MONEY MORNING

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Germany: The Secret Emerging Market

Many commentators have picked the East Asian economies of China, Korea and Taiwan to emerge the most vigorously from the ongoing global financial crisis. And with some justification, for China and the two Asian "tigers" share some alluring characteristics:

- A highly competitive and innovative manufacturing industry.
- Excellent government and workforce discipline.
- Modest fiscal and monetary stimulus (or, like China, they started from a position of budget surplus).
- And an export orientation that seems likely to benefit quickly as order is restored in the global trading economy.

But there's another country that shares those characteristics. It's nowhere near East Asia. But investors can expect this particular economy to also bounce back from this recession with considerable vigor.

I'm talking about the center of supposedly sclerotic Old Europe itself: Germany.

Germany lacks the huge financial sector that has been the bane of the United States and British economies, but it has manufacturing industry that is the envy of the world. Its balance of payments surplus was $205.8 billion in the 12 months through April, and is expected to be 4.4% of gross domestic product (GDP) for all of 2009.

The German government resisted the urge to splurge on "stimulus" packages, and consequently is expected to run a budget deficit of only 4.4% of GDP in 2009 – a ratio far smaller than other "advanced" economies, and one that should be easy to finance.

Furthermore, the European Central Bank (ECB) has been the most conservative of all major central banks outside Brazil, and German Chancellor Angela Merkel has indicated pretty strongly that it had better stay that way, **as she is worried about inflation.**

German labor discipline is world-famous, partly because of its sophisticated system of "*mitbestimmung*" (co-determination) between industry and labor unions.

When it comes to banking or global economics, there's literally no one better than *Money Morning* Contributing Editor **Martin Hutchinson**, who brings to the table the kind of high-level expertise that our readers have come to expect. Hutchinson was recently honored by Slate for correctly calling the Bear Market bottom. He also writes regularly for our monthly newsletter, *The Money Map Report,* in which he and other *Money Morning* colleagues also make investment recommendations for subscribers. To find out more about *The Money Map Report* – including a special offer that includes Peter Schiff's acclaimed book, **"Bull Moves in Bear Markets."**

Thus, Germany loses only four days to strikes per 1,000 employees in an average year, an average that's well below the same statistic for each of its European neighbors. Skill levels are also excellent, because of the superior German education system, much of which is run in partnership with industry.

Because of its more conservative fiscal stance – with less stimulus – Germany has suffered through a much-deeper recession than many other countries, with first-quarter GDP down 6.9% from the previous year.

By comparison, economic output declined 2.5% in the United States and 4.2% in Korea, but 8.8% in Japan and 10.2% in Taiwan. However, manufacturing orders stabilized in April and it seems likely that Germany will experience a return to growth in the second half of 2009.

The ZEW indicator of German economic sentiment for June came in at 44.8 – up more than 13 points from the previous month, and a three-year high. When Germany starts to recover, its economic rebound is likely to be healthy, without resurgent inflation or bond market turmoil, because of Germany's cautious fiscal and monetary policies.

What to buy? Well, for a start there's the German exchange-traded fund (ETF), the iShares MSCI Germany Index (NYSE: EWG). At $489 million, it's surprisingly small, but it has a Price/Earnings (P/E) ratio of 12 and a yield of 6.4%, **meaning it provides shareholders with a decent income.**

It also provides a much-broader exposure to the German market than do the American Depository Receipt (ADR) shares, which relate only to very large companies, and not to the highly successful *"mittelstand"* medium-sized enterprises.

There are eight German companies whose ADRs have a sponsored full listing on the New York Stock Exchange (several others have moved to the Pink Sheets recently because of the costs of Sarbanes-Oxley compliance).

Of these, Infineon Technologies AG (OTC ADR: IFNNY), a semiconductor manufacturer, is making a loss, while Qimonda AG (OTC ADR: QMNDQ), a maker of computer memory devices, is in bankruptcy.

That leaves six possible profit plays:

- **Allianz SE: (NYSE ADR: AZ):** This huge insurance company sold its shares in Dresdner Bank AG and is now a shareholder in Commerzbank AG (OTC ADR: CRZBY). Allianz lost money in 2008 because of investment losses, but is trading on only nine times projected 2009 earnings, with a 5% dividend yield.

- **Daimler AG (NYSE ADR: DAI):** A major automaker, and producer of the upscale Mercedes Benz brand (including the fashionable "Smart" small car), Daimler is now thankfully devoid of Chrysler LLC involvement. Daimler gratuitously tossed away a considerable amount of shareholder value with two foolish diversifications – into aerospace in the 1980s and into Chrysler in the 1990s. If management can keep its eyes on the road (stay on the black stuff between the trees), this stock could be quite attractive. Daimler's shares are trading at 20 times recession-year earnings. The dividend yield is only 1.7%, but overall there's a lot of upside in an economic recovery.
- **Deutsche Bank AG (NYSE ADR: DB):** This is Germany's premier bank and investment bank, but it is currently losing money and the stock yields only 1%. For a play on a German financial sector recovery, I prefer Allianz.
- **Deutsche Telekom AG (NYSE ADR: DT):** Germany's traditional fixed-line telephone service, Deutsche Telekom also has mobile-phone operations and has increased its revenue by also offering high-speed Internet access. Currently operating at a loss, DT also cut its dividend. Avoid – there are better telecom plays out there.
- **SAP AG (NYSE ADR: SAP):** A globally known provider of so-called "enterprise resource planning" (ERP) software, SAP shares have a dividend yield of only 1.2%, and are trading at 19 times prospective earnings. The stock looks a bit pricey to me: I like the sector, but not SAP's bureaucracy-friendly product line.
- **Siemens AG (NYSE ADR: SI):** With its wide array of product offerings, Siemens is operationally akin to General Electric Co. (NYSE: GE). Indeed, with heavy-equipment offerings that range from locomotives to electric power plants, Siemens is selling the kinds of products that are likely to benefit from heavy "stimulus" spending worldwide. The company has recovered from losses in 2006. But the shares are trading at only 11 times estimated earnings for the 12 months that end in September. That low valuation, coupled with a nice dividend yield of 2.9%, makes the stock appear fairly attractive.

[**Editor's Note:** Is it a new bull market, or just a bear-market rally that's going to separate investors from the last of their cash? For the shrewdest investors, it may not matter. A **new offer** from *Money Morning* is a two-way win for investors: Noted commentator Peter D. Schiff's new book – **"The Little Book of Bull Moves in Bear Markets"** – shows investors how to profit no matter which way the market moves, while our monthly newsletter, *The Money Map Report,* provides ongoing analysis of the global financial markets and some of the best profit plays you'll find anywhere – including such markets as Taiwan and China. To find out how to get both, **check out our latest offer**.]

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