

Europe Equities: Pause and Refresh

Fourth Quarter 2025

European equities have largely traded sideways since March after a strong start to the year, reflecting weaker earnings momentum and elevated valuations after the strong price moves. Looking ahead, we see scope for further gains, supported by an improving growth backdrop, robust cash returns to shareholders, and selective pockets of strength in capex and fiscal infrastructure. Meanwhile, high US valuations and concentration, along with an uncertain US economy under the Trump administration, continue to drive diversification away from US assets. Investors' positioning surveys show that Europe equities are generally under-owned and should therefore be a beneficiary of capital flows diversion from the US.

We expect German fiscal policy to expand significantly, paving the way for growth to be lifted from 4Q25 onwards. In line with this, German confidence surveys have been trending higher, particularly in stimulus-sensitive sectors such as manufacturing and construction. This underpins our conviction for European equities, especially Germany, to outperform.

Earnings impacted by tariffs and strong euro. Projected EPS growth for 2025 has been revised down to flattish growth from 8% since the start of this year. In the latest 2Q earnings results, European equities under STOXX 600 reported aggregate earnings growth of 4% and 2% sales decline. The prospect of additional margin compression in 4Q25 is a growing concern as i) more tangible impact of the US 15% tariffs on most European goods will gradually become more visible and ii) a strengthening euro, further spurred by the Fed's easing cycle, will exacerbate the negative impact on export-reliant sectors.

Among the domestic sectors, the aerospace and defense (A&D) industry was a standout performer, registering an exceptional 68% earnings growth. Financials and utilities also contributed significantly, showing robust earnings expansion that exceeded market expectations by over 10%. The resilience of these sectors were underpinned by underlying structural growth drivers and defensive attributes.

Table 1: Europe's 2Q25 sales and earnings by sector

2Q25	Growth (% y/y)		Surprise (%)	
	Sales	Earnings	Sales	Earnings
Technology	4%	56%	-1%	6%
Health Care	5%	20%	0%	5%
Financials	-3%	12%	-6%	11%
Materials	-5%	6%	-3%	-19%
Industrials	3%	6%	0%	2%
Utilities	-2%	6%	-7%	11%
Real Estate	3%	5%	2%	1%
Comms. Services	-1%	5%	0%	-4%
STOXX 600 Europe	-2%	4%	-1%	5%
Cons. Staples	1%	0%	-2%	3%
Energy	-9%	-24%	4%	3%
Cons. Discretionary	-5%	-35%	-2%	-1%

Source: Bloomberg, DBS
Data as at 1 Sep 2025

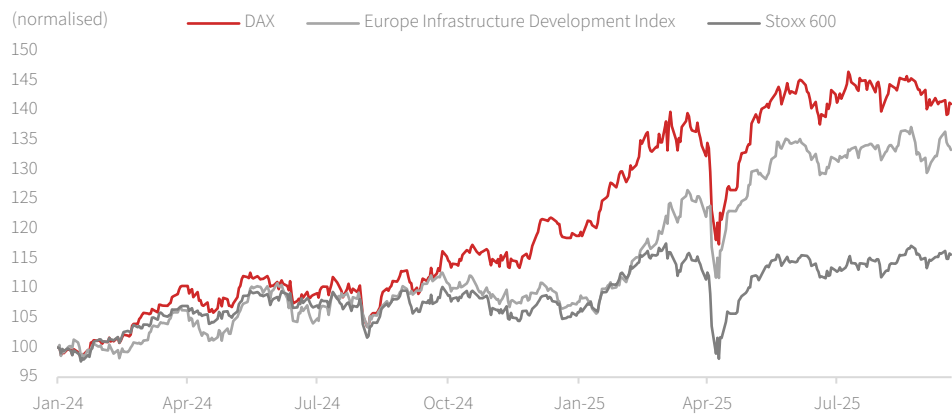
Joanne Goh

Strategist

Key Points

- Further gains are likely, despite 1H25 outperformance, supported by improving growth outlook, robust shareholder returns, and German fiscal stimulus
- Attractive valuations relative to the US and under-ownership position them as prime beneficiaries of diversification away from US assets
- 4Q25 margin compression from tariffs and a strong euro are growing concerns for export-oriented sectors
- The impact of France's political uncertainty on Europe equities should be limited as Europe outperformance was largely driven by German infrastructure and defense sector
- We prefer sectors which are defensive, less-export oriented, and beneficiaries of long-term structural tailwinds, especially defense, utilities and financials

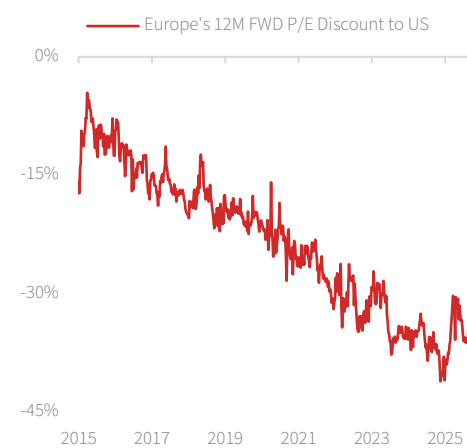
Figure 1: Outperformance of German and infrastructure & defence equities



Source: Bloomberg, DBS

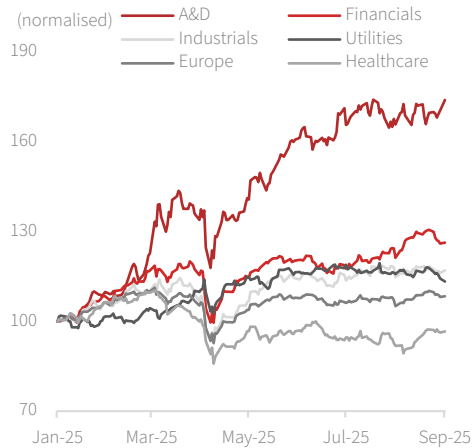
Valuations not expensive on a relative basis. Following strong early-year gains, European equity valuations have moved up by 40% from its lows and traded above its 10-year average. Moreover, with ECB bond yields moving higher, equity valuations appear less attractive relative to bonds when assessed on an Earnings-Bond yield gap basis. That said, at 14.6x forward PE, Europe still appears attractive relative to the US at 22.8x. Additionally, Europe offers an average dividend yield of 3.2% - comfortably above Eurozone's bond yields. Whether seeking income or diversification, investors will find that Europe remains well positioned on these metrics.

Figure 2: Valuation discount to US near historical high



Source: LSEG, DBS

Figure 3: Strong performance of Europe's financials, defence, and utilities sectors



Source: Bloomberg, DBS

Based on MSCI; Data as of 1 Sep 2025

Changing French politics not a concern. France's political uncertainty lingers after ex-PM Bayou failed to secure parliamentary support for his budget measures at the confidence vote on 8 Sep. President Macron has announced new PM Lecornu where the market will wait for meaningful fiscal resolution. Despite this turmoil, we expect limited impact as Europe equities' outperformance was largely driven by Germany's expansionary fiscal policies.

4Q25 Sector Strategy

European sectors would continuously be affected by a blend of cyclical and structural forces, including:

1. Euro appreciation pressuring export-heavy sectors
2. Potential ceasefire of Russian-Ukraine war would benefit all sectors while near term volatility for defense sector remains
3. German fiscal spending boosting domestic demand and infrastructure activity
4. AI-led demand shifts reshaping tech, industrial, and utilities sectors
5. Tariff escalation/de-escalation, particularly affecting autos and materials sectors

Given these, we prefer sectors which are defensive, less-export oriented, and beneficiaries of long-term structural tailwinds.

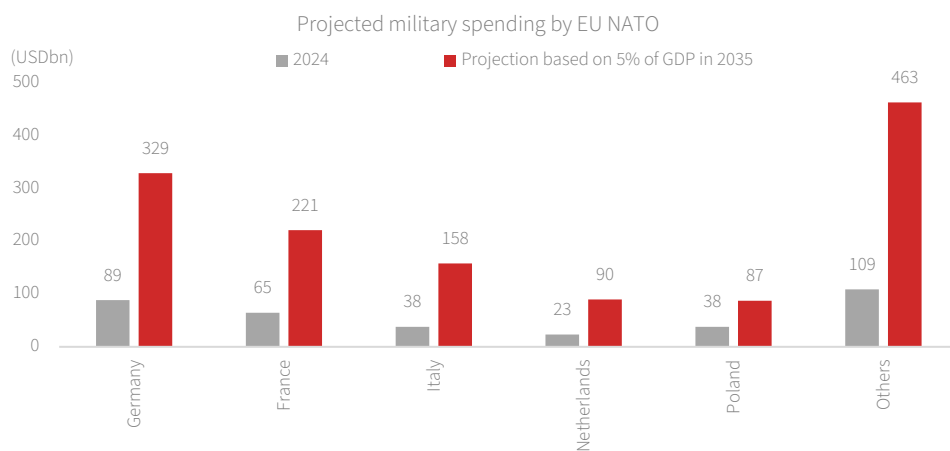
Defence: A new era of investment and technology modernisation

Despite recent consolidation of the defence sector from market expectations of a potential Russia-Ukraine war ceasefire, we maintain our constructive view as long-term tailwinds for the sector remain.

Europe is unequivocally embarking on a multi-year rearmament cycle, with defence budgets rising sharply and fiscal rules easing to support sustained investment—highlighted by the EU’s EUR800bn “ReArm Europe” initiative and increase in NATO’s defence spending target to 5% of GDP by 2035 from 2%. In alignment with these strategic objectives, the total EU NATO military spending is projected to register 13% CAGR growth during 2024-2035, according to SIPRI.

Furthermore, the sector is evolving beyond legacy contractors towards an accelerated adoption of AI, autonomy, and cyber technologies. This presents significant upside potential for Europe’s defence tech contractors (including SMEs), given the urgent need for technology modernisation and integration. Consequently, Europe’s defence industry is primed for superior earnings growth globally.

Figure 4: EU NATO defence spending to register 13% CAGR during 2024-2035



Source: Bloomberg, DBS

Utilities: Enduring resilience and strategic growth

Following a robust 2Q25, marked by resilient earnings and strategic positioning for energy transition, our constructive stance on the utilities sector remains firm given i) the sectors’ strong dividend policies, ii) secured cash flows, and iii) regulatory tailwinds and high investment visibility from decarbonisation and energy security agendas across the region. Europe’s electricity demand is projected to grow c.2% CAGR through 2030, driven by AI data centres, EV charging, and heat pumps.

Financials: Beneficiaries of a steepening yield curve

The sector’s forward PE has rerated sharply over the past 30 months, supported by the widening of the 10-2Y EU yield spread. Banks benefit from the classic model of borrowing short and lending long, while high yields enable insurers to invest premiums more profitably and enhance the appeal of long-term savings products such as annuities. Looking ahead, a substantial fiscal stimulus could drive the 10Y yield above 3% while easing inflation may steady the short end around current levels (we expect ECB to stay put on rates), further widening the spread and reinforcing profitability.

Meanwhile, credit growth has shown resilience, especially to households, where unemployment in Germany had fallen against expectations of a rise. Credit costs should largely remain benign despite a stronger growth environment.

While the banks’ absolute valuations based on PB now stand above its post-GFC high, the sector’s PE is still trading at a 26% discount to its post-GFC high, 38% discount to the broader European index, and 29% to US banks. We believe that the combination of sustainable profitability and discounted valuations continues to justify the sector’s upside.

Figure 5: Financials PE vs yield spread

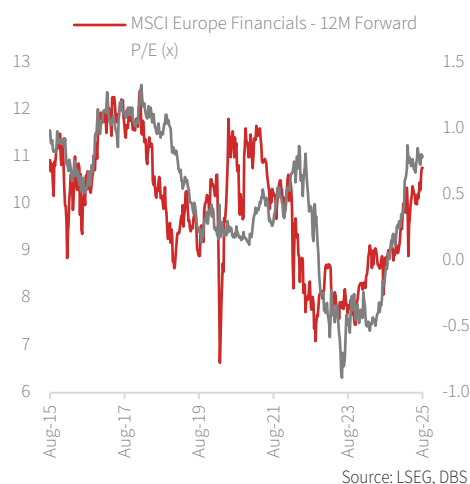
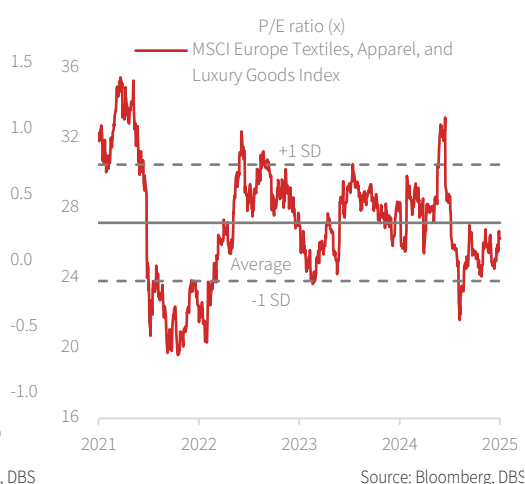


Figure 6: Luxury sector's attractive valuation provides cushion for further earning downgrades



Luxury: Navigating headwinds with selective opportunities

We maintain our cautious stance on luxury largely due to i) anticipated slowdown in consumer spending across key global markets, including the US and China, and ii) ongoing margin pressure from US tariffs. Given the challenging environment, our preference remains with companies with less US exposure, strong pricing power and brand desirability, and robust underlying fundamentals. We also see opportunities from luxury's attractive valuation, which is trading in-line with 4-years historical average, potentially providing cushion for further earnings downgrade.

Europe Sector Allocation – 4Q25

	Overweight	Neutral	Underweight
Europe	Technology	Energy	Materials
	Utilities	Cons. Staples	Cons. Discretionary
	Financials	Real Estate	
	Industrials	Comm. Services	
		Healthcare	

Source: DBS

Europe Valuation Table

	Forward P/E (x)	P/Book (x)	EV/EBITDA (x)	ROE (%)	ROA (%)	OPM (%)
Europe	15.2	2.1	10.9	12.1	1.4	12.7
Financials	10.8	1.3	-	12.0	0.7	18.2
Energy	10.0	1.1	4.2	11.8	2.8	9.2
Technology	28.8	5.2	22.1	15.8	6.6	15.5
Materials	17.2	1.7	9.1	9.2	2.9	7.9
Industrial	21.7	3.9	12.4	16.3	5.0	11.0
Cons. Staples	16.6	3.1	12.0	17.1	4.9	10.6
Cons. Discretionary	15.7	1.7	7.4	11.3	2.7	8.3
Comm. Services	20.8	2.2	7.4	8.4	2.1	14.3
Utilities	14.0	1.8	8.3	5.5	3.1	14.4
Real Estate	14.6	0.9	32.4	6.7	1.0	35.9
Healthcare	15.1	3.5	12.9	17.4	5.7	17.9

Source: Bloomberg
Data as at 22 Sep 2025

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