

Is it time to add to European equities?

CIO Essentials

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- European equities had a very good start of the year following the announcements about increased spending by the German government and NATO, but momentum faded over the second half of the year.
- We believe there is still upside in European equities driven by three factors: an improving cyclical outlook, a more favorable structural backdrop, and reasonable valuations.
- Within Europe, we prefer the IT, utilities, industrials, banks and real estate sectors. We like Germany and have introduced a “European Leaders” theme.



Source: Pexels

Early-year optimism in European equities, sparked by the announcements of increased German fiscal stimulus and defense spending in Europe, was quickly tempered by US tariffs, subdued economic data, and lower expectations for defense outlays. As a result, European equity prices have remained steady since the summer. But sentiment is now turning more constructive, and we have upgraded our outlook for the market to Attractive.

European equity markets have often been overlooked due to limited exposure to artificial intelligence (AI) compared to the US and China. Despite this, Europe remains home to world-leading companies across various sectors. Rapid advances in technology and renewed capital investment are fueling productivity gains and reinforcing the competitive strength of European firms. The adoption of AI, digital manufacturing, and robotics is driving a new wave of industrial investment, solidifying Europe’s leadership in automation equipment and industrial software. At the same time, electrification and the energy transition are creating long-term demand for networks, renewable energy, and efficiency solutions—areas where European utilities and engineering companies excel.

Another reason for past caution has been Europe’s significant exposure to manufacturing. However, recent improvements in manufacturing indicators and industrial

production, combined with fiscal stimulus in Germany, are expected to spark new investments and boost order momentum. As economic activity normalizes, profit growth is likely to broaden across sectors, paving the way for a more robust and sustainable earnings cycle.

The improved cyclical outlook and supportive structural trends are not accompanied by excessive valuations. Following the fading of earlier enthusiasm, European equities are now trading just above their 10-year average, presenting an appealing entry point, in our view. The next phase of potential outperformance is anticipated to be driven by earnings growth. In addition, European equities remain attractively valued compared to global peers, in part due to the US market’s higher weighting in technology and AI. Even when comparing similar subsectors, Eurozone stocks continue to trade at a larger discount than their US counterparts.

The industrial, technology, and utility sectors stand out as key beneficiaries of global trends such as AI adoption, data center expansion, rising energy demand, the energy transition, and increased defense spending. These sectors are also well placed to benefit from improving cyclical conditions. Elsewhere, we now rate European banks as Attractive, supported by reasonable valuations, improved earnings prospects, renewed loan growth, and ongoing

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asset revaluation. We expect Europe's real estate sector to recover thanks to European Central Bank rate cuts, and we have upgraded Germany to Attractive as a leading force in fiscal easing. At the company level, firms that harness both global and European structural shifts are highlighted in our "European Leaders" theme.

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Attractive – We consider this asset class to be attractive. Consider opportunities in this asset class.

Neutral – We do not expect outsized returns or losses. Hold longer-term exposure.

Unattractive – We consider this asset class to be unattractive. Consider alternative opportunities.

Least attractive – We consider this asset class to be among the least attractive. Seek more favorable alternative opportunities.

Appendix

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