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## EQUITY MANAGEMENT

# European equities: trends and catalysts

*Olivier Baduel, Head of European Equities at Ofi Invest Asset Management, provides some insight into trends and catalysts on the European equity markets, which are now near their all-time highs.*

## WHAT IS YOUR TAKE ON THE EURO ZONE ECONOMY?

The European economy is being pulled in opposite directions. On the one hand, US tariffs are expected to cost European countries between 0.3 and 0.4 percentage points of GDP. But, on the other hand, this is likely to be offset by Germany's massive stimulus plans.

Frederic Merz's election as chancellor has triggered a fiscal "double bazooka" in Germany in both infrastructure financing and increased defence spending. The sums involved over a 10-year period – 50 billion euros annually over a 10-year period for infrastructures and almost 450 billion euros for defence spending – are greater than those of the US Inflation Reduction Act (IRA) and CHIPS Act<sup>(1)</sup> combined, and greater than the EU Recovery & Resilience Fund<sup>(2)</sup>. The stimulus plan is expected to add 0.3 or 0.4 percentage points of growth, which, based on Germany's weight in European GDP, works out to 0.1 to 0.15 percentage points of additional growth for the euro zone. Meanwhile, increased defence spending could generate about a cumulative 1.15 percentage points of GDP over several years.

Another bright spot: at 2.2%, euro zone inflation has almost reached the target set by the European Central Bank (ECB). Our economists expect it to level off at 2.1% on average in 2025 and continue receding, to 1.6% in 2026. This should help sustain a favourable monetary environment throughout the euro zone.

Seen from this angle, although the ECB is a little less active than the other central banks, it is also taking part in the extensive global monetary easing trend. In fact, over the past 12 months,

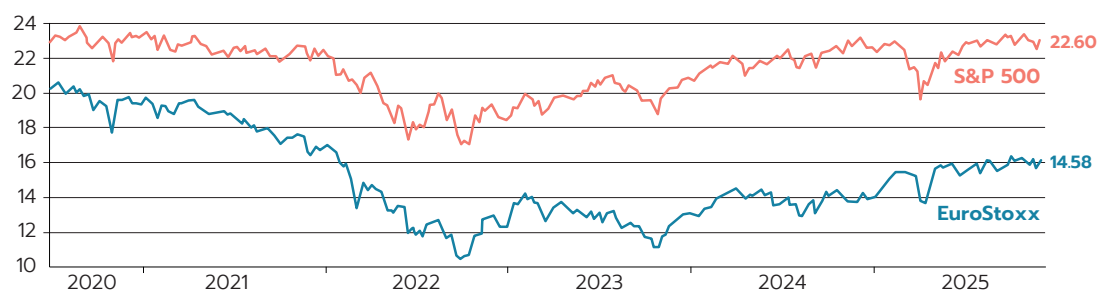
no fewer than 168 key rate cuts have been made worldwide. This is good news for the economy and for the markets, for two reasons: 1/ when interest rates fall, companies and households can finance at lower cost, and that, in turn, boosts economic activity; and 2/ when returns on risk-free assets are driven down by lower short-term interest rates, investors are more likely to seek out risky assets, which accordingly remunerate risk more.

## HOW IS ALL THIS AFFECTING EUROPEAN EQUITIES?

All these factors have sent European markets to record levels in recent weeks and helped them shrink their valuation discounts.

Three years ago, European equities were very low-priced, at 10 times earnings. Two years ago, they were near 11. P/E's are now back up slightly above their long-term median. And it is indeed this rerating that is behind most of the 20% year-to-date gains by euro zone equities. Only 2% of those gains have been driven by earnings growth (which has been undermined by the dollar's depreciation). 3.5% of the gains have been driven by dividends. The rest – almost 15% – is due to a rerating.

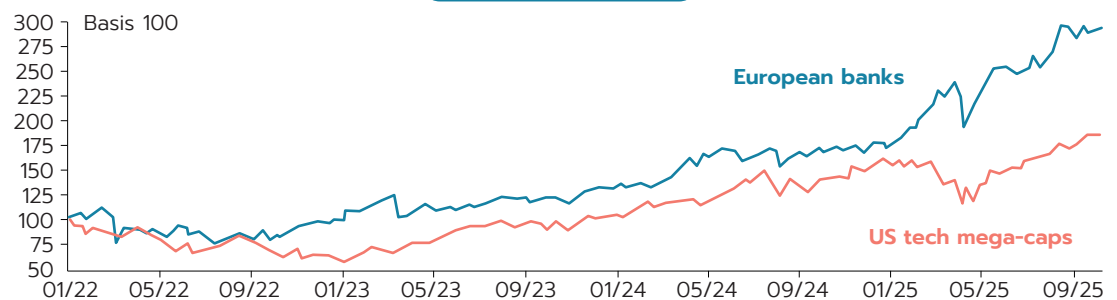
### P/E TRENDS<sup>(3)</sup>



Sources: Macrobond, Ofi Invest AM - Data as of 03/10/25

Some distinctive market features are worth pointing out. The main one is the extreme concentration of index performance on a few sectors. Much has been made of the US tech sector and its "Magnificent 7"<sup>(4)</sup>, but another phenomenon has also stood out, this one in Europe: euro zone banking shares have gained almost 60% on the year to date. Over the past three years, European banks have outperformed US tech mega-caps by more than 50%.

### TOTAL RETURN



Sources: "Equity Strategy: Not a bubble... yet (but still reasons to diversify)", Datastream, Goldman Sachs Global Investment Research, 08/10/2025

Despite this massive outperformance massive over the past four years, valuations still look reasonable in both absolute terms and compared with their track-records

## WHAT IS YOUR CURRENT EUROPEAN EQUITIES EXPOSURE?

In our view, European equity valuations have caught up so much that the buying signal for this asset class has weakened, and we are accordingly remaining close to a neutral weighting, especially as earnings growth remains modest in the current year. That being said, we would describe our stance as "positive neutrality", as we are bullish on the whole, so much so that we are considering buying on a market dip.

Past performances are not a reliable indicator of future performances.

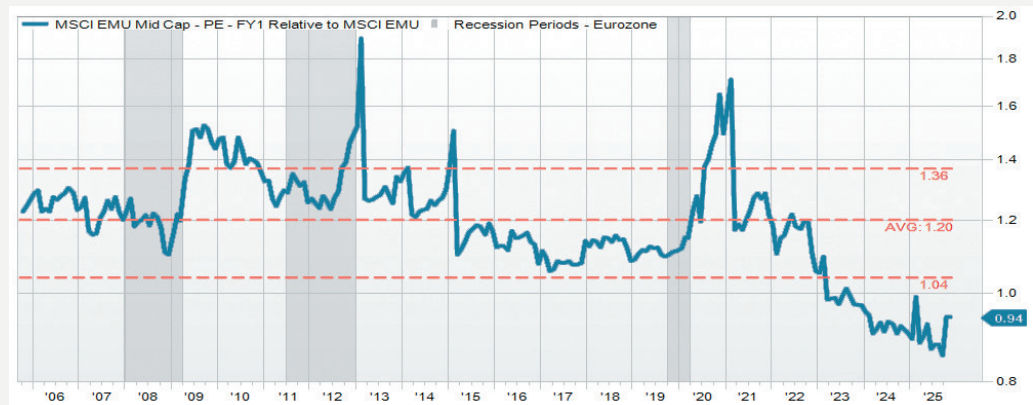
<sup>(3)</sup> The Price-Earnings Ratio is an equity market research indicator. It is a company's market cap divided by its net earnings forecast over the next 12 months.

<sup>(4)</sup> The "Magnificent 7" are the "GAFAM" (Alphabet (Google), Amazon, Meta (Facebook), Apple and Microsoft) plus Nvidia and Tesla.

## EUROPEAN MIDCAPS DUE FOR A COMEBACK?

European midcaps have underperformed considerably in recent years and are now trading at a wide discount. This was not always the case.

### MSCI EMU MID CAP



Source: Factset, 31/10/2025 - Past performances are not a reliable indicator of future performances.

When the midcap segment began to develop, it traded at a discount due to its lower liquidity. But valuations very soon began to reflect some of the advantages that midcaps enjoy, precisely due to their size. These include their innovativeness and capacity to gain market share and, hence, their higher potential medium-term growth. The valuation premium driven by this growth potential tended to be even greater during the steep drop of interest rates of the 2010s.

But midcaps have not been well-served by interest-rate hikes, as the toughening of credit access terms and rising borrowing costs have squeezed their valuation multiples. This is still the case, despite the monetary easing of recent months.

One more thing: midcaps, by nature, are more domestically oriented. An acceleration of growth in the euro zone could serve as a catalyst to a rerating.

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