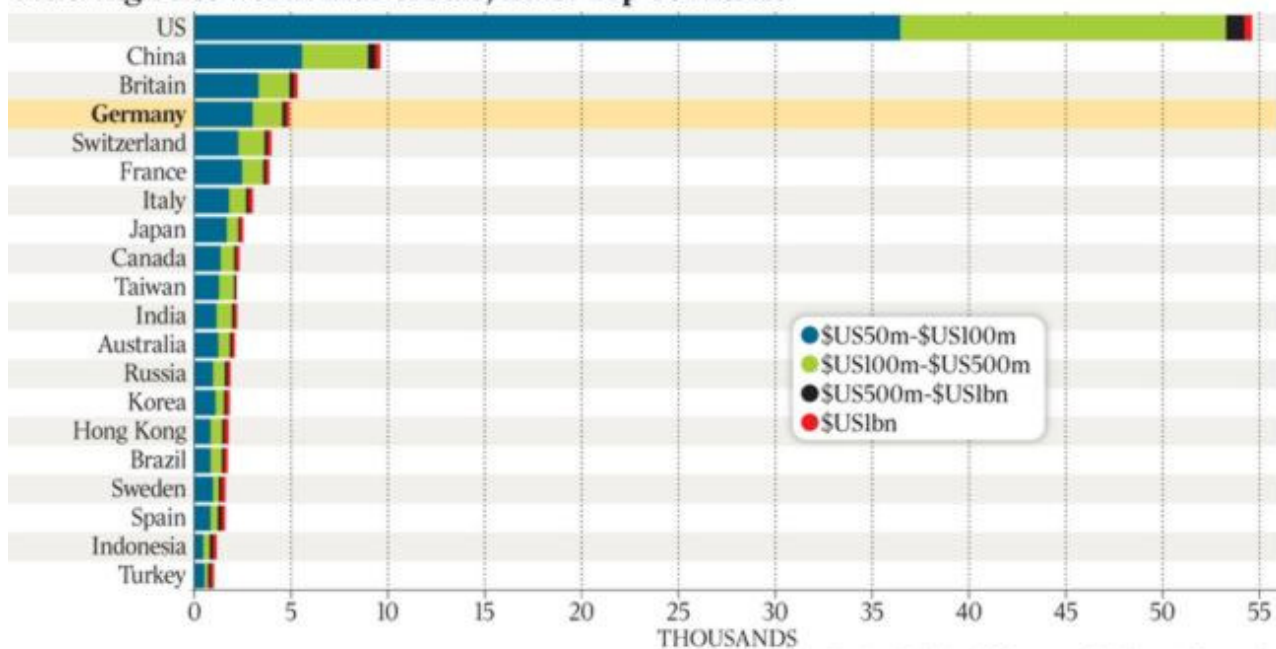


## THE AUSTRALIAN

# It pays to look at German economic health to gauge Asian prospects

STIRLING LARKIN THE AUSTRALIAN OCTOBER 24, 2015 12:00AM

### Ultra high net worth individuals, 2015: Top countries



Source: James Davies, Rodrigo Lluberas and Anthony Shorrocks

Ultra high net worth individuals, top countries, 2015. Source: TheAustralian

### For so many important reasons, Germany remains a central player in the global ultra-high-net-worth investment mix.

German banking, industrial complex and financial engineering leads at the front of the curve and can be seen directly in Australia via the footprint left by Deutsche Bank, Commerzbank and other German financial conglomerates.

These trends matter for two significant reasons: Germany, as represented in the graph, remains a dominant force itself, in individual UHNW wealth but secondly and as importantly, Germans continue to be China's best friend in Europe and arguably also the West and have been so since the Chinese Communist Party took control in 1949.

Anybody who has spent five minutes on the ground in China realises this undisputable fact — China and Germany have an unusual but unwavering alliance across commerce, finance and more broadly, their societies.

This dedicated bilateral relationship has been recently challenged by Britain's pursuit of China's external foreign exchange business, with the hope that London could be Beijing's international yuan foreign exchange hub in the near future.

When the yuan (or renminbi as it also called) achieves UN's reserve currency status, which is only a matter of time, then London can challenge Frankfurt and Berlin as China's financial ally in Europe.

Why this matters to Australians is that between Britain, Germany, France and also Switzerland —

which acts as a wealth proxy on behalf of other European jurisdictions — four-fifths of the top UHNW industry leadership have allied themselves to the immediate fate of China and Emerging Asia.

For the Australian economy and wealth sector, which has tied its cart to the same horse, these developments have ramifications that directly affect us in turn.

For these reasons, some are taking a deeper look at the health of the German economy, not only as both a reflection on the vibrancy of the eurozone but also as a proxy to trade and investment with China and Emerging Asia.

Commerzbank's leading indicator for the German economy — known as the “Early Bird” indicator — dropped again in September and, at 0.19 points, is now much lower than at the beginning of the year, when the indicators recorded a more stable 0.49 points.

As the global economic environment is still weakening and the euro is picking up again, Commerzbank believes this suggests that sentiment indicators will also turn downwards again and that the German economy will lose rather than gain momentum in the coming year.

As these warning signals become louder for the German economy, the pressure will mount on the ECB to support the bloc with an extended QE program. According to Commerzbank, a majority of German companies listed on the DAX index have this quarter released profit warnings and those who have account this to weaker demand from China and the strong depreciation of various emerging market currencies.

They believe this negative trend will continue and particularly for companies with a high share of sales in China and other emerging markets such as Brazil and Russia, which cannot compensate for this through US dollar gains versus the euro.

Examples include Volkswagen (VOW), Adidas (ADS) and Duerr (DUE). For Australian global investors wishing to identify DAX-listed companies that do not suffer these complications, companies such as Fresenius (FRE), Deutsche Telekom (DTE), Hochtief (HOT) and MTU Aero Engines (MTX) are likely to feel little or no pressure on this front.

But the realignments within the UHNW top 20 countries mix, as seen in the graph, matter as well.

Since 2014, China has moved up to second place with 9600 UHNW individuals (up 1800 on the year), followed by Britain (5400, up 400) which switched places with Germany (4900, down 1000). Switzerland (3800, down 200) moved up by overtaking France (3700, down 600).

More than simply musical chairs, these shifts reflect the wealth effects that a growing and then slowing China has on its closest trading partners.

For the Australian global investor who remains anxious about developments seen in the US, the German bond market, commonly referred to as the “bund” market, provides valuable insight into the market that sets the risk-free rate, from which all other markets are benchmarked.

Bund spreads have widened recently and are close to the highs seen earlier in the year, when the market believed that ECB QE would drive bund yields into negative territory and a shortage of bunds appeared imminent.

Some of the recent widening in bund spreads can be attributed to heightened risk aversion and increased anticipation of further ECB easing, in response to the deteriorating inflation outlook and weakening global growth prospects but as importantly, they provide the Australian global investor a barometer to gauge risk aversion linked to the trajectory of the Chinese economic machine.

As helpful as these gauges are, it remains important that the global investor not over rely on the proxy proponents of these spreads, as after all, the German manufacturing orders domestically fell 1.8 per cent month-on-month in August on their own volition.

As Deutsche Bank recently commented, “For the average German, a sack of rice falling over in China has long been considered none of his business”, but as the importance of events in China for the German economy have come to be recognised, this indifference is changing and changing fast.

For the Australian UHNW and global investor, taking this deeper look at the German economy and relying on the cold fact that Germans are notorious for saying it as it is, becomes a dependable voice that is heard through all the Chinese whispers.

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