



FIRST CAPITAL
FINANCIAL



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FINANCIAL MANAGEMENT INC.
Sponsoring Mutual Fund Dealer



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After German troops rolled into Poland in 1939, many feared the imminent destruction of Europe and its economy. British investors did not. In the year following the invasion, London's stock market rose, and by the end of hostilities in 1945, British companies had delivered returns to shareholders of slightly more than 100%.

Although today's dangers are not in the same league as a world war, they are significant. Pundits talk of a "polycrisis" running from the Covid-19 pandemic, land wars in Europe and the Middle East, in addition to stubborn inflation, banking scares, a Chinese property bust and tariff trade wars.



Despite this, the world economy appears impressively -and increasingly- shock-absorbent. Supply chains in goods—widely believed to be a source of fragility—have shown themselves to be remarkably resilient. A

more diverse supply of energy and a less fossil-fuel-intensive economy have reduced the impact of changes in the oil price. And across the world, economic policymaking has improved.

This year just 5% of countries are on track for a recession, according to the International Monetary Fund. Unemployment in the club of rich countries is below 5% and close to a record low. In the first quarter of 2025, global corporate earnings rose by 7% year-over-year. Emerging markets, long prone to capital flight in times of trouble, now tend to avoid currency or debt crises. Consumers across the world, despite claiming to be down in the dumps, spend freely. On almost any measure, the world economy is doing well.

Little wonder that investors are optimistic. Over the past 15 years, as the polycrisis has built, US stocks have moved higher and now represent over 70% of total stock market capitalization. More than half the rich world's stock markets are within 5% of their all-time high. Wall Street's fear gauge, the VIX, an index of stock market volatility, is running below its long-term average. Markets fell in April, when Mr. Trump announced his "Liberation Day" tariffs, but quickly recouped their losses. Many investors now follow a simple rule whenever markets decline: "Buy the dip."

It would appear that a new form of capitalism has emerged -a *teflon* economy, where firms are better than ever at dealing with shocks. This means markets continue to function even at a time when politics breaks down, as governments offer their economies unprecedented levels of protection. The average rich-country government now runs a fiscal deficit of over 4% of GDP, far above the norm in the 1990s and 2000s. Their support goes beyond budget deficits, which are simple to measure. Many countries now have vast "contingent liabilities"—off-balance-sheet commitments that nonetheless represent an enormous potential outlay. When the feds are backstopping the entire economy, it is hardly surprising that recessions are few and far between.

With all this said, we believe that the price of positive economic and investment outcomes is eternal vigilance. The laws of Supply and Demand have not been revoked and capitalism is defined by fiscal reality. Higher interest rates make profligacy expensive, and at some point, governments will have to cut back. More, geopolitical shocks may yet escalate to a point where even today's robust supply chains cannot cope. A Chinese invasion of Taiwan could destroy, pretty much overnight, the West's supply of high-end semiconductors.

In 1939 investors in the City (as London's Financial District is called) wagered that the war would not stand in the way of their profits. Investors in 2025 are making a subtler bet: that politicians, regulators and central bankers will continue to stand behind them when things go wrong. The danger is that, in the next crisis, the bill for perpetual protection could come due—and it could be steep.

For this reason we remain, as always, cautiously optimistic and defensively positioned. Our investment models are positioned to capture much of the upside and much less of the downside. Delivering returns within a narrower range of investment outcomes is conducive to staying invested across all market and economic cycles. This is foundational to building long-term wealth, a goal that is our mission-critical undertaking.

Thanks for reading!

Martin

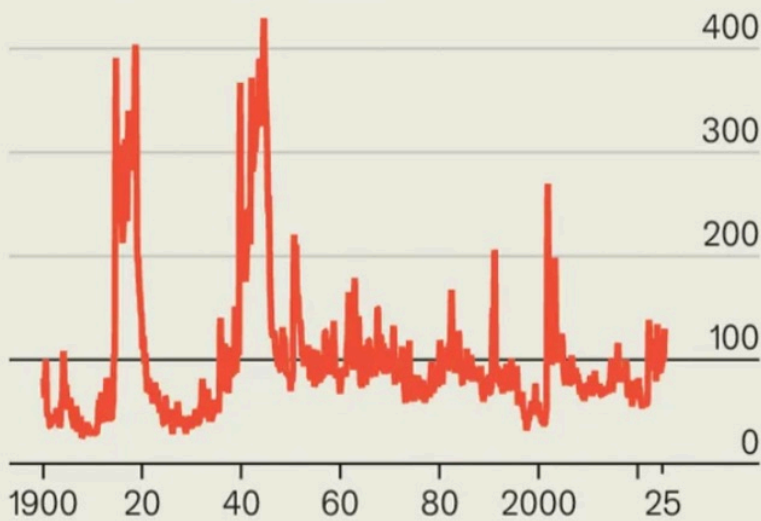
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History restarts

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Geopolitical risk index*, long-term average=100

Three-month moving average



*Measured by the frequency of articles discussing adverse geopolitical risks as perceived by leading English-language newspapers

Source: "Measuring geopolitical risk", by D. Caldara and M. Iacoviello, 2022 and updates

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