Courtville Partners – Investment Outlook, April 2025

Summary of the key points in this quarter's Investment Outlook

- Fiscal policy continues to trump monetary policy, which suggests investors should go with the flow...
- ...which in turn means boosting exposure to equities in Europe and China at the expense of the US.
- We see the exceptionalism of US equities' as being on hold, but not undermined, given that country's enduring advantages.
- European leaders face a nasty choice at some point: guns or butter (to recycle that old saying). Rearmament may trigger second-order effects.
- Gold's performance has exceeded all expectations, but is still a hedge against runaway US government debt.
- Tariffs make investors nervous, but may not have as great an effect on growth as some fear.

"Most men think that the ideal social order is that which prevailed when they were 20." So said Napoleon Bonaparte in exile on St Helena; and his observation came to mind last month when the Bundestag, notwithstanding its dissolution three months earlier, voted in effect to erase Germany's "debt brake" from the constitution. Since 2009, the country's structural budget deficit each year has been limited by law to 0.35% of GDP.

When the partners of Courtville started work in the City in the early 1980s, the ruthlessly independent Bundesbank was a byword for rigour – above all of the monetary kind. Ever since the War, the slightest sign of loose fiscal policy had been met with a tightening of the interest-rate vice. The result was a macroeconomic triumph despite – or perhaps because of – a steady appreciation of the Deutschmark. We British could only look on with envy from our inflation-prone island. It seemed obvious to us that West Germany's economic model was superior in the same way that a Mercedes was more reliable than a Jaguar.

Then in 1989 the Berlin Wall collapsed. Within a year Germany was unified, but at a previously unimaginable cost to the West German taxpayer. The high priests of the Bundesbank fought on, pushing up interest rates to a peak of 9.75% in December 1991. But Chancellor Kohl's decision to convert worthless Ostmarks into Deutschmarks at a rate of one-to-one proved to be a dagger to the heart of Bundesbank orthodoxy. Germany then went on to spend somewhere between €1.5 and €2.0 trillion on dragging the former DDR up to West German standards (still a work-in-progress, actually).

Could the spending splurge of Germany's outgoing "traffic-light" coalition come to rival the stimulus that accompanied reunification? Is history repeating itself – or at least rhyming? And, if so, what might it mean for asset prices? For now, the size of the fiscal boost is unknown and unknowable; but €1trn (about 22% of current GDP) over the next decade seems perfectly possible once €500bn of infrastructure spending is combined with any defence spending above 1% of GDP.

Cynics would argue that Germany's Damascene conversion to mega-spending on defence and "infrastructure" (which could mean almost anything) is mightily convenient. The new government – almost certainly another CDU/SPD coalition – can rip up its manifesto promises, claim a moral imperative to splurge taxpayers' money ("because Russia") and still keep the AfD behind the firewall. Whether cynicism is merited or not, Germany's journey from fiscal rectitude to almost British Keynesian laxity has taken just one-and-a-half generations.

Investors in the early 1990s who bet on reunification to spark a German stock market boom were left disappointed, at least until late 1993. The First Gulf War (August 1990 to February 1991) didn't help. But the Bundesbank's aggressive monetary policy outweighed the prospect of much looser fiscal policy. Indeed, successive German interest rate hikes – all the way to that December 1991 peak – did much to induce a brutal recession across Europe. Today, by contrast, we live in a (Western) world that assumes and expects central banks to ride to the rescue, as they have done twice in 17 years (first the GFC in 2008, then lockdown in 2020). Can you imagine the ECB raising interest rates in response to Germany's latest spending plans, let alone taking them to nearly 10%? No, you can't. Fiscal and monetary discipline are both so last century.

With no party-pooping central bankers to stand in their way, equity investors stand a much better chance this time of profiting from Germany's spending blitz. Follow the money, to coin a phrase. Moreover, the breaking of fiscal taboos in Germany may well encourage an increase in government spending (and borrowing) across the Continent. Happily, the Eurozone's bank lending cycle is improving, which should give another fillip to growth in what are still very bank-dependent economies. Almost at a stroke, then, the two big deflationary influences in Europe – Germany's tight-fistedness and the de-gearing of private sector balance sheets in Southern Europe – have been magicked away. Just like that.

Even after the Eurostoxx's strong start to the year (up 8% in 1Q25), valuations remain deeply modest by US standards (an issue we discussed in our last Outlook). On the simple yardstick of prospective P/E, both the DAX and the Eurostoxx on 16x and 15x, respectively, stand at material discounts to the S&P 500's 23x. Conversely, German government bonds look set to remain friendless far into the future; and yields have been rising. We are more sceptical that defence stocks are still the best bets after some steepling share price rises (e.g. Rheinmetall AG up 15x – yes, fifteen times – since Russia invaded Ukraine in February 2022). More intriguing are the possible second-order effects of European rearmament. Could the long-term legacy of JD Vance's mic-drop Munich speech be a reassessment of Europe's two fiscal sinkholes, welfare and Net Zero? Neither of these looks affordable any more (if they ever were). Meanwhile, companies are voting with their capex budgets. BP, for example, recently slashed its forecast of (energy) "transition" spending from $6-8bn p.a. to a mere $1.5-2.0bn, adding that it intends "to reallocate capex to the highest-returning businesses in order to drive growth". This is the same challenge that Europe's leaders will have to face sooner or later.

Germany isn't the only country turning on the taps. China has announced its "special action plan", aimed at boosting household consumption. Opinions vary on whether the plan is a re-hash of existing measures – or an outright, Draghi-style whatever-it-takes moment. Research house Gavekal reckons this year's all-in budget deficit could approach 11% of GDP, up from less than 9% last year. So much for notions of China as a bastion of fiscal prudence. It may also explain why the government's reluctance to roll out anything resembling an "emergency" stimulus – because fiscal policy is already astonishingly loose. Even so, this latest fiscal stimulus is a serious statement of intent on the government's part – and crucially targets household budgets. What no one knows yet is whether it will be enough to offset any impacts on external demand from planned US tariffs.

Among the drunkest sailors on shore leave in recent years has been the US. Budget deficits under Biden ran at 6-7% of GDP *despite* strong economic growth. In fact, over the period since lockdown the US has racked up a cumulative deficit of 44% of GDP, far outstripping the likes of Japan (25%) or the EU (22%). The many moving parts to US fiscal policy under the incoming administration include the impact of DOGE, Treasury Secretary Bessent's deficit target (3% of GDP) and the end of powerfully pro-cyclical programmes such as the Inflation Reduction Act (was there ever a more blatant misnomer?). What is *not* in doubt is the need at least to slow the rate of growth of the US government debt mountain (a regular theme of ours). All in all, we see a better-than-evens chance that US fiscal policy from here will offer less stimulus than in the recent past, even if out-and-out hair-shirts remain in the wardrobe. And this would mean less of a following fiscal wind for US equities, though it would be better news for US treasury bonds. (Yields on 10-year treasuries have already fallen 25bp this year and 70bps from their high a year ago.)

In summary, then, we think that stock market leadership is already passing from the US to other regions, above all Europe and China (and to some extent Emerging Markets), partly because of major changes in the fiscal weather. More borrowing by governments outside the US means more fuel for non-US asset prices. Expectations of technological wonderment epitomised by the Mag 7 stocks have not evaporated completely, but are now also vested in non-US companies (viz., the shock of China's DeepSeek). We suggested three months ago that the exceptionalism of US equities might be drawing to a close. One important caveat, though: the US retains enormous – and enormously powerful – natural and strategic advantages over most other nations which in due course are likely to generate superior stock market performance, but not for the time being. We may be tilting equity exposure away from the US and towards the rest of the world – and underweighting the Mag 7 valuation bubble in particular. But we are absolutely not giving up on US equities.

The elephant in the macroeconomic room is the imposition of wide-ranging tariffs by the US government. No one has a clear idea of their impact. We do know, however, that imports, exports and manufacturing all comprise relatively small parts of US GDP. The March business confidence (PMI) surveys revealed weakness in sentiment among manufacturing companies, but a big step up in the services sector. Given the relative weights in GDP, the composite confidence index duly surged ahead. So whatever tariffs may do to the rest of the world, they seem unlikely to dent American growth prospects. (They will probably give US inflation another nudge upwards. A random example: Ferrari has announced 10% across-the-board price hikes for its US customers. We'll see if the customers balk at this. It's not as if import substitution is an option.) For what it's worth – which may not be much given the lack of information – the OECD estimates that Trump's tariffs will trim 0.3% from global growth this year, but add 0.4% to inflation. More lurid predictions that tariffs will provoke a recession in the US or elsewhere seem to us likely to fall wide of the mark.

The newsflow so far in 2025 has been frankly chaotic, especially from across the Atlantic: "Ukraine started the war", Gaza as a beach resort, NATO may or may not be dead, "We're going to take Greenland" – and so on. As usual, it is better to take President Trump seriously, but not literally. Amid the geopolitical confusion, it is easy to forget that global equity markets are essentially unchanged over the quarter, albeit with large regional variations (China A-shares +15% and Germany +11% versus Japan -10% and the US -5%). Global bonds have done a bit better in aggregate, but also with wide regional dispersion (yields rose in German and Japan, but fell in the US). Perhaps the stand-out mainstream asset has been good old gold, which is up a whopping 19% in dollars since the start of the year and has almost doubled over the last two years. We have always been happy to own gold in our Model Portfolio. Should a 50% rise over 12 months temper our enthusiasm? We see it like this: if the Trump administration succeeds in turning round the supertanker of federal government spending, gold is likely to fall (and *vice-versa*). Place your bets.

Asset Classes	Courtville Partners Asset Allocation (%)	FTSE PI Balanced Index (%)
UK Equities	10	12.9
International Equities	56	50.2
Fixed Income	11	25.5
Alternatives	14	5.8
Commercial Property	1	0.1
Cash	8	5.5
Total	**100**	**100.0**

Courtville Partners Model Portfolio	ETF	Jan Weight	Weight (%)	Changes this quarter	Weighted OMC (%)
UK Equities		**10**	**10**	**0**	
UK	VUKE LN	8	8	0	0.09
UK	VMID LN	2	2	0	0.10
International Equities		**53**	**56**	**3**	
Global	IWQU LN	3	2	-1	0.30
US	VUSA LN	10	9	-1	0.07
	XDPG LN	7	7	0	0.09
	EWSP LN	9	9	0	0.20
	IUVD LN	3	3	0	0.20
Euro	VERX LN	3	5	2	0.12
	XDAX LN	0	2	2	0.09
Japan	VJPN LN	4	4	0	0.19
Asia ex-Japan	VAPX LN	5	4	-1	0.22
Emerging Markets	VFEM LN	7	9	2	0.25
Emerging Markets ex-China	EXCS LN	2	2	0	0.18
Fixed Income		**13**	**11**	**-2**	
Government Bonds					
UK Inflation Linked	INXG LN	2	0	-2	0.25
UK	IGLT LN	2	2	0	0.07
US	IDTM LN	3	4	1	0.17
EM	SEML LN	2	2	0	0.50
China	CNYB NA	2	1	-1	0.35
Corporate Bonds					
US	CORP LN	2	2	0	0.20
Alternatives		**14**	**14**	**0**	
Gold	PHAU LN	4	4	0	0.39
Oil	WEL5 GY	2	2	0	0.18
Infrastructure	INFR LN	2	2	0	0.65
Uranium	NUCG LN	2	2	0	0.55
Water	IH20 LN	2	2	0	0.65
Carbon Allowances	CARB LN	2	2	0	0.35
Commercial Property		**1**	**1**	**0**	
Global	IWDP LN	1	1	0	0.59
Cash	XSTR LN	**9**	**8**	**-1**	0.15
Total		**100**	**100**		**0.20%**

Courtville Partners	Model Portfolio	FTSE PI Balanced Index	Relative performance
2025 YTD	-1.3%	-1.3%	0.0%
Since inception(1/1/2015)	104.8%	97.1%	7.7%
CAGR	7.3%	6.8%	0.5%

The value of your investments can fall as well as rise. You may not get back all the money you invested.