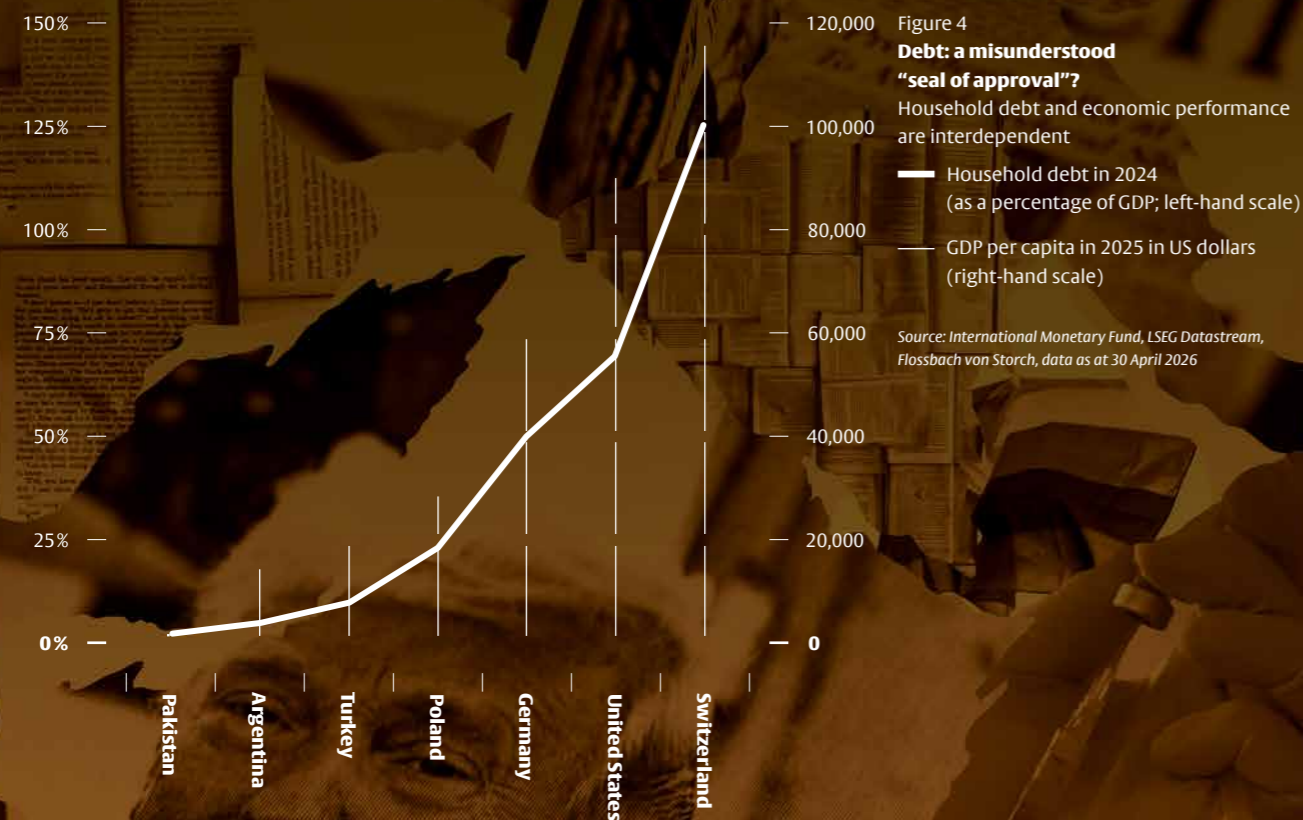
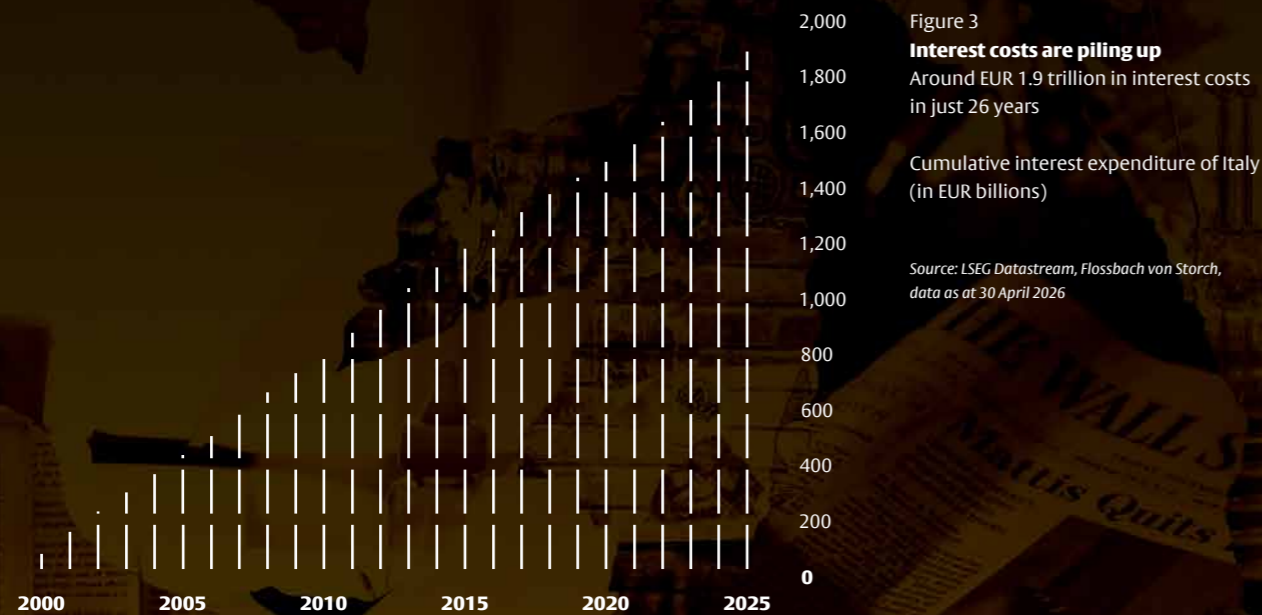


\* International Monetary Fund estimates.  
Source: LSEG Datastream, Flossbach von Storch, data as at 30 April 2026

Figure 2  
**Many generations, no state bankruptcies**  
Historical government debt-to-GDP ratios

Source: International Monetary Fund, LSEG Datastream, Flossbach von Storch, data as at 30 April 2026





default. If the heart no longer pumps sufficient blood, the other organs inevitably suffer as well.

This is also why sovereign issuers are generally perceived as (relatively) low risk on the bond market and often form the first port of call for numerous financial investors. Unsurprisingly, Italian banks and financial institutions are also investing heavily in domestic government bonds, even though Italy’s debt-to-GDP ratio, at over 130 per cent, is among the highest in the world. Most recently, they had invested more than EUR 750 billion in Italian government bonds.

**THE STATE OUTLIVES THEM ALL**

It is correspondingly difficult to define potential tipping points for “excessive” government debt. The fact that government debt-to-GDP ratios may rise significantly further than one might generally expect is demonstrated not only by Japan, the current debt champion. The trend in the UK is also noteworthy; data for this country goes back a long way, and its public debt-to-GDP ratio has at times exceeded 250 per cent. Following major crises such as the Napoleonic Wars and the two World Wars, Britain repeatedly managed to reduce its debt burden to sustainable levels over extended periods without sliding into national bankruptcy. Government bonds issued were always repaid (see Figure 2).

In countries with sound institutional frameworks, where government debt is generally not denominated in foreign currencies, even public debt ratios of 200 per cent of GDP or more need not spell a death sentence for public finances. In the current phase of historically high and rising public debt, this may be all the truer, given that past crises have shown that monetary policy interventions in the government bond market enjoy a high level of public acceptance under certain conditions.

It was only a few years ago that the European Central Bank (ECB) acquired more than 20 per cent of eurozone government debt in the wake of the euro crisis and the Coronavirus pandemic. In the case of Japan, currently the country with the highest level of government debt, almost 40 per cent of outstanding government debt was still held on the Bank of Japan’s books as recently as a short while ago. This not only depresses the yield on government securities and thus the government’s interest expenditure. In the best-case scenario, the central banks’ securities portfolios even generate substantial profit distributions – in the 2010s, the US Federal Reserve (Fed) paid out a good USD 800 billion to the US government.

In times of historically high government debt, there is therefore a strong case for public finances to be (further) supported by monetary policy safeguards going forward, by limiting

governments’ interest payments where necessary. Instruments such as the “Transmission Protection Instrument”, created in 2022, already enable the ECB to “counteract unjustified, disorderly market developments” and, if necessary, to purchase government bonds of individual countries without limit. This is another reason why there is a credible chance that Germany, Japan and others will survive without their citizens facing national bankruptcy.

**THERE’S NO FREE PASS**

However, a positive outlook on the long-term sustainability of public finances does not mean that it is advisable to expand government spending indiscriminately. Even if a country does not necessarily have to slide into sovereign default in the face of a high debt and interest burden, high levels of debt can, of course, significantly restrict its financial room for manoeuvre.

A prominent example is Italy, which in the 1990s even faced the prospect of being excluded from the euro because it was grappling with unresolved fiscal challenges. Ultimately, in 1997, it succeeded in bringing the budget deficit below the required threshold of three per cent of GDP. As a result, Italy was readmitted to the European Monetary System (EMS) and introduced the euro in 1999. However, the mountain of debt remained, and so Italy embarked on the “euro experiment” with a substantial national debt of 114 per cent →

of GDP. The country is still paying the price for this today.

Admittedly, since joining the eurozone, Italy's politicians have managed the economy more responsibly than all other eurozone countries – at least in terms of the budget balance before interest (primary balance). Between 2000 and 2025, the country achieved a primary surplus over a 20-year period. Germany managed this in 13 years, whilst the eurozone countries averaged just under 11 years. France, bringing up the rear, achieved a primary surplus in only two years.

Nevertheless, Italy's balance sheet is deep in the red as soon as the interest burden is factored in. Italy has not managed to close a single year in this millennium with an overall positive budget balance. Total debt was simply too high. In 2000, for example, around EUR 76 billion in interest had to be paid. At the time, this corresponded to around six per cent of GDP or 14 per cent of government revenue. In total, Italy has had to spend around EUR 1.89 trillion on interest costs alone this millennium (see Figure 3), whilst Italian government debt rose by "only" just under EUR 1.74 trillion over the same period.

Money that would certainly have been better spent elsewhere. Consequently, Italy's primary surpluses do not necessarily reflect a desire on the part of Italian politicians to consolidate the budget. Rather, interest rates are

having a constraining effect here and limiting the scope for fiscal manoeuvre.

### A QUESTION OF PERFORMANCE

Unlike sovereign states, individual private debtors are not usually of significant systemic importance. In Germany alone, there have been more than 100,000 insolvencies per year in recent years. Nevertheless, the fundamental principles of a market economy apply equally to them in the context of lending. The debtor's economic capacity is of central importance here: for only those with stable (long-term) income will be able to service their debts in the future.

Seen in this light, high debt can also be understood as a kind of seal of approval, because a debtor's debt-bearing capacity is, by definition, correlated with their financial capacity. Debtors who do not have sufficient "horsepower" often find it correspondingly harder to find a lender (at all). This becomes particularly clear when looking at some ideal-typical examples (see Figure 4).

According to the IMF's Global Debt Database, Pakistani households are among the least indebted in the world. In 2024, household debt stood at just two per cent of GDP. However, there are serious reasons behind such a low debt-to-GDP ratio. The South Asian country faces enormous challenges.

Around half of government revenue must be spent on interest payments. The literacy rate for men is just under 70 per cent, and for women even less than 50 per cent. Pakistan's per capita GDP stood at a meagre USD 1,700 last year, which is merely three per cent of the German level. Estimates by the International Labour Organisation (ILO) also suggest that more than 80 per cent of workers are employed in the informal sector, meaning they are not registered with the state and therefore do not enjoy any legal protection.

Yet without a secure income, the vast majority of people in Pakistan lack the very basis required to be classified as creditworthy in the first place. For many Pakistani households, the dream of financing more and better-quality housing for their own family is nothing more than wishful thinking. Pakistan's low household debt is therefore primarily due to the precarious economic situation in the country.

By comparison, the world is turned upside down more than 5,000 kilometres away. Switzerland has the world's highest household debt-to-GDP ratio – a staggering 125 per cent of GDP. At the same time, however, this small Alpine nation also boasts an extremely robust economy. A per capita GDP of more than USD 100,000 is among the highest in the world.

But it is not just the income situation that points to a healthy debt-bearing

capacity among Swiss households. What's more, the debt is offset by assets of lasting value. After all, more than 90 per cent of Swiss household debt consists of mortgages. And the fact that Swiss debt is so high by international standards is certainly also linked to the tax deductibility of mortgage interest: as a rule, only one in 10 homeowners in Switzerland is debt-free. A rate that is exceptionally low by international standards.

### WHEN WILL WE REACH THE END OF THE LINE?

The extreme examples of Pakistani and Swiss households illustrate just how difficult it is to define universally applicable debt ceilings. In the case of Switzerland, even higher household debt ratios are theoretically conceivable. According to figures from the Swiss Federal Office for Housing, just 36 per cent of all permanently occupied dwellings in the Alpine nation are actually occupied by their owners. This is the lowest home ownership rate among all European countries. A higher proportion of households with owner-occupied (mortgage-financed) homes could therefore actually increase the debt ratio in Switzerland, a country where renting is the norm.

For Pakistani households, however, significantly higher debt ratios are hardly conceivable. Despite the fact that there is currently hardly any debt. This would first require noticeable improve-

ments given the country's precarious economic situation. At present, most households simply do not meet the criteria necessary to access credit.

Essentially, when it comes to debt sustainability, the question is whether a debtor can credibly service their debt. However, such an assessment can never be static in nature, as it is subject to a multitude of dynamic factors. A country's institutional framework changes over time, as does its real economic strength.

Positive inflation rates provide relief in terms of debt sustainability through the ongoing devaluation of existing debt, whilst interest payments increase liabilities. With regard to interest rates, however, central banks possess a powerful lever to increase debt sustainability. They have demonstrated this impressively during past crises. It is quite possible that they will one day deploy this lever again in times of rising (sovereign) debt.

For that reason, the more relevant question in some cases may be not how much debt we can afford, but rather how much debt we are willing to accept. Moreover, debt is not only directly linked to interest costs. It also raises broader questions concerning inflation risks and intergenerational fairness, particularly when future generations are required to bear the burden of debt accumulated to finance current consumption. At the same

time, essential investments should not be postponed indefinitely, and in certain circumstances higher debt levels may be justified if they help secure long-term prosperity. The result is a continual balancing act.

The fact that "maximum" debt levels cannot simply be quantified in this context is, on the one hand, unsatisfactory. However, there is also hope that the end of the road is not so quickly reached, even in times of record-high and rising (public) debt levels. Britain's debt history stretches back more than two centuries. Seen in that perspective, the current debt cycle may be little more than a brief stop on a very long journey. ♦

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# THE DEBT ATLAS

## – ARGENTINA –

### A SOVEREIGN DEFAULT RARELY COMES ALONE

“As rich as an Argentine” was once a common saying. Around 1900, Argentina was regarded as one of the wealthiest nations in the world. Its meat and wheat exports brought the country considerable wealth. Millions of hard-working Europeans, mainly from Italy and Spain, emigrated there during those decades. Abundant natural resources, vast agricultural land and a favourable maritime location could have provided the foundations for a lasting success story in what is now the world’s eighth-largest country. In theory.

But by the end of the Second World War at the latest, economic decline had set in. Juan Perón’s “third way”, which was intended to strike a balance between capitalism and socialism, failed. Rapidly rising social spending (such as the introduction of paid maternity leave, paid annual leave and free medical care for all workers) was largely financed through monetary expansion, resulting in persistently high fiscal deficits and inflation rates. At the same time, economic productivity eroded amid widespread nationalisations and growing protectionism. Tellingly, meat production fell from a peak of 145,000 tonnes under Perón to 87,000 tonnes by the end of 1961. A devastating trade imbalance was the result.

The country never regained its former strength. To this day, Argentina’s economy is characterised by a lack of confidence in the monetary system and political institutions. “La Grieta”, the divide, refers to the deep social and political polarisation that defines modern Argentina. The country has gone bankrupt nine times – three times in this millennium alone. State failure is a tradition in Argentina.

## – CHINA –

### IN THE FAST LANE

China’s economy has experienced a meteoric rise in this millennium. As recently as 2000, the Middle Kingdom’s gross domestic product

(GDP) accounted for just one-fifth of the eurozone’s economic output. Less than 20 years later, China has overtaken the eurozone. Since 2018, China’s GDP has exceeded that of the eurozone year after year.

But China is also in the fast lane when it comes to debt. Not only has China’s public debt-to-GDP ratio almost tripled between 2010 and 2025, rising from 33 to 99 per cent of GDP, but the growth in debt has also taken hold of businesses and private households. While household debt has climbed from 22 to around 60 per cent of GDP over the past 15 years, Chinese companies, with a debt-to-GDP ratio of just over 140 per cent, are among the most indebted in the world. However, a large proportion of corporate debt is held by state-owned enterprises and can therefore be considered part of public debt.

As a result, China’s total debt (the sum of government, corporate and household debt) had reached a level of around 300 per cent of GDP by the end of last year. By contrast, the world’s largest economy, the USA was just under 270 per cent, and the eurozone at slightly less than 250 per cent of GDP.

## – ITALY –

### LIVING ON THE EDGE OF INTEREST RATES

“Italy, the model pupil!” This idea is not entirely far-fetched, even though Greece is the only other eurozone country with a higher public debt ratio than Italy. Between 2000 and 2025, Italy recorded a primary surplus in 20 years – in other words, before interest payments, government revenues exceeded government expenditure in those years. No other eurozone country has managed this feat as frequently. On average, eurozone countries have achieved a primary surplus in only 11 years this millennium.

Yet Italy’s overall fiscal balance remains deep in the red. Once interest costs are taken into account, Italy posted budget deficits throughout the entire period – and by no means modest ones. Over the past 26 years, Italy’s annual budget deficit averaged 3.8 per cent. The cost of

the interest accrued during these years amounted to almost EUR 1.9 trillion, compared with Italy’s most recent annual economic output of EUR 2.26 trillion. This example illustrates just how much legacy debt and the associated interest burdens can limit fiscal manoeuvre.

## – JAPAN –

### THE “PERPETUAL MOTION MACHINE” OF PUBLIC FINANCES

Japan remains the undisputed number one among sovereign debtors. By 2025, Japan’s national debt was 2.1 times its domestic economic output. This situation is not new: for the past 13 years, Japan’s public debt has consistently exceeded 200 per cent of GDP. Nevertheless, Japan’s finance ministers have been able to draw on ample resources for many years. Japan’s annual primary deficit (public deficit excluding interest costs) has averaged more than four per cent of GDP this millennium.

This was made possible thanks to the resolute support of the Bank of Japan (BoJ). Thanks to decades of ultra-low interest-rate policies and large-scale government bond purchases by the central bank, the sustainability of Japan’s public debt appeared to know virtually no limits. Most recently, the BoJ still held just under 40 per cent of Japan’s government debt on its books. But it is not only the Japanese government that excels at accumulating debt. Japan’s total debt stands at around 400 per cent of GDP. By global standards, this also puts it in a remarkable first place.

## – NORWAY –

### A CAREFREE DEBT BURDEN

With a government debt-to-GDP ratio of 45 per cent, Norway has a relatively low level of government debt by international standards. For example, the debt-to-GDP ratio of the eurozone countries is more than double that. However, the question arises as to why the Norwegian government borrows at all. After all, there is the Norwegian sovereign wealth fund, which manages the substantial revenues from the →



country's oil and gas reserves – and whose assets under management far exceed the value of the national debt.

At the end of March, the fund's assets amounted to around NOK 20 trillion (just under EUR 1.8 trillion, or more than EUR 300,000 per Norwegian citizen). That is more than eight times Norway's national debt. In effect, Norway is therefore debt-free. The fact that it nevertheless retains its national debt is likely due primarily to "market maintenance". Government bond issuance helps sustain a liquid market for Norwegian krone-denominated bonds.

**– PAKISTAN –  
TWO SIDES OF THE SAME COIN**

There are few countries where half the national budget is set aside for debt servicing. This is the case in Pakistan. For the 2025/2026 financial year, the government planned interest payments of 8.2 trillion Pakistani rupees, which amounted to 46.7 per cent of the total federal budget. Seen in this light, Pakistan's public debt burden appears overwhelmingly high.

However, having no debt appears to be just as unadvisable. Pakistan's households, whose debt amounts to a mere two per cent of GDP, can attest to this. On a per capita basis, this corresponds to less than USD 50 of debt per person. The reason for the low debt is quite simple: given their precarious economic situation, many people simply lack access to credit. More than 80 per cent of the country's workforce is employed in the informal sector. Life expectancy averages less than 70 years.

In the case of Pakistan, an over-indebted state and a population that, whilst having low levels of debt, also has a low standard of living, are two sides of the same coin.

**– SWITZERLAND –  
HIGH DEBT AS A MARK OF QUALITY**

Where can the world's most heavily indebted households be found? In places where house-

holds generate particularly high economic output and have a steady income. With a per capita economic output of more than USD 100,000, Swiss households rank among the absolute top tier in a global comparison. This means that the average Swiss person generates almost twice the economic output of the average German and 16 times that of the average Paraguayan.

However, per capita debt is even higher in the small Alpine nation. In 2024, this stood at just over USD 130,000 per person. By way of comparison: Germany had a per capita debt of just around USD 28,000, whilst in Paraguay it was not even USD 500. High levels of debt can therefore also be seen as a sign of quality – as they often reflect strong economic performance and sound institutional frameworks.

**– USA –  
THE DEBT MAGNET**

Since 1992, the United States has recorded nothing but current account deficits. On average, these amounted to three per cent of GDP. In absolute terms, the cumulative US current account deficit between 1992 and 2025 reached a staggering USD 17 trillion. One might therefore conclude that the USA is inevitably living beyond its means. After all, year after year, it imports more goods and services into the USA than it exports abroad.

This situation is made possible by the "dollar privilege" – the consistently strong global demand for the US dollar and US dollar-denominated assets. This becomes apparent when looking at US debt. At the end of last year, non-US citizens held US debt securities worth around USD 16 trillion, including USD 9.3 trillion in US government securities. Conversely, US citizens held just USD four trillion in foreign bonds. Put somewhat simplistically, the rest of the world is effectively financing America's generous consumption of foreign goods and services. ◆

# The Faces of the US Dollar

By Julian Marx

At the start of US President Donald Trump's second term, the US dollar initially went into a tailspin. Has the world's reserve currency passed its peak?

When looking for the fastest-growing industrialised nations, it is currently difficult to look beyond the world's largest economy – the USA. Robust consumer spending and rising investment, particularly in data centres, helped the US economy achieve real growth of around two per cent last year. According to estimates by the International Monetary Fund (IMF), US growth is set to be just over two per cent again this year. A notable achievement.

Elsewhere, economic growth is more modest, as a comparison of the G7 nations shows: the IMF forecasts average real growth of only 0.9 per cent this year for the remaining six (Germany, France, the UK, Italy, Japan and Canada) – and thus only about half as much as in the USA. Last year's growth pattern could therefore repeat itself. This makes it all the

more surprising at first glance that the US dollar lost notable value against the euro, the British pound and the Canadian dollar last year. The reasons for this dollar weakness were clearly more profound.

## A QUESTION OF TRUST

All the more so as the USA is regarded as the global financial hub. For many companies in the financial sector, the US dollar is the most important asset class, while for central banks worldwide, the "greenback" is the dominant reserve currency. The extent to which the global financial world looks to the USA is underlined by the volume of portfolio investments by non-US nationals in the United States: at the end of last year, these amounted to a good USD 38 trillion. A sum that exceeds the annual US gross domestic product (GDP) and that continued to grow last year. According to the US Treasury, non-US investors invested a net total of USD 1.55 trillion in new funds into long-term US securities in 2025.

Yet the US dollar's strong international role is not based solely on the sheer size of the country's economy or capital market. For many decades, the US dollar has also been perceived as a crisis-proof investment because the USA (at least until now) has offered a stable institutional and macro-economic environment that promised planning security. Yet under President Donald Trump, that sense of predictability has begun to erode – particularly since "Liberation Day" in

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April 2025, when Trump signalled the end of the free-trade era with a series of highly unconventional tariff threats on US imports, even if subsequent deals later mitigated some of the impact.

One example that further undermined the confidence of European investors in particular was Trump's threat in January 2026 to annex Greenland. In doing so, the US president initially even left open the possibility of the use of military force against allies. At the same time, he imposed tariffs on Denmark and European countries that support Greenland's long-standing protectorate status, simply to lend weight to this demand. These renewed tariff threats came just a few months after Trump had negotiated a trade deal with the European Union (EU). Even though the proposed "Greenland tariffs" were quickly withdrawn, this was hardly a recipe for building trust.

#### A GRADUAL SHIFT AWAY

While a certain loss of confidence in the US dollar is a more recent phenomenon from the perspective of Western allies, the USA's political opponents have harboured reservations about the world's reserve currency for many years. After all, since the start of the war in Ukraine, the risk of sanctions targeting US dollar-denominated assets is no longer a theoretical consideration, as the example of Russia demonstrates.

Against this backdrop, efforts to gradually reduce dependence on the US dollar are entirely understandable. Yet in practice, implementing "de-dollarisation" remains a challenging task for America's geopolitical rivals, as a look at global central bank reserves suggests. More than 90 per cent of all currency reserves – excluding gold for the time being – are still denominated in US dollars or the currencies of other Western industrialised nations. This includes, in particular, the euro (accounting for around 20 per cent of global currency reserves), the Japanese yen (around six per cent) and the British pound (just under five per cent). The Chinese renminbi, by contrast, accounts for only two per cent. If one also considers that the USA and its allied economies account for more than half of global economic output and dominate world trade, the hurdles to moving away from the US dollar are very high.

Nevertheless, "de-dollarisation" is progressing in small steps in some economies. This is indicated by the ongoing gold purchases by numerous central banks, for example in Brazil, China and Turkey. According to estimates by the World Gold Council, central banks purchased a total of just over 860 tonnes of gold in 2025. In terms of volume, this is slightly less than in the previous three years, during which more than 1,000 tonnes were purchased each year. However, if one adjusts the still enormous volumes of gold for the rise in the gold price, the gold rush by numerous central banks has actually accelerated.

As a result, the share of gold in total foreign exchange reserves has risen further – from just under 10 per cent in 2015 to around 28 per cent by the end of 2025. Conversely, the US dollar's share of global foreign exchange reserves has fallen from 58 per cent to just over 40 per cent.

#### THE DIFFICULT SEARCH FOR ALTERNATIVES

Pessimists could use this data as a basis to spin a narrative about the dollar's decline. But it is not quite that simple. For one thing, global US dollar reserves have been stagnating at just over USD seven trillion for many years – so in absolute terms, not much is happening. Furthermore, the relative decline in the importance of US dollar reserves is largely explained by the rise in the price of gold in recent years.

Conversely, gold – aside from currency reserves – is only of limited use as a substitute for the dollar or money. Although gold has strategic value as a store of value and thus fulfils an essential function of money, it cannot, for example, be readily used as a universal means of payment.

Accordingly, the dominance of the US dollar appears largely intact across many areas of global finance. A recent study by the Bank for International Settlements (BIS) found that the US dollar and the euro have further expanded their dominance in the field of international lending in this millennium. Among the 29 countries examined, an average of 60 per cent of all international debt securities were denominated in US dollars in 2000. By 2024, this share was just over 63 per cent; some emerging economies, such as Brazil and Turkey, recently even recorded a dollar share of more than 90 per cent.

At the same time, the euro managed to increase its average share from 12 to 21 per cent.

The fact that the relatively young market for stablecoins has so far been almost exclusively pegged to the US dollar can also be seen as a positive indicator of dollar dominance that has remained largely unchallenged to date. In the competition among fiat currencies, the US dollar thus (still) occupies an exceptional position.

#### TWO SIDES OF THE "GREENBACK"

All in all, the US dollar is showing two faces in the current environment. On the one hand, there is a currency whose use on the international financial markets has so far been regarded as largely without alternative. Against this backdrop, we believe caution is warranted when it comes to over-emphasising short-term exchange rate movements. There have been weak periods for the US dollar from time to time in the past as well.

Especially as the US dollar is currently trading at almost exactly the same level against the euro as it was at the time of the euro's introduction in 1999: back then, one euro was worth around USD 1.18 – a level around which the currency duo has also fluctuated in recent quarters. Unlike back then, however, the trade-weighted euro exchange rate – which measures the euro against a broad basket of currencies – is now almost 30 per cent stronger. Seen in this light, the euro's strength can also be directly attributed to the US dollar.

On the other hand, however, the picture that emerges is of a once extremely dominant reserve currency whose relative importance is under pressure. Numerous central banks are endeavouring to expand their gold reserves. Looking ahead, there are also further efforts towards emancipation. Several major currency areas have ambitions to take market share away from the US dollar.

#### IS THE USA UNDERMINING ITSELF?

For several years, China has been striving to expand its political and economic power through the "Belt and Road

Initiative" by making infrastructure investments in other parts of the world. In a politically divided world, attempts to "export" the renminbi are also likely to increase.

For its part, the European Central Bank is using the recent erosion of confidence in US politics to tout institutional stability in the eurozone and position the euro as an investment alternative to the US dollar. Furthermore, the development of the digital euro aims to reduce dependence on US payment service providers and thus achieve greater financial autonomy. From a US perspective, these ambitions within the euro area may also serve as a warning signal. If the United States – or President Trump in particular – pushes its recurring threats too far, even countries traditionally aligned with the US may eventually stop responding to American pressure tactics.

In that sense, the USA could ultimately become a victim of its own strategy: the more frequently Washington uses its dominant position as leverage, the weaker that leverage may become over time. Every threat could result in a further distancing from the USA and the US dollar as the primary reserve currency.

For now, the reserve-currency status of the US dollar does not appear to be under any immediate threat. However, a persistently confrontational Trump administration could at least accelerate processes of emancipation and thus also increase the likelihood of a scenario in which the status of the US dollar suffers. ♦

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, the focus is on the rise of non-regulated employment arrangements in her country

At first glance, it sounds both modern and liberating: so-called “gig workers” carry out short-term assignments, which are usually allocated via digital platforms. They are not tied to fixed working hours or contracts. They work when and how they like. Payment is made per assignment. This flexibility certainly suits companies very well in the age of artificial intelligence (AI), where work processes can be broken down into an increasing number of tasks and coordinated relatively easily.

As a result, 27 per cent of all employed people in China now work as gig workers. In the public sector, the figure is said to be as high as 43 per cent. Officially “gig work” is defined as tasks carried out without an employment contract, provided the individual works for more than one hour per week in return for payment.

This astonishingly high proportion was calculated by the Chinese media group Caixin. According to official data, there are approximately 740 million people in employment in China, 470 million of whom are urban workers. This compares with 200 million gig workers. Yet only a decade ago, this was a minority phenomenon in China.

## HOW DID GIG WORK BECOME MAINSTREAM SO QUICKLY?

One factor is likely to have been the persistent weakness of the economy. The average lifespan of a private company has fallen from 3.2 years in the 1990s to 2.5 years today. In the private sector, therefore, long-term employment contracts often make little economic sense.

Furthermore, companies surveyed by Caixin reported that they outsource 10 per cent of all jobs as gig positions, saving between 20 and 30 per cent in personnel costs through this measure alone. This is because employers must pay social security contributions for permanent staff, amounting to 35 per cent of gross salary, whereas no such costs are incurred for gig workers. Companies also face stricter employment law regulations if they wish to dismiss a permanent employee. Gig workers have no such protection.

Consequently, more than 52 per cent of the companies surveyed would like to increase the proportion of gig workers even further. Recruitment agencies stand to benefit from this; here, they are able to find 10 gig workers for a company within three hours and establish contact. The number of such agencies has tripled over the past 10 years.

## FREEDOM OR PRECARIOUS WORKING CONDITIONS

Many gig workers are young and well-educated. In most cases, they appear to choose gig work over traditional employment voluntarily, as it offers greater flexibility. If things do not work out, they can generally rely on support from their parents or extended family.

Gig workers over the age of 30, however, often have no other choice. For example, 77 per cent of ride-hailing drivers surveyed by the Caixin magazine stated that they became platform drivers after losing their jobs, with more than half of them providing the family's sole or main source of income. The problem is that the number of taxi drivers and ride-hailing drivers in passenger transport has risen by 159 per cent

between 2020 and 2024, whilst the number of bookings has grown by only 38 per cent. Consequently, individual drivers now have to work longer hours to earn a decent wage.

In the off-season, a third of all construction workers in our region work as freelancers; in the peak season, the figure rises to two-thirds. In some internet companies, too, there are currently more freelancers than permanent staff, whilst in other business areas, such as online customer service, the proportion of outsourced work is as high as 70 per cent.

According to a study by Zhipin, the largest online recruitment platform in China, 45 per cent of those working in services such as passenger transport or parcel delivery earn between 10,000 and 15,000 renminbi per month, placing them at the upper end of the segment. However, this is not the case everywhere.

Above all, gig workers are affected by fluctuating incomes and must arrange their own social insurance coverage. There is, however, no obligation to take out insurance. If they opt for statutory social insurance, they are subject to the same rates as permanent employees with a corresponding gross income. However, gig workers must also pay the employer's contribution of 35 per cent themselves. Many cannot afford this. The above study shows that, for example, only 10 per cent of the food delivery workers surveyed consider the current social insurance rate to be reasonable.

At the most recent National People's Congress, there were calls for platforms to take on greater responsibility in this area. Given that the entire gig workforce in China now accounts for almost 30 per cent of the total workforce, solutions are urgently needed. Our society cannot afford to see such a large proportion of the workforce leave our system due to high social insurance costs. ♦

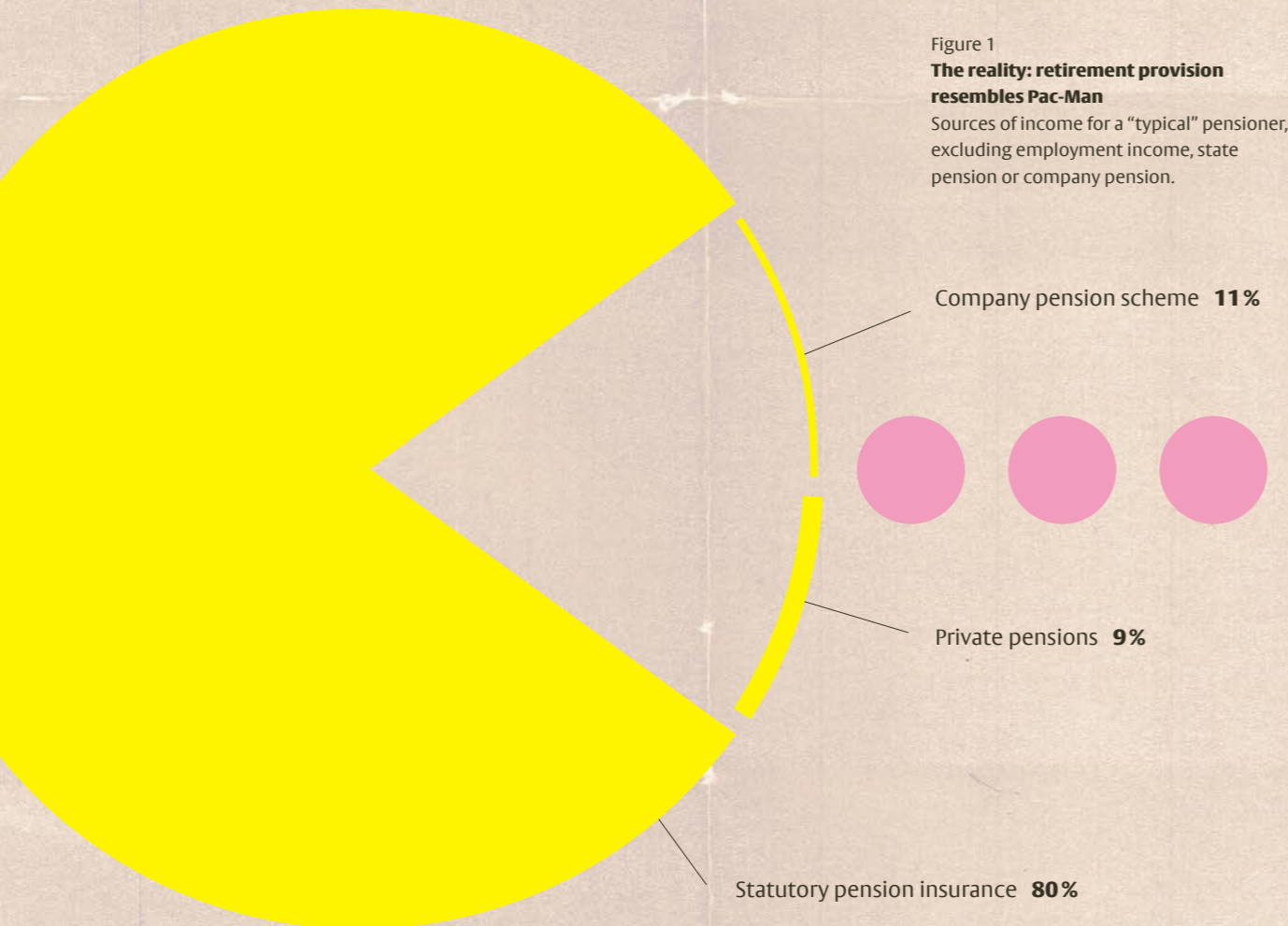
Shenwei Li is an Analyst in Shanghai.

T I T L E

# The Wrong Hero

By Sven Ebert

What does the German pension system have in common with the Japanese video game character Pac-Man? Unfortunately, more than many people probably realise ...



An average German pensioner who spent their working life as an employee currently derives 80 per cent of their income from the state pension. Company and private pensions play only a minor role, accounting for roughly 10 per cent each. If you added an eye to the resulting pie chart, it would resemble Pac-Man, the cute star of the eponymous 1980s video game (see Figure 1). However, setting aside nostalgic childhood memories, this concentration of risk in pension provision should give us cause for concern. When it comes to pension provision, Pac-Man is the wrong hero.

This is because demographic change – the increasing ageing of the population – will make it even more difficult to finance the state pension in the coming decades. The number of pensioners is rising, while the number of contributors is falling (see also: "System Error", page 36).

Without fundamental reforms, the burden of taxes and social security contributions on gross wages would rise from 43 per cent to 60 per cent. This could only be offset by productivity gains of one per cent per year. However, such increases have not been observed anywhere near this level since the 1990s.

## THE BETTER WAY ...

We therefore find ourselves at a crossroads. Public spending on pensions in Germany currently amounts to 10.8 per cent of gross domestic product (GDP), which is already well above the OECD average of 8.1 per cent. Without a reform of the pension system, we will follow in the footsteps of countries such as France or Italy, where more than 15 per cent of GDP is spent on providing

Without fundamental reforms, the burden of taxes and social security contributions on gross wages would rise from 43 per cent to 60 per cent.



for pensioners. This is another reason why these countries have high levels of public debt.

Strengthening funded pension provision would be the better way forward. Countries, such as the Netherlands and Sweden, demonstrate that reliable pension provision is possible even with lower public expenditure, provided that a statutory basic pension is combined with company or private provision. Our aim should therefore be a system in which the three pillars – state, company and private provision – contribute equally to maintaining living standards in old age.

To achieve this, expenditure on the statutory pension must first be curbed. Under current legislation, this is set to rise to around EUR 600 billion by 2035. That would represent a total increase of around 50 per cent over 10 years, or just over four per cent per year. However, partly due to high tax and social security burdens, annual economic growth currently stands at less than one per cent.

In the long term, however, individual pensioners do not benefit from these increases in expenditure, because the higher burden on the working population must be spread across an ever-growing number of pensioners. Consequently, despite political declarations to the contrary, the pension level under the current system will soon (have to) fall again, thereby continuing a trend in the state pension system that has prevailed since the mid-1980s.

**THE NETHERLANDS AS A MODEL**

Greater honesty would be preferable: the German state is economically strong enough to guarantee every pensioner a basic level of security in old age. However, it is becoming increasingly difficult to

safeguard the individual standard of living of every single citizen. There is no need to fear a shift towards a system based on statutory basic provision, as such models have already been implemented successfully abroad. In the Netherlands, for example, there is only a state-funded basic pension that is not linked to income. Nevertheless, old-age poverty is significantly lower than in Germany, not least because the privately organised company pillar is much more developed.

Company pension provision should therefore reach a larger share of the population in Germany as well. In the Netherlands, collective agreements ensure broad participation among the working population. Sector-wide pension funds invest capital professionally, with a substantial allocation to equities.

In Germany's highly fragmented company pension landscape, only one in two employees has such a supplementary pension scheme. In total, there are over 10 different ways in which a company can organise retirement provision for its employees. Some schemes require guaranteed contributions, which reduces returns. Others provide for a lifelong monthly pension as the sole payout option in retirement, which limits flexibility.

This fragmentation should be addressed by making it easier to switch between different models. At the same time, existing schemes that combine higher equity allocations with more flexible use of savings in retirement should be strengthened.

**INVESTING IN EQUITIES**

At the same time, funded private pension provision should be expanded. The pension savings account planned by the German government is an

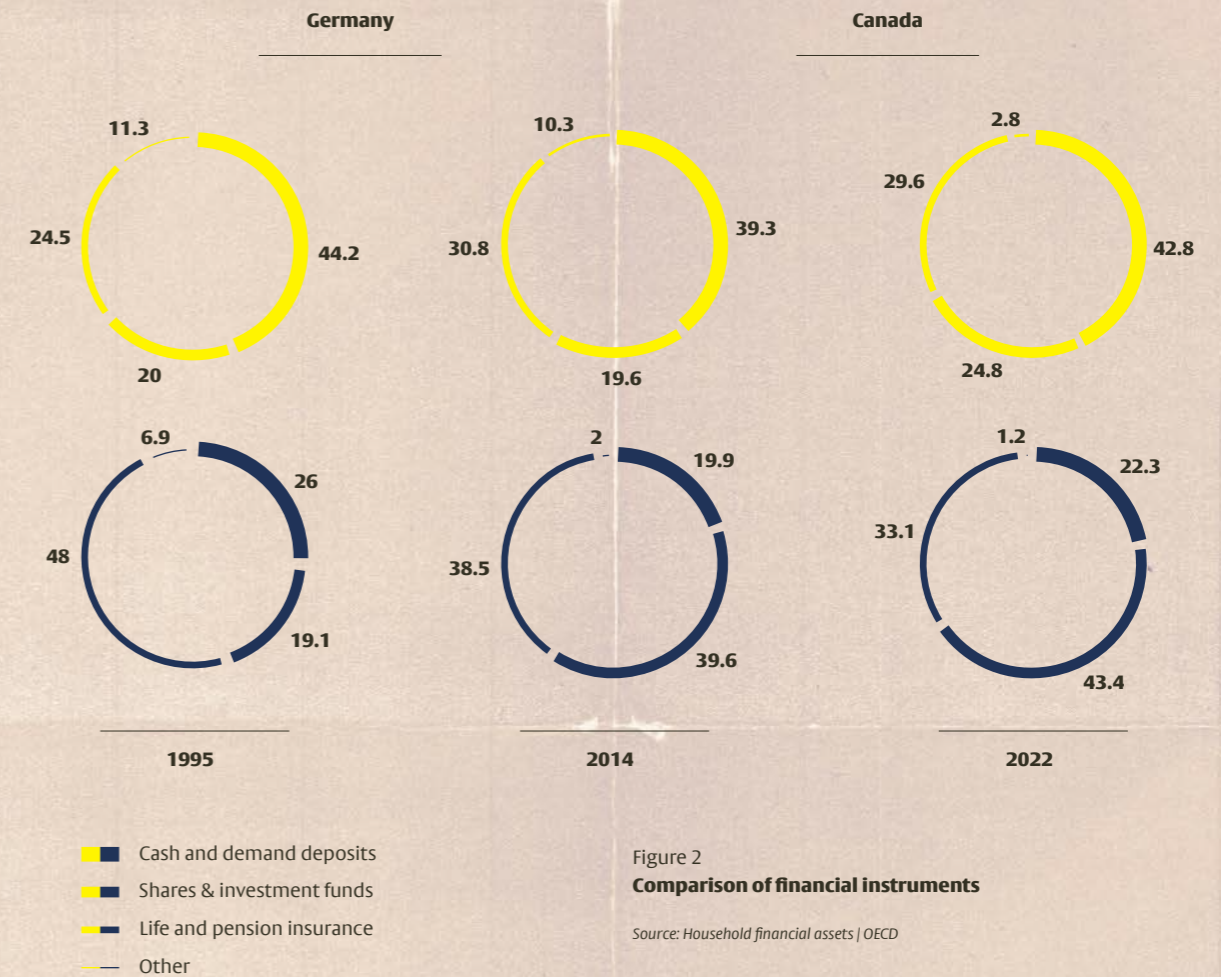


Figure 2 Comparison of financial instruments

Source: Household financial assets | OECD

important step in this direction. Its predecessor, the Riester pension, already appeared to mark a shift towards greater private provision as early as 20 years ago. However, the mandatory contribution guarantee led to negative real returns during the low-interest-rate period of the 2010s, resulting in a loss of confidence in the scheme. Under the new pension savings account, a contribution guarantee is no longer required. This makes long-term equity investing with more robust returns possible. Government grants and tax savings provide an incentive for private wealth

accumulation. Greater freedom in the use of capital during retirement makes the product even more attractive: converting savings into a lifelong annuity is possible, but no longer mandatory. Up to 30 per cent of the savings can be withdrawn at the start of retirement if desired, while the remainder can be paid out in monthly instalments up to the age of 85.

Savers should make use of this newly gained investment freedom and allocate a greater share of their assets to equities. To ensure that



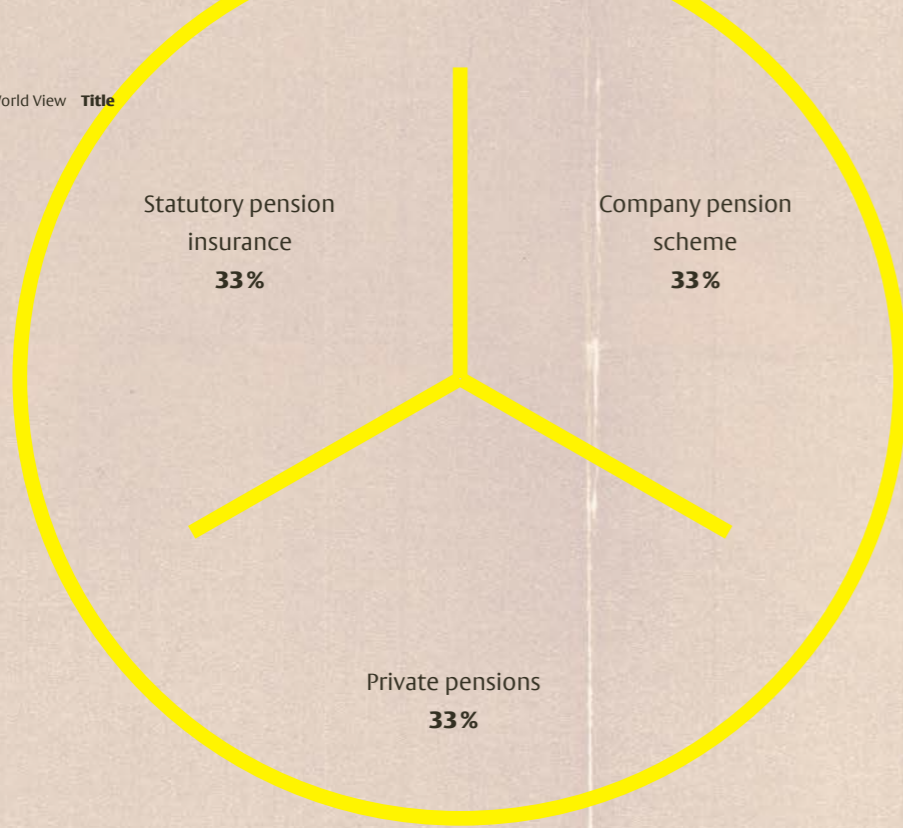


Figure 3  
**The ideal:  
 old-age provision  
 shaped like the  
 “Mercedes star”**

Source: 2024 Social Insurance  
 Report of the Federal Ministry of  
 Labour and Social Affairs.

individuals can make informed decisions, financial literacy within society must be strengthened. The result will be directly visible in personal pension accounts. This creates a strong foundation for a new investment culture in which equities, rather than inflation-prone savings accounts, play the central role. A comparison with Canada highlights the potential for catching up (see Figure 2).

#### **THE “MERCEDES STAR” AS A ROLE MODEL**

As implementation will take time, we should begin the conceptual overhaul – moving away from Pac-Man towards the “Mercedes star” (see Figure 3) with its three equally weighted pillars of retirement provision – sooner rather than later. In doing so, three fundamental principles should be observed.

Firstly, the state pension can in future serve only as a basic provision in old age. No more, but also

no less. This may also mean that people on higher incomes receive only moderately higher state pensions in return for their contributions.

Secondly, company pension schemes must become more widespread. More than in the past, it should introduce broad segments of the population to equity-based retirement saving via the workplace. With the statutory pension providing a basic safety net, mandatory contribution guarantees are no longer essential.

Thirdly, private pension provision must be strengthened, a process which will be facilitated by the planned, state-subsidised pension savings account. To ensure that more money is left over at the end of the month for private saving, growth-friendly reforms are needed at the same time, which will lead to higher wages through productivity gains.

## Historical Milestones in the Pension System

By Sven Ebert

Once a global role model, Germany’s pension system has become a system in need of reform. How this came about and what other countries have done better.

– 1.1 –

#### **THE BISMARCK PENSION SYSTEM (1891 – 1957)**

In 1889, Otto von Bismarck introduced statutory pension insurance in Germany. The plan was to use a capital fund to protect Germans from poverty in old age. A lack of start-up capital and a contribution of 1.7 per cent of wages – split equally between employees and employers – meant that only minimal cover was possible. Many people did not live long enough to reach the retirement age of 70.

Subsequently, wars, inflation and currency reforms hampered the growth of the capital stock. Until the mid-1950s, the statutory pension in the Federal Republic of Germany remained a basic form of social security, financed one-third from

the state budget and two-thirds from contributions. The retirement age had meanwhile been reduced to 65.

#### **The Bismarck pension system at a glance**

Compulsory insurance, income-based, funded system  
**Employee contribution:** 0.85%  
**Employer contribution:** 0.85%  
**State subsidy:** 50 marks per year per contributor  
**Net replacement rate:** 20–25% of income  
**Retirement age:** 70 years (from 1916: 65 years)  
**Life expectancy at introduction:** men 41 years; women 44 years

– 1.2 –

**THE BISMARCK PENSION AS ROLE MODEL**

Although Bismarck's social insurance model offered only rudimentary cover, it served as a blueprint for other countries. In the Austro-Hungarian Empire, old-age provision for civil servants was introduced early on. The Workers' Accident Insurance Act and the Workers' Health Insurance Act were also adopted by Bismarck at an early stage. In 1906, a Pension Insurance Act followed for white-collar workers, who were regarded as privileged compared to blue-collar workers. In 1927, a corresponding law for blue-collar workers was passed, but it never came into force.

In the Netherlands, too, most older people had to rely on private or church support. While protection in the event of disability was regulated in 1913, statutory pension insurance was not introduced until after the Second World War.

In the USA, the Social Security Act was enacted in 1935, which, in addition to disability and health insurance, also included a (rudimentary) pension scheme. In 1908, the UK introduced the Old Age Pensions Act, a tax-funded pension scheme designed to guarantee a minimum standard of living in old age. France created a pension insurance scheme for workers and farmers in 1910, but participation ceased to be compulsory from 1912 onwards, limiting its effectiveness. Italy adopted the Bismarck model in 1919.

Conclusion: Since the introduction of the Bismarck pension system in 1891, Germany has provided at least a basic level of protection against old-age poverty. The system insured individuals, at a fundamental level, against the financial risks associated with a long life. Many other countries subsequently followed Germany's example.

– 2.1 –

**THE LAUNCH OF THE MODERN STATUTORY PENSION IN 1957**

In 1957, Germany abandoned the aim of building up a capital reserve for pensions. Chancellor Konrad Adenauer introduced the statutory pay-as-you-go system – the intergenerational contract that still underpins the German pension system today. Initially, the pension level amounted to around 60 per cent of average gross income, while the contribution rate was 14 per cent of gross income. Since then, individual pensions have depended on the number of years of contributions, the level of salary and general wage trends.

**Statutory pensions in 1957 at a glance****Employee contribution:**

7% of gross pay

**Employer contribution:**

7% of gross pay

**Contribution ceiling:** DM 9,000 with an average income of DM 5,043**State contribution:** 27% of total pension insurance expenditure or DM 1.3 billion**Replacement rate:** 60% of average gross wages**Retirement age:** 65 years**Life expectancy:** men: 67 years;  
women: 72 years

– 2.2 –

**FIRST ALTERNATIVE:  
BASIC PROVISION  
BASED ON  
THE BEVERIDGE MODEL**

In the UK, too, the social security system had come under pressure as a result of two world wars. In 1940, British economist and politician William Beveridge was commissioned to draw up proposals for reform. A tax-funded basic pension was intended to guarantee a minimum standard of living for everyone in old age.

The Netherlands adopted a similar approach: after the Second World War, the Dutch Social Democratic Minister for Social Affairs introduced an emergency old-age pension act. This introduced a contribution-based system with a low contribution ceiling, offering flat-rate benefits to every citizen. In 1956, the emergency act was incorporated into the General Old-Age Pensions Act, which remains the basis for the Dutch pension system to this day.

For those who have lived in the Netherlands for 50 years, the gross monthly pension in 2025 was around EUR 1,600. This is slightly below the German gross basic pension of around EUR 1,800 – the pension received by an average earner in Germany after 45 years of contributions. For couples living together in a household, the figure in the Netherlands is just under EUR 1,100 per person. The contribution rate is 18 per cent of taxable income, close to Germany's current rate of 18.6 per cent. However, the contribution assessment ceiling, up to which contributions must be deducted from income, was around EUR 38,000 in 2025 – more than half less than that of Germany's EUR 96,600.

Conclusion: After the Second World War, Germany opted for an income-based pension system designed to maintain living standards. Other countries were already relying on basic old-age provision at that time.

– 3.1 –

**1972 PENSION REFORM  
IN GERMANY**

As in most industrialised countries, the birth rate in Germany dropped by around 40 per cent between 1965 and 1970. This is often attributed to the introduction of the oral contraceptive pill ("Pillenknick"), although there are likely to have been other reasons as well. Either way, pay-as-you-go pension systems quickly reach their limits when an increasing number of pensioners are supported by a decreasing number of contributors, especially as life expectancy continues to rise.

However, in the early 1970s, the pressure on pension expenditure was still low due to the high birth rates of the past: the federal subsidy for pensions had fallen from 27 per cent of pension insurance expenditure in 1957 to 15 per cent in 1970. Thus, as part of the 1972 pension reform, Germany introduced the option of early retirement, thereby increasing pension fund expenditure, rather than responding to foreseeable future problems.

### After the 1972 pension reform

**State pension:** compulsory insurance, income-related, pay-as-you-go system, adjusted to wage levels

**Employee contribution:**

8.5% of gross pay

**Employer contribution:**

8.5% of gross pay

**Contribution ceiling:** DM 25,200 per annum, average income DM 16,335

**State contribution:** 15% of pension expenditure or DM 6.5 to 6.8 billion

**Net replacement rate:** 64%.

**Retirement age:** 65 years, early retirement from 63 years of age with 35 years of contributions; from 60 years of age for women and the unemployed

**Life expectancy:** : men: 67 years; women: 73 years

– 3.2 –

#### ALTERNATIVE

#### STRENGTHENING OF COMPANY PENSIONS IN THE USA

In the wake of the Great Depression, the USA had introduced a state pension scheme in 1935 with the Social Security Act. A disability pension was added in 1956. However, the net replacement rate of the state pension was a meagre 29 per cent until 1970. Poverty in old age was particularly striking during the 1970s, a period marked by high inflation. In 1974, the Employee Retirement Income Security Act (ERISA) was passed to better regulate private pension schemes. Yet the product that is now the most important for Americans' retirement provision came about almost by chance.

In 1978, the US Congress decided to amend the tax codes. Tax consultant Ted Benna carefully reviewed the legislation and discovered that Section 401(k) appeared to allow companies to offer tax-advantaged retirement savings plans for employees. Contributions up to a certain limit could be deferred from taxation until retirement, enabling significantly more capital to compound over time. By 1990, savings had already reached USD 384 billion. In 1996, the first trillion was surpassed. Today, the figure stands at around USD 10 trillion.

American savers today have, on average, invested seven out of every 10 dollars in their 401(k) plans in shares. Among those under the age of 40, the figure is even more than 90 per cent. Fees for company pension schemes average less than one per cent per year. If an employee changes employer, the savings can be transferred without any problems. Simple regulation fosters competition, which in turn leads to a wide range of products and low costs. Tax-advantaged contributions to company pension schemes in the USA amount to many times the level of company pension schemes in Germany.

Conclusion: Germany lulled itself into a false sense of security with its pay-as-you-go system. In the USA, a strong second pillar has been established through funded company pension schemes.

### USA: pension provision

**Employer contribution to the state pension system:** 6.2%

**Employee contribution to the state pension system:** 6.2%

**Contribution assessment ceiling:** USD 137,700

**Average pension in 2022:** USD 1,400

**Average savings of a 75-year-old thanks to 401(k) plans (according to Federal Reserve data):** USD 462,610, 80% of pensioners also own their own property

– 4.1 –

#### FROM 1990: INCREASED PRESSURE FOR REFORM BUT NO LASTING OVERHAUL OF THE SYSTEM IN GERMANY

In Germany, the reunification of 1990 – which saw 3.6 million people brought into the pension system – exacerbated the imbalance in the intergenerational contract, particularly as the generous early retirement schemes continued to have an impact. While the average retirement age for men claiming old-age pensions had still been above 65 in 1970, it had fallen to below 63 by 1990. Since the “Pillenknick”, birth rates had remained at around 1.5 children per woman and life expectancy had risen. Fewer and fewer young people had to, and still have to, provide for an ever-increasing number of older people.

As part of the 1992 pension reform and Agenda 2010, there were brief periods of austerity in which pension reductions for early retirement were introduced and the options for early retirement were curbed. The pension replacement rate fell from 55 per cent in 1990 to around 48 per cent

by 2014. In 2007, it was decided to gradually raise the retirement age to 67 by 2031.

In 2014, politicians returned to the principle of expanding benefits with the introduction of the “Pension at 63” and the “Mothers’ Pension” measures. Between 2015 and 2025, pension expenditure increased on average by around 3.5 per cent per year, while federal subsidies rose by approximately 3.7 per cent annually. Since 2019, the pension level must not fall below 48 per cent.

### State pension from 1992

Compulsory insurance, income-based, pay-as-you-go system, adjusted to wage levels

**Employee contribution:**

8.85% of gross pay

**Employer contribution:** 8.85% of gross pay

**Assessment ceiling:** DM 81,600 with an average wage of DM 46,820

**Federal subsidy:** 24% of pension insurance expenditure or DM 58 billion

**Net replacement rate:** 54–55%

**Retirement age:** 65 years for both men and women

**Life expectancy:** men: 72 years; women: 79 years

– 4.2 –

### CRISIS AND SUSTAINABLE PENSION REFORM IN SWEDEN DURING THE 1990S

In the 1950s, the statutory pension in Sweden amounted to only around 30 per cent of the average wage. However, employees and public sector workers were additionally covered by a company pension scheme. Consequently, the trade unions called for a statutory supplementary pension scheme for all workers. When Sweden found itself in a severe economic crisis in the early 1990s, the opportunity was seized to implement far-reaching reforms.

Today, Sweden's pension system combines a universal basic pension designed to prevent old-age poverty with an earnings-related component that is partly capital-funded. There is no fixed retirement age. Instead, the retirement age is used as the basis for determining the individual pension amount. A longer working life leads to a higher pension. Thus, the retirement age has risen from 62 in 1994 to around 64.5 years in 2024. All 65-year-olds in Sweden receive a median statutory gross pension of 51 per cent of the average income, adjusted for inflation, from the last five years prior to retirement.

Company pension schemes are virtually mandatory for every employee in Sweden under collective agreements. This results in a coverage rate of 90 per cent of all employees. Shares are an integral part of these portfolios. This company pension provision increases the pension level by 28 percentage points to 79 per cent.

Conclusion: Germany and Sweden were both forced to implement pension reforms in the early 1990s. Germany, however, partially reversed

reforms once economic conditions appeared to stabilise. In Sweden, the reforms were maintained

– 5 –

### THE STATUS QUO IN GERMANY

In Germany, there have been repeated attempts to establish a genuine three-pillar model, in which the state pension is just one of three pillars. This remains to be achieved. Today, the average pensioner derives 80 per cent of income from the state pension. Funded company and private pension schemes each account for only around 10 per cent of retirement income.

Politicians seem to have recognised the need for action. A pension commission has been established to examine both the future of the statutory pension system and the overall retirement income level of current and future pensioners. The aim is to encourage wider uptake of company pension schemes amongst the workforce. And the new retirement savings account is an attempt to make private pension provision attractive to everyone through tax incentives.

Germany is no longer regarded a “technology leader” in pension provision. At least this has the advantage that we do not have to reinvent the wheel. We can now find numerous examples of successful reforms abroad.

Conclusion: Pension provision in Germany currently relies largely on the state pension insurance scheme. Increasingly, however, the system is struggling to maintain the living standards of its contributors. Other countries have better prepared their pension systems for demographic change and introduced funded elements across the board.

### State pension 2026

**Employer contribution:**

9.3% of gross pay

**Employee contribution:**

9.3% of gross pay

**Contribution ceiling:** EUR 101,400 with an average salary of EUR 51,944

**State contribution:** 27% of pension insurance expenditure or EUR 127 billion

**Net replacement rate:** 48%

**Retirement age:** (until 2031) 67 years for men and women

**Life expectancy:** men: 79 years;  
women: 84 years

In Germany, there have been repeated attempts to establish a genuine three-pillar model, in which the state pension is just one of three pillars. This remains to be achieved.

Dr Sven Ebert is a Senior Research Analyst at the Flossbach von Storch Research Institute.

# System Error

By Philipp Vorndran

Germans are living longer, while too few young people are entering the workforce. This poses a challenge for a pay-as-you-go pension system

For most pensioners in Germany today, enjoying retirement without financial worries remains a reality. That is precisely what the so-called inter-generational contract envisaged – a contract that was never formally ratified yet has become an integral part of Germany’s post-war social model. In 1957, the previously funded pension system was replaced by a pay-as-you-go system. Since then, the working population – the young – have been paying into the statutory pension system to finance the pensions of the elderly – and hoping that their children will do the same for them later on. An agreement between the generations that was meant to last forever. Similar pension systems exist in other euro area countries, such as Spain. The problem is that societies change. Far fewer

children are being born today than in the 1950s, while people are living significantly longer. As a result, industrialised countries now have a much larger proportion of older people and fewer younger people than in the past – meaning more pension recipients and fewer contributors.

The so-called old-age dependency ratio measures the balance between these two groups and, by extension, the resilience of a pay-as-you-go pension system. According to data from the Organisation for Economic Co-operation and Development (OECD), the ratio was 16 in 1950, meaning there were 16 people of retirement age for every 100 people of working age. Today, the ratio has already risen to 37 – more than double the level recorded

in 1950. The projections for 2060 are even more dramatic: Germany is expected to reach an old-age ratio of around 60, while Spain could be as high as just under 80.

There can therefore be no question of robustness when it comes to the pay-as-you-go system. Even the otherwise rather cautious representatives of the Deutsche Bundesbank have been warning for years of the worsening problems facing the state pension scheme. Without substantial adjustments, for example to the age of retirement, the pay-as-you-go system will reach its limits sooner rather than later.

## PENSIONS ARE SECURE ...

The extent of the pressure already being felt today is demonstrated by the subsidies from federal funds that flow into the state pension system year after year – and increasing every year. For 2026, EUR 127.8 billion is estimated to be transferred from tax revenues (see Graph)! This corresponds to a quarter of the federal budget. The real stress test is likely to come in the next few years, when the baby boomer generation – those born between 1955 and 1969 in Germany – reach retirement age. Without fundamental pension reform, the system faces eventual collapse.

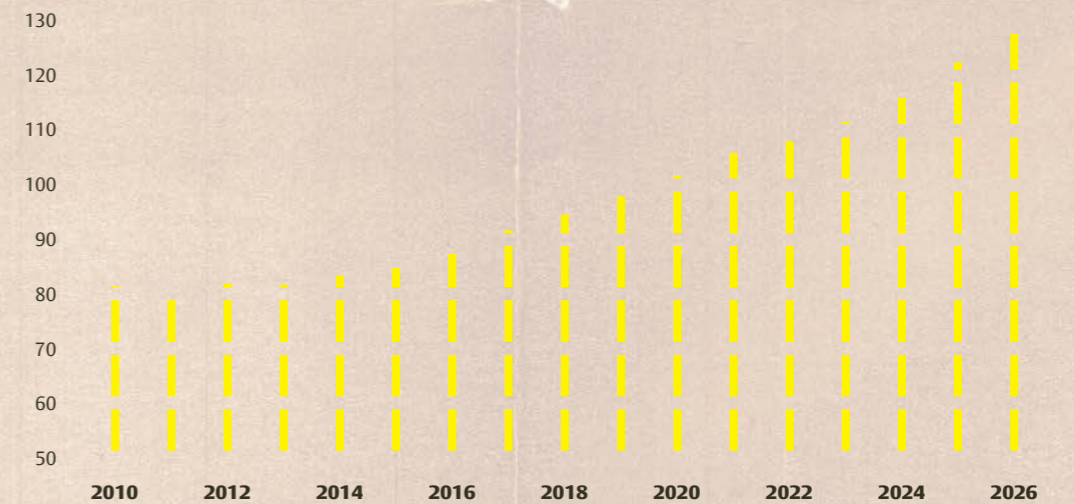


Figure  
**The burden is growing ...**  
 ... and so too is the strain on the German federal budget (federal funding for the pension insurance system in EUR billions\*).

\* Estimates for 2025 and 2026.

Source: Federal Finance Ministry, German Pension Insurance, Flossbach von Storch, data as at 31 March 2026

The issue itself is not new, nor is the scepticism among contributors. As early as 1986, Norbert Blüm, then Federal Minister for Labour and Social Affairs, felt compelled during the election campaign to make a high-profile statement assuring the public that pensions were secure. Since then, successive governments have introduced a range of reforms – or rather, minor adjustments. In 1992 and again in 2006, for example, the retirement age was raised and the pension level reduced. Policymakers tinkered with the system: a small change here, another there. Yet such measures do little to address the underlying structural weakness inherent in a pay-as-you-go system. Demographic change may progress slowly, but it does so relentlessly.

At the same time, the pension system has increasingly become a political instrument. Depending on the composition of the government, generous benefits have been granted over the decades to various voter groups without corresponding contribution increases. The so-called “mothers’ pension” is one example, though by no means the only one. As if demographic change were not already enough of a burden on the system, the pension pot has been tapped time and again. In the end, it is younger generations who are left to bear the cost of these well-intentioned promises to electoral constituencies.

### ... OR PERHAPS NOT?

The Bundesbank estimates that, without fundamental reform, the contribution rate is likely to rise from the current 18.6 per cent to a staggering 31 per cent by the year 2070. These are not encouraging prospects for today’s (and tomorrow’s) contributors. Unlike their parents, only very few of them are likely to retire before the age of 69. The river cruise will therefore have to wait. More likely, it will not happen at all – because there will be neither enough time nor enough money.

Today, no one truly believes that the pension is secure, as campaigner Norbert Blüm – who has sadly since passed away – once famously promised. From what we knew of him, he would certainly no longer endorse slogans of that kind but would instead campaign vigorously for the interests of future generations.

Now more than ever, we need an honest and equally frank debate about the viability of the statutory pension scheme – and about what needs to be done. It is certainly worth taking a look at our European neighbours – the Swiss or the Dutch, for example. They have adopted a far more effective approach.

One thing, however, is certain: no society can sustain millions of people living in old-age poverty over the long term.

Philipp Vorndran  
is a Partner at Flossbach von Storch

# The Price of Prosperity

By Philipp Immenkötter

Asset prices have risen rapidly in recent years, much faster than consumer prices. For many households, this has become a growing problem

Whether at the supermarket checkout or the petrol station, one issue has dominated public attention in recent years: rising prices. After the COVID-19 pandemic, the prices of many food products, building materials and services increased significantly. Then came the wars in Ukraine and Iran, with corresponding repercussions for motorists. When consumer prices rise, inflation is felt directly in everyday life with every purchase. What receives far less attention is that another, less visible form of inflation has been spreading in the background – one whose consequences for many people may ultimately prove far more significant.

All too often, asset price inflation only reveals its full impact when major life decisions are being made. When buying a property, investing an inheritance or planning for financial security in retirement, it becomes clear that prices are rising here too – and significantly faster than for consumer goods. This is illustrated, for example, by the Flossbach von Storch Asset Price Index for Germany, which is calculated on the basis of the weighted price development of real and financial assets owned by private German households.



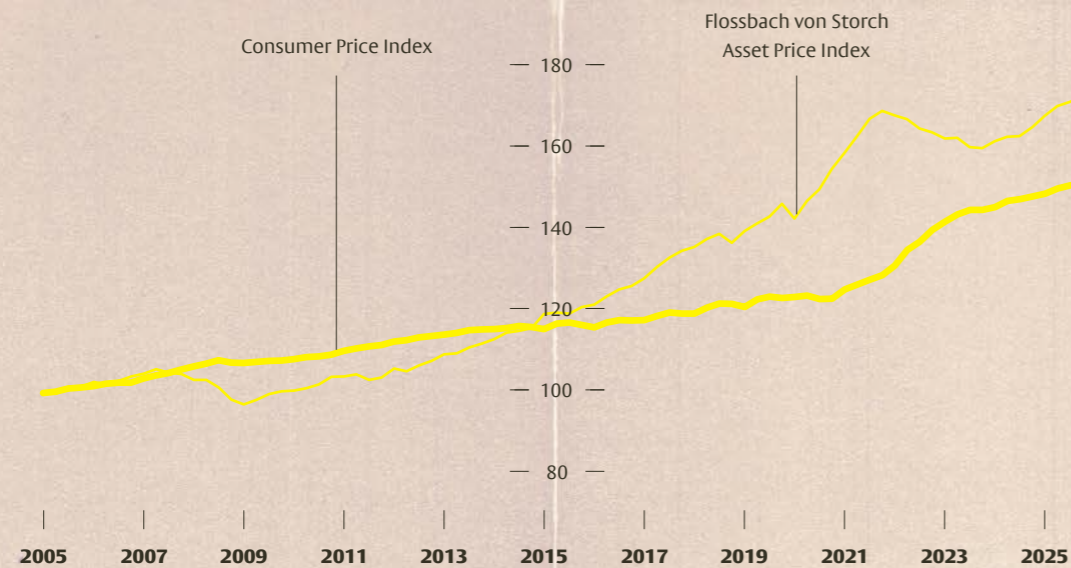


Figure 1  
Asset prices and consumer prices

Source: Calculations by Flossbach von Storch based on data from Art Market Research, BIS, Bloomberg, BVI, Chrono24 ChronoPulse, Deutsche Bundesbank, destatis, GDV, HAGI, IMF, Liv-ex, LSEG, vdpResearch GmbH and destatis, data as at March 2026

The increase has been substantial. At the end of 2025, asset price inflation in Germany was 4.5 per cent compared with the end of the previous year and was thus twice as high as consumer price inflation, which was 2.2 per cent over this period. Building wealth and providing for retirement have therefore become significantly more expensive. In the long term, the difference becomes even more pronounced. Over the past 20 years, asset prices have soared 70 per cent, whilst consumer prices have climbed 50 per cent (see Figure 1). By way of comparison, real wages grew only 15 per cent over the same period.

This is a trend that could lead to social tensions if the gap between wealthy households and those with lower incomes in Germany widens. It is be-

coming increasingly difficult for households with lower incomes to catch up. This is particularly evident in the property market. The renewed rise in prices is making the dream of home ownership a distant prospect for many middle-class households.

What drives the trend in asset prices in Germany?

Three factors play a decisive role in shaping asset prices: economic growth, government spending and monetary policy. Their effects are transmitted primarily, though not exclusively, through interest rates. Lower interest rates increase the value of assets by raising the present value of future income streams, while higher interest rates tend to depress asset prices.

- The primary factor influencing the trend in asset prices is economic growth. A growing economy enables households to increase their demand for goods and financial assets thanks to rising real incomes. Recessions and falling incomes, conversely, limit households' ability to invest in assets, or even force them to liquidate parts of their assets. Whilst economic growth in Germany provided a boost to asset prices up until 2018, growth has since been low, meaning that asset prices are currently receiving little support through this channel.
- A second factor driving asset price inflation is government spending, which can affect asset prices through two channels. Firstly, government spending can lead to falling asset prices via the interest rate channel, as debt-financed government spending can raise interest rates. Secondly, rising government spending can have a positive impact on corporate profits. If companies benefit from economic stimulus programmes, prices for business assets and company shares rise, depending on how the funds are spent. Plans to increase government debt in spring 2025, for example, led to rising prices for shares in defence companies. However, this effect was overshadowed across the market by the fact that the plans for new borrowing caused a rise in interest rates, which put downward pressure on share prices and business assets.
- The third and arguably most important explanation for the development of asset prices in Germany lies in the monetary policy of the European Central Bank (ECB). The expansion of money supply and interest-rate cuts by the central bank create a breeding ground for inflation. Money newly created through lending

or bond purchases initially flows into property and bond markets, causing prices there to rise. Only later does the newly created money reach the wider public, causing consumer prices to rise (the so-called Cantillon effect). Similarly, as government debt rises, pressure on the ECB to buy government bonds and thus lower interest rates again may increase, so that the effect of monetary policy on asset prices overshadows the effect of government spending. Between June 2024 and June 2025, the ECB gradually lowered key interest rates again in response to falling consumer price inflation. The falling interest rates led to rising prices for tangible and financial assets, particularly in the property market.

The question remains as to how Germans have their assets invested. A 76.6 per cent part of their wealth is held in real assets. The largest share is in real estate (64.4 per cent of total assets), which, according to price indices compiled by vdpResearch – a leading real-estate market research institute that provides data-driven insights and valuation tools for Germany's property and credit markets – had risen by 3.6 per cent year-on-year by the end of the fourth quarter of 2025. Demand for property depends to a significant extent on the level of mortgage interest rates, as the majority of all property transactions are carried out with the help of loans. After mortgage interest rates rose sharply in 2022, they have essentially moved sideways since 2023. The stabilisation of mortgage interest rates has bolstered demand for property.

On the supply side of the property market, the situation continues to be dominated by a limited supply of properties in Germany's metropolitan regions, coupled with high construction costs and

low levels of new-build activity. These conditions have led to a further rise in residential property prices in Germany. Multi-family homes, in particular, are a focus for investors and have risen in price by more than 5.3 per cent compared with the end of the previous year.

**EQUITIES SERVE THEIR PURPOSE**

Financial assets account for an average of 23.8 per cent of German household wealth. The average private household is invested primarily in savings and demand deposits (10.6 per cent), equities (6.4 per cent) and bonds (5.8 per cent). Savings and demand deposits are not subject to price fluctuations. The low proportion of shares was less advantageous last year: whilst the value

of private households' shares was 10.6 per cent higher at the end of 2025, the value of savings deposits (a large proportion of which is held in current accounts) remained largely unchanged, whereas bond assets (fixed-income securities) lost 1.2 per cent of their value compared with the end of the previous year.

Social differences are evident in the composition of assets. Lower-middle-class households recorded a 1.3 per cent increase in value, as their assets were predominantly invested in savings and demand deposits or durable consumer goods. Wealthy households, by contrast, benefited from their extensive real estate and business assets, causing the value of their assets to rise by 5.9 per cent over the period under review.

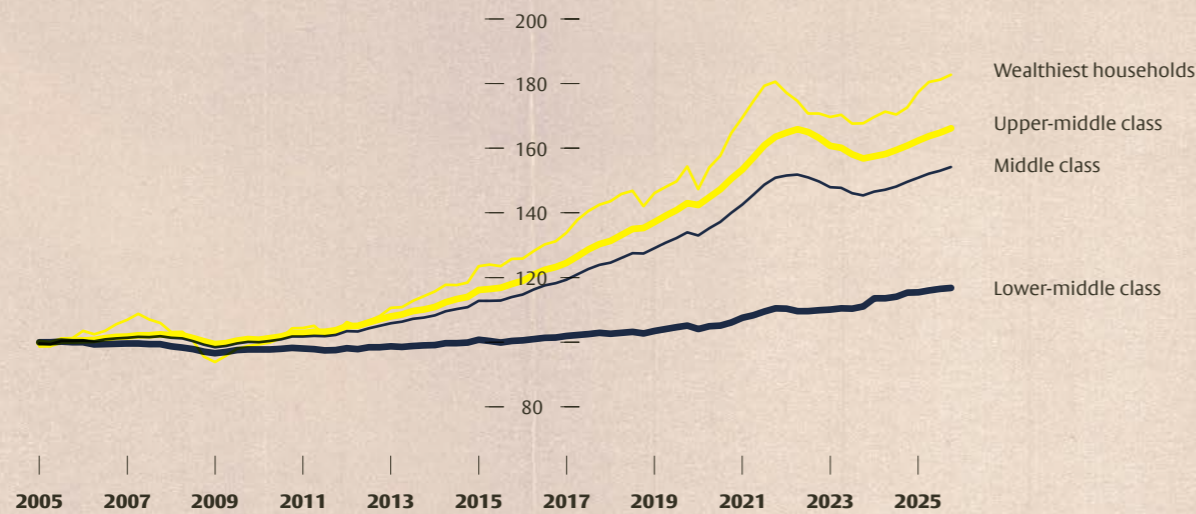


Figure 2  
**Asset price inflation across different wealth brackets**  
Note: Household categories by net wealth quantiles. The wealth quantile of the poorest households was not included in the analysis, as they own very few assets.

Source: Calculations by Flossbach von Storch using data from Art Market Research, BIS, Bloomberg, BVI, Chrono24 ChronoPulse, Deutsche Bundesbank, destatis, GDV, HAGI, IMF, Liv-ex, LSEG and vdpResearch GmbH, data as at March 2026

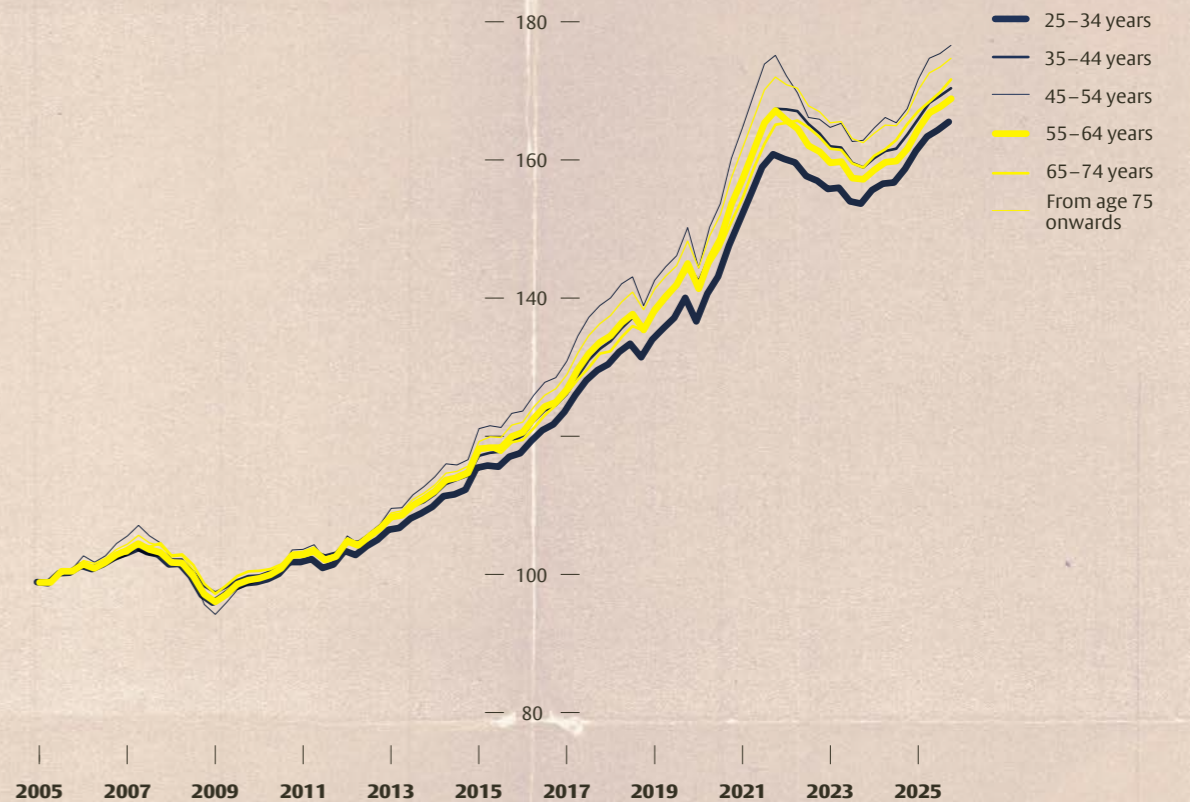


Figure 3  
**Asset price inflation by age group**  
Note: household categories by age of the reference person.

Source: Calculations by Flossbach von Storch based on data from Art Market Research, BIS, Bloomberg, BVI, Chrono24 ChronoPulse, Deutsche Bundesbank, destatis, GDV, HAGI, IMF, Liv-ex, LSEG and vdpResearch GmbH, data as at March 2026.

Even households in the middle and upper-middle classes, which typically own property but have only limited exposure to business assets, recorded price increases of just 3.0 and 3.3 per cent, respectively (see Figure 2).

The figures also highlight the challenges facing younger generations. In the long term, the assets held by 25- to 34-year-olds have seen the lowest price increases (see Figure 3). Unlike their parents and grandparents, they have generally missed out

on the rally of recent years. They now have to pay higher prices to buy a property or build up a share portfolio. Yet private wealth accumulation is likely to become even more relevant in the everyday lives of young people in the future. They have little alternative, not least given the country's ailing pension and health care systems. ♦

Dr Philipp Immenkötter is a Senior Research Analyst at the Flossbach von Storch Research Institute.

By Lars Conrad

# Movement Needs

# A GOAL

The bond market is facing significant challenges. Simply holding on to bonds until maturity and sitting out the coupon payments is no longer enough. What is needed now is an active, global and flexible investment strategy



“Fixed income”, as the bond asset class is known internationally, sounds like stability. A predictable income without risks – who wouldn’t want that? Predictability and reliability are arguments in favour of bonds, but the reality of recent years paints a more nuanced picture: inflation shocks, abrupt shifts in interest rates, geopolitical tensions. Added to this are volatile commodity prices and a structural rise in global debt. Developments such as these have fundamentally changed the rules of the game in the bond market.

Most recently, the war in Iran has shaken the markets. Rapidly rising oil prices can have a massive impact on the economy – not least because prices are rising across the board, not just for heating and fuel. However, for there to be a lasting impact on inflation and the interest rate market, this new “oil crisis” would need to persist for a long time. It remains to be seen whether the crisis will actually last six months or longer. It is likely to be difficult to make well-founded forecasts here.

In such an environment, added value in bonds is not generated by rigid index-tracking. What is needed here is a robust investment strategy that has proven itself over many years – in good times and bad. The basis for this is pragmatic, business-minded thinking and action. Clear convictions, independence and active management. We do not view bond investments as “fixed income”, but rather as “active income”. What this means in practice can be summarised in eight key principles.

#### FREEDOM CREATES RETURN OPPORTUNITIES

The relevant benchmarks, which many ETFs track, are of little help in this regard. The logic of traditional bond indices is simple: those with the most debt receive the highest weighting. For investors, this means an implicit focus on the largest issuers – irrespective of their attractiveness.

We invest with the mindset of prudent business owners. Value for money is essential. Anyone wishing to succeed

in the bond market should carefully analyse the relative valuations of the various market segments and reallocate between sectors and individual bonds where this appears justified. This allows overvalued bonds and sectors to be avoided. Duration should be aligned with the risk-return profile at a given point in time to take advantage of the full potential, rather than being constrained by rigid guidelines. We therefore manage our bond portfolios entirely free of benchmark constraints. This means:

- No structural index biases.
- No artificial weighting requirements.
- No forced allocations.

Instead, the focus is solely on commercial risk-reward analysis. Where are risks adequately compensated? Where are they not? Where do opportunities arise? This freedom allows us to actively and independently manage duration, credit segments, regions and risk premiums – with a clear goal: to achieve attractive risk-adjusted returns over the long term. Taking advantage of the benefits that bonds have to offer as an asset class.

#### “ACTIVE” INVESTING MEANS TAKING A POSITION – AND THEN ADJUSTING IT AGAIN

The bond market is characterised by rapid shifts in sentiment and abrupt regime changes. This is true not only during oil shocks or crises such as Covid-19. Narratives come and go. They often change faster than expected – whether due to new inflation data, monetary policy signals or geopolitical events.

Against this backdrop, we expressly do not see ourselves as “buy-and-hold investors”. We are “bond pickers”. What does that mean in practice? For us, active management means consistently building up positions when the risk-reward ratio is convincing. On the other hand, risks must be reduced

quickly whenever valuations appear to be exhausted. Preserving flexibility and the ability to act at all times is paramount. To achieve this, we maintain a strategic liquidity reserve on an ongoing basis, ensuring that we remain ready to act even during periods of market stress. This is the only way to take advantage of market inefficiencies (which can always offer opportunities). Our objective is simple: we do not merely react to market developments; we seek to act ahead of them.

#### INVESTING GLOBALLY: BEING WHERE THE RISK-REWARD RATIO HOLDS CONVICTION

The global economy is not moving in sync. Central banks are in different interest-rate cycles, inflation trends are diverging, and political risks vary greatly from region to region. It is precisely this lack of synchronisation that creates opportunities. For us, a global approach means capitalising on relative valuation differences between regions. This is the only way to utilise opportunities that remain (or must remain) untapped in purely regional strategies.

Of course, potential risks should always be kept in mind. Active management of currency and duration profiles, for instance, is crucial. We never put all our eggs in one basket: only broad diversification – the sensible spreading of potential risks – offers protection in a world of mounting debt. A global allocation is thus not merely a driver of returns – it is also a key factor for stability when risks are consciously diversified.

#### FLEXIBILITY AS KEY TO ROBUSTNESS

Ultimately, active portfolio management and flexibility are two sides of the same coin. Flexibility is evident not only in allocation, but also in the choice of investment instruments. Depending on the market environment, different tools can

Returns  
are not a matter of chance –  
they result from  
active management



deliver decisive added value. This was most recently demonstrated very clearly in the bond market, for example in ...

- ... inflation-linked bonds, which combine hedging and opportunity.
- ... futures, options and interest rate swaps (i.e. derivatives, financial instruments whose value is linked to an underlying asset), which help to precisely steer duration and yield curve exposure.
- ... a targeted positioning along the maturity structure, where there were significant movements.
- ... the selective use of attractive risk premiums in the investment grade, hybrid or high-yield segment (which at times fell to historic lows).

It is always important not to stray from the framework. We see ourselves as long-term investors, not short-term speculators. The instruments described above are therefore never used dogmatically. We act opportunistically – but always with an eye on the overall portfolio and its robustness.

### AGAINST THE TIDE

The basis of an active investment strategy in the bond market is conscious countercyclical action. This is the only way to balance opportunities and risks. When risk premiums in a particular market segment widen significantly and uncertainty suddenly dominates the buying decisions of many market participants, the most attractive entry levels often arise. Similarly, we reduce our exposure when valuations appear ambitious or excessive.

How does this work in practice? Two examples from the past illustrate how our approach works.

In April 2025, “Liberation Day” occurred in the USA. Donald Trump appeared before the cameras unveiling a series of substantial new tariffs, triggering a sharp rise in market

uncertainty. As the tariff conflict escalated, we deliberately positioned our bond portfolio to be liquid, focusing on good credit ratings. When risk premiums widened significantly in the short term, we took advantage of the opportunity to tactically increase our holdings of corporate bonds in the lower investment-grade segment and, selectively, in the high-yield and hybrid segments. We then realised the gains when calm returned to the market and yield premiums for weaker credit ratings normalised again.

Prior to this, there was another significant development. In the aftermath of the Covid-19 and Ukraine crises, inflation rose rapidly, followed by a sharp increase in central bank key interest rates. In the fourth quarter of 2023, there was a monetary policy turnaround in the USA: the “Fed pivot”, an interest-rate reversal that caused market yields to fall. We had already increased the duration of the portfolio before Jerome Powell’s “U-turn”. When the Federal Reserve Chair signalled the change of course at a press conference, a year-end rally in bond prices began, from which we were able to benefit substantially.

These two examples reflect our approach to all investment decisions. We want to be prepared for market movements, act flexibly and implement decisions in a disciplined manner.

### RETURNS ARE NOT A MATTER OF CHANCE – THEY RESULT FROM ACTIVE MANAGEMENT

The fixed income market offers a variety of sources of return. It is not just about the coupons, the annual interest guaranteed by the issuer on the nominal value of a bond. Bonds can be traded on a global market on a daily basis. Demand is reflected in the price of a bond. Ultimately, it always comes down to how much a buyer is willing to pay for a security in their portfolio.

Income in the bond market can be generated from a variety of sources, including:

- Interest rates and duration
- Credit risk premiums
- Currency contributions
- Positioning on the yield curve, which reflects different maturities
- Liquidity premiums
- Relative value opportunities that may arise when there are significant price differences between similar bonds on the market

Active management means consciously orchestrating these sources of return – rather than passively accepting them. Much like a well-conducted orchestra, the individual components must work together harmoniously. Only then can the full potential of the portfolio be realised.

Every investment decision therefore involves a deliberate assessment of where to build duration exposure, which currencies to favour and which maturities offer the most attractive opportunities. It is always a question of which credit segments we collect risk premiums in and when we reduce risk and secure our capital. Only in this way can “fixed income” become a dynamically managed income portfolio.

### A CHANGING WORLD

An investment strategy must prove itself in different market environments. In our view, return considerations over a few months are not helpful. It is not without reason that we have always consistently refrained from making short-term forecasts and do not provide calendar year outlooks. We believe that these are not only obsolete for long-term investment success but can even jeopardise it.

The one constant in financial markets is change. What politicians describe as watershed moments, historic turning

points or once-in-a-century crises occur with remarkable regularity. Inflation comes and goes; high and low interest rates alternate over long periods of time. Nevertheless, we have recently seen some fundamental changes.

Bond markets are now much more complex and volatile than they were a decade ago. Inflation is no longer a theoretical risk, the debt dynamics of industrialised countries are structural, and geopolitical risks are ever-present.

In a turbulent environment, passivity itself becomes a risk. For us, “active income” means (in a nutshell):

- Independence from benchmark constraints.
- Global diversification and a focus on opportunities that may arise worldwide.
- A counter-cyclical investment mindset.
- A consistent and flexible approach.

In our view, our active, global and flexible approach creates the basis for robust portfolios and sustainable excess returns. After all, returns in the bond market are no longer “fixed” today. They are the result of clear convictions and active decisions.

Ultimately, the aim is always to achieve attractive performance over time in all likely scenarios. This does not mean always getting the scenario right at every point in time. The desire to perform well at all times is often the biggest obstacle to achieving the goal of delivering excellent performance. ♦

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

## 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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