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Ninety One

Investing for a world of change

European equities: look at the evidence, not the headlines



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The fast view

- **Fundamentals over headlines:** We believe that the challenging macro backdrop is largely priced in, while the actual operating environment for companies is strong, evidenced by upgraded earnings estimates.
- **Reform is becoming law:** About 40% of Draghi's recommendations are moving towards implementation. Where capital and reform have been applied with conviction, such as defence, the results are already visible.
- **A broad capex cycle:** Investment in data centres, defence, grids and infrastructure is showing up in orders, company guidance and credit data. This is an earnings cycle with real-economy support.
- **Genuine diversification:** Europe's correlation to the Nasdaq-100 is about 50%, versus around 80% for emerging markets. For portfolios already heavy in US technology and AI exposure, Europe offers exposure to a different set of earnings drivers.
- **Cheap and under-owned:** Europe's forward P/E discount to the US is roughly double its long-run level, only a third of fund outflows since 2018 have returned, and global managers remain materially underweight. To us, it appears that fundamentals have improved faster than investor positioning.

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Political fragmentation, surging energy costs amid the Middle East conflict, the war in Ukraine and Chinese competition in manufacturing have all counted against Europe in recent months. But headlines describe the macro backdrop, not the operating environment for companies, and as bottom-up investors it is the latter that we focus on.

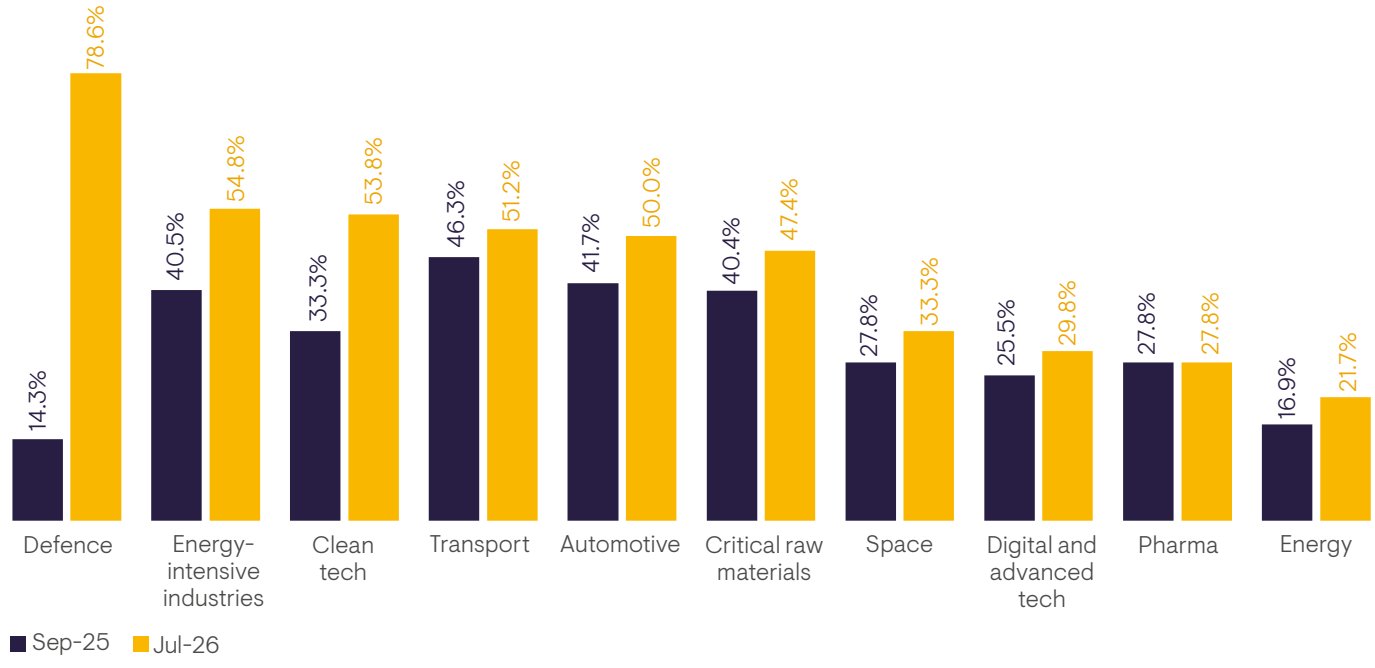
Much of the bad news is known and, we would argue, largely priced in, while the evidence at company level tells a different story. Under pressure to "reform or die", Europe is turning policy into legislation, which is feeding through to broad-based earnings growth. Because that growth comes from a different set of drivers to the AI-heavy US market, Europe also offers genuine diversification. Yet the market has been slow to recognise this: Europe's forward P/E discount to the US sits at the 89th percentile of its range over the past 30 years, which suggests the opportunity is not yet reflected in valuations.

Reforms are becoming legislation

Europe's reform agenda has a clear objective: to close the competitiveness gap with the US and China. Mario Draghi's 2024 report set out a roadmap of hundreds of recommendations to get there. Those recommendations have since moved from think tanks to the statute book, and roughly 40% are now moving towards implementation. Europe will never be a low-regulation economy, but markets reprice on the rate of change. Faster deregulation lowers compliance costs, frees management time and capital for investment, and supports margins. That is why it matters for earnings, not just for headlines.

Figure 1: Draghi's proposals are gradually being implemented

Recommendations implemented or partially implemented (%)



Source: EPIC/KEFIM Draghi Observatory, July 2026. Scored on adopted legislation, not announcements.

Where capital and reform have been applied with conviction, the results are already visible. Defence shows what happens when capital is mobilised at scale. EU defence spending is up 32% since 2023, yet a shortfall of around €250 billion a year remains against NATO's 3.5% of GDP target. That gap is an investable pipeline for European industrials over years rather than quarters. Greece shows the reform side of this: after a decade of crisis, deregulation and fiscal repair took the budget from a deficit of around 15% of GDP in 2009 to a surplus of around 2% and restored the country's investment-grade rating. They also drove a strong market recovery, with MSCI Greece outperforming MSCI ACWI over the past ten years.

Much of the capital needed to fund this already exists in European households, which save about €1.4 trillion a year and hold around 30% of their wealth in low-yielding bank deposits. Much of this capital is not currently put to work at home, with about €300 billion a year leaving the EU, largely for the US, according to the 2024 Letta report. Mobilising it again requires reform, and the Savings and Investments Union is designed to restructure how European savings are channelled through deeper capital markets and pension reform, redirecting deposits into productive investment and creating a structural source of demand for European assets.

€15bn

of the €37.5bn recurring annual cost-saving target from EU simplification has been delivered to date.

+32%

increase in EU-27 defence spending since 2023, showing what happens when capital is mobilised.

€1.4tn

saved by euro-area households each year, with about €300bn leaving the EU annually.

Source: European Commission simplification agenda, July 2026 (plus €5.6 billion of one-off costs removed); European Defence Agency, NATO/ICDS, July 2026; European Commission Savings and Investments Union strategy; Eurostat, 3 July 2026.

Earnings are being upgraded despite weak GDP

Euro-area GDP growth for 2026 has been cut to 0.6% from 1.0%,[1] yet MSCI Europe consensus EPS has been revised up by about 5% year to date, a reminder that European profits are not European GDP. About half of STOXX 600 revenues come from outside Europe, rising to around two-thirds for the top 100 companies,[2] and that global revenue base has allowed earnings to hold up as the domestic economy has softened.

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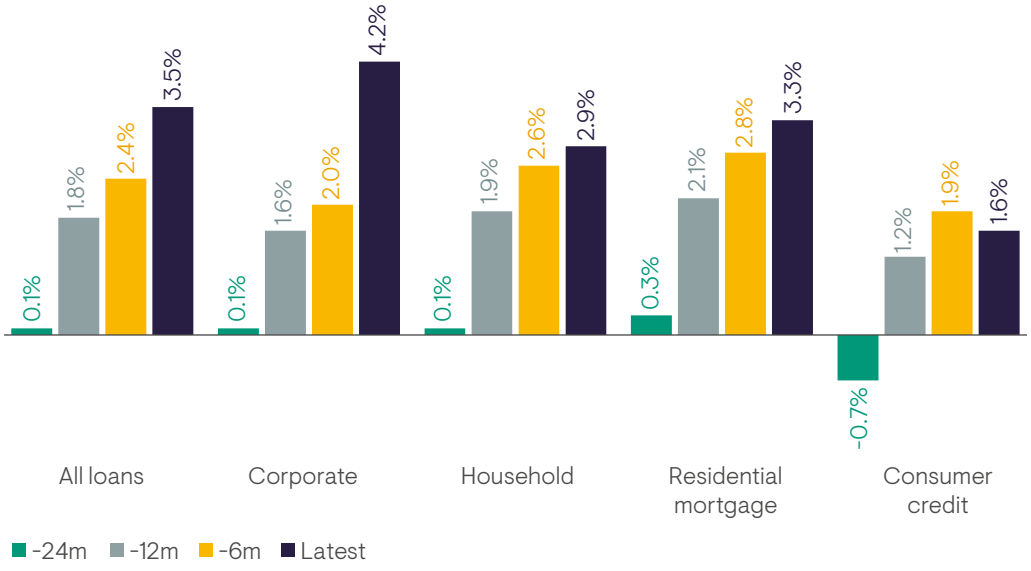
1. ECB Survey of Professional Forecasters, July 2026.
2. Ninety One, FactSet GeoRev via STOXX, September 2026.

Global revenues are only part of the story, however, as the upgrades extend well beyond the large exporters. Revisions are positive across about three-quarters of sectors, including domestically focused areas such as banks, utilities and capital goods, alongside chemicals, staples, aerospace, energy and healthcare, and collectively they point to expected EPS growth of 16% on last year. We believe this is a regime shift that is going largely unnoticed, and the breadth suggests the cycle can last.

Much of that domestic strength reflects a broadening investment cycle across data centres, defence, grid renewal and infrastructure, which is already showing up in orders and company guidance. It is also visible in credit data, where corporate loan growth has accelerated to 4.2%, from 1.6% a year ago and 0.1% two years ago. With companies borrowing to invest and banks willing to lend, this is an earnings cycle with real-economy support.

Figure 2: European corporate loan growth has accelerated

Eurozone loans outstanding, y/y (%)

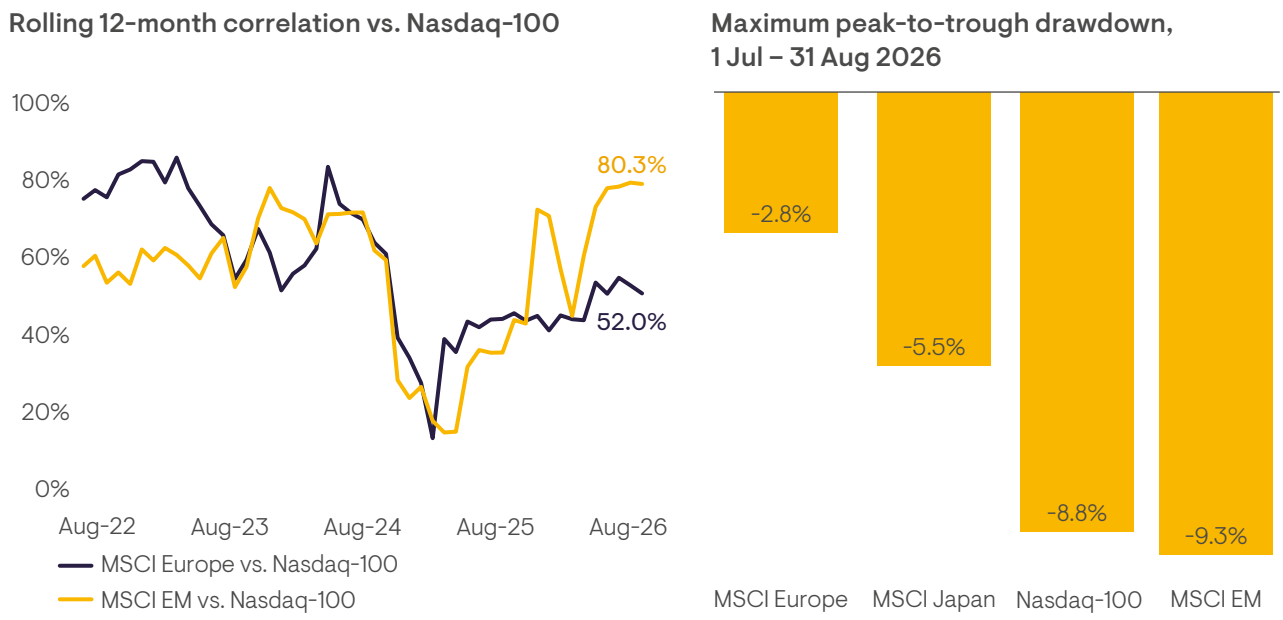


Source: ECB Data Portal, loans outstanding to euro-area residents, annual growth rate. Latest is the most recent monthly observation; -6m, -12m and -24m are the same series lagged. Data as at September 2026.

Europe is a genuine diversifier

Diversification matters in any allocation decision, and we believe the breadth of the earnings and capex cycles, together with the makeup of the index, makes Europe a genuine diversifier away from the leveraged AI-infrastructure bet. Its rolling 12-month correlation to the Nasdaq-100 is about 50%. Emerging markets sit near 80%, a 30-point gap. For portfolios already heavy in US technology and AI exposure, Europe offers exposure to a different set of earnings drivers: banks, industrials, defence, utilities and healthcare. That matters when AI-linked positioning unwinds, as it did over the summer, when Europe's drawdown was far smaller than more AI-exposed indices.

Figure 3: Europe offers the potential for diversification away from the AI trade



Source: Bloomberg as at August 2026. Maximum peak-to-trough drawdown of daily closing index levels over 1 July – 31 August 2026 (44 trading days). MSCI indices are net total return in USD: MSCI Europe (NDDUE15), MSCI Japan (NDDUJN), MSCI Emerging Markets (NDUEEGF). Nasdaq-100 is gross total return in USD (XNDX), as no net variant is published. Drawdown is measured within the period shown, not from an all-time high. All four indices had regained their pre-drawdown peak by 31 August 2026. Past performance is not a reliable indicator of future results.

Valuation and positioning suggest there is more to come

When a particular trade becomes especially popular, it can be too late to capture the full potential upside. Europe is far from loved, which is why we see it as an early-stage opportunity. On the valuation front, MSCI Europe trades at a 22% forward P/E discount to the S&P 500, or 19% on a sector-neutral basis, indicating this is not simply a result of sector mix. Either measure is roughly double the longer-run level of around 10%, and the broadening earnings cycle leaves room for this discount – which has begun to narrow – to close further.

Moreover, only about one-third of the outflows from European equity funds since the 2018 peak have returned, leaving roughly US$230 billion still to come back.[3] That sounds large but is small when compared with the US$8.8 trillion of US equities held by European investors.[4] Even modest reallocation would be significant. In terms of positioning, global fund managers are net 5% underweight Europe, close to the historic lows (excluding true systemic stress episodes such as the GFC and the eurozone crisis). EU hedge funds are the most overweight the US in years, so Europe is an uncrowded trade. In short, fundamentals have improved faster than investor positioning.

3. Source: Ninety One; FactSet; BofA Global Fund Manager Survey, September 2026; Morgan Stanley Prime Brokerage, 25 September 2026. Fund flows cumulative since 2016.
4. Source: European Parliament, March 2026, citing US Treasury data. When the UK, Switzerland, and Norway are included, European investors collectively hold about US$8.8 trillion in US equities (44.4% of the total foreign holdings) and US$6.1 trillion in US short-and long-term debt (39.7% of the total foreign holdings).

Closing thoughts

It remains important to be cognisant of the risks. Macro visibility is poor; euro-area growth forecasts have retreated, and gas is nearly 10x the equivalent price in the US, which weighs on energy-intensive sectors. There are several uncertain electoral outcomes, with events in France remaining a source of concern. The Middle East conflict has a binary influence on inflation and front-end yields and shows little sign of coming to a swift resolution, despite early hopes. Positioning could also override fundamentals for prolonged periods, so the valuation discount could persist.

These risks are real, but as bottom-up investors we treat country and political risks, alongside industry cycles, as context that informs our fundamental analysis rather than as primary drivers of stock selection. Despite the macro uncertainty, the company-level picture in Europe is positive: reform and capital mobilisation are supporting a broad capex cycle, and earnings are being upgraded across most sectors.

Europe also offers diversification from AI-driven concentration, while valuations, flows and positioning point to a cheap and under-owned asset class. Our focus remains on the marginal rate of change in the business drivers that matter for share prices over the next 12–24 months, and on where those changes are not yet reflected in market expectations. In Europe today, we see those changes going unrecognised at both the market and the company level.

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