

## Weekly Market Flash

### The German Stock Market's Strange Exuberance

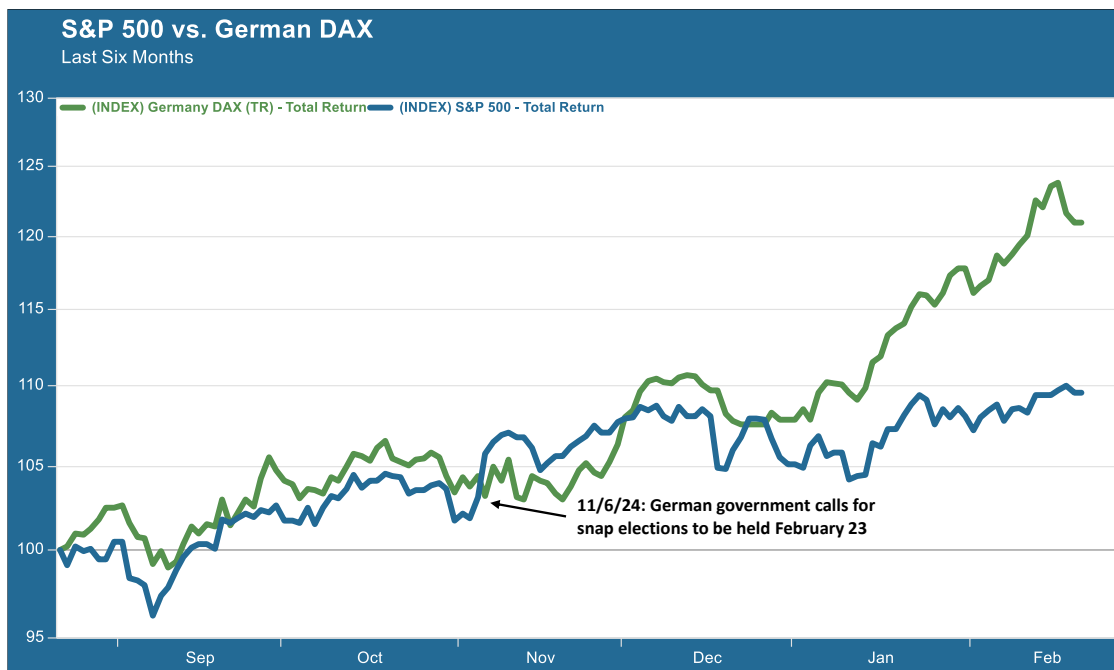
February 21, 2025

This Sunday, the good citizens of Germany will go to the polls to vote for the country's next government. The composition of that government will likely not be known for some time, since no party is on track to win an outright majority. But it will almost certainly not be led by Olaf Scholz, the current chancellor who set this whole snap election thing in motion last November by dismissing one of his own partners from the fragile coalition of the Social Democrats (Scholz's party), Greens and Free Democrats. More likely will be a yet-to-be-identified coalition led by the Christian Democrats (CDU) and its leader, Friedrich Merz.

#### Growth Engine No More

This new government will inherit a bevy of economic, political and social problems plaguing a country that was once a byword for "Europe's growth engine." That growth has not been in evidence now for some time, with GDP more or less stagnant for more than two years, domestic infrastructure needs not being met (thanks in part to an unduly restrictive constitutional "debt brake" capping Germany's structural deficit at 0.35 percent of GDP), and a business model largely dependent on high quality exports in a world of worsening conditions for global trade and a key trading partner, China, with its own major problems.

But hey, if nothing else, the new incoming chancellor can at least enjoy (for now) the performance of German equities, which have been on a bender so far this year.



Source: MVF Research, FactSet

#### A Zeitwende for Bargain Hunters?

The German word "Zeitwende" signifies a major change of some kind that alters the present course of events. Chancellor Scholz used the phrase back in 2022 to describe a major overhaul of Germany's foreign

policy and defense strategy in response to Russia's invasion of Ukraine that year. The country is due for another Zeitwende this year – specifically, a bold political decision to scrap that outmoded debt brake that has kept policymakers from carrying out much-needed investment in infrastructure and social spending. There has been talk of this happening among political analysts observing the electoral vibe ahead of this weekend's elections, and some of that talk may be fueling investors' optimism that a new set of policies could boost economic fortunes – and lift those outperforming shares on the DAX index even further.

Where that talk is not being heard with much conviction, though, is among the candidates themselves. Merz, the CDU leader, has been tepid in replying to questions about whether his government would be ready to ditch the brake. At this point, Merz has no clear idea of what his coalition is even going to look like, let alone what kind of policies would come out of what promises to be a protracted set of negotiations and concessions. According to the latest polls, the CDU is on track to win around 30 percent of the vote. In second place, alarmingly, is the far-right Alternative for Germany (AfD) party, currently polling around 20 percent. Scholz's beleaguered SPD is in third place with around 15 percent, closely followed by the Greens in fourth. For the time being, at least, both the CDU and the SPD have declared themselves unwilling to form a national government that would include the AfD. We will see what the reality looks like after the results come in on Sunday.

Even if the new government does manage to shake off its customary lethargy and enact some vigorous new policies, it will still be operating in the growing shadow of a wholly different set of conditions for global trade and, for that matter, global security. Western Europe has been a key member of the world order that lasted for eighty years since the end of the Second World War. That order is unraveling, and the continent's future in whatever takes its place is uncertain. The times are going to call for bold thinking and decisive action by the new government in Berlin, traditionally the center of European policymaking. And that will have to come sooner rather than later, if both the trust and support of the German people and the current optimism of German equity investors are to be in any way validated.

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