Rothschild & Co
Asset Management

Economic Resilience and the Return of Risks

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European fundamentals prove resilient amid renewed inflationary pressures.

The third quarter of 2026 ultimately confirmed two trends that may appear contradictory. On the one hand, the European economy continued to prove more resilient than expected, with a gradual improvement in activity indicators, the initial materialisation of German fiscal support measures, and strengthening earnings momentum. On the other hand, renewed energy-related pressures and rising long-term interest rates served as a reminder that Europe's trajectory is likely to remain volatile. Eurozone economic surprise indicators improved markedly over the summer, while the recovery in activity, particularly in manufacturing, became progressively more apparent. Against this backdrop, the Stoxx 600 declined modestly by 1.1% over the quarter.

The questioning of the framework agreement reached in June between the United States and Iran was one of the quarter's most significant developments. The return of traffic through the Strait of Hormuz to pre-agreement levels reignited the geopolitical risk premium and triggered a temporary rebound in Brent crude prices above USD 90 per barrel as early as July, with prices continuing to rise and reaching USD 103.5 by the end of September.[1] After providing significant support during the second quarter, easing energy prices gave way to a more uncertain environment, with direct implications for inflation expectations and monetary policy outlooks

The quarter was not, however, a straightforward one. Markets paused in July amid renewed geopolitical tensions and a correction in technology stocks before recovering in August thanks to resilient economic activity and strong corporate earnings. In September, higher energy prices and, above all, a sharp rise in bond yields weighed on European equities, while renewed enthusiasm for artificial intelligence once again supported US

technology stocks and semiconductor companies.

A still resilient global economy, but central banks constrained by inflation

In the United States, economic activity remained robust during the third quarter despite tighter financial conditions. This resilience limited concerns about growth but also sustained inflationary pressures and reduced the Federal Reserve's room to ease monetary policy rapidly.

The more hawkish tone adopted by the Federal Reserve at the Jackson Hole symposium reflected this situation. Rising energy prices throughout the quarter reinforced these concerns, while stronger activity indicators in September encouraged central banks to maintain a cautious stance.

In the euro area, growth remained more subdued, although signs of improvement gradually strengthened. This resilience in growth, combined with renewed inflationary pressures and persistently elevated financing needs, nevertheless contributed to a very significant rise in bond yields. **The yield on the 10-year German Bund increased by nearly 73 basis points during the quarter, closing at 3.58% at the end of September.**[1] This environment also led the ECB to raise its key policy rates by a further 25 basis points in September.

In Europe, a gradual improvement in activity despite a more uncertain external environment

The third quarter nevertheless brought several reassuring elements regarding Europe's economic momentum. Improvements in leading indicators suggest that the slowdown observed in previous quarters has not developed into a broader weakening in activity. Over the medium term, infrastructure investment, increased defence spending and fiscal support measures, particularly in Germany, should gradually support European investment.

The environment has nevertheless become more challenging. Rising energy prices have once again emerged as a risk factor for a European economy that remains especially sensitive to energy costs. This may weigh on corporate margins, household purchasing power and inflation prospects.

In addition, the quarter saw renewed tensions surrounding certain European sovereign debt markets, particularly in France. Concerns regarding the trajectory of public finances and the deterioration of the French budget deficit led to a widening of 48 basis points in the spread between French OATs and German Bunds, reaching 127 basis points on 30 September.[1] The return of a France-specific risk premium therefore represented an additional source of volatility for European assets ahead of the budget vote and the presidential election due in the spring.

European equity markets slightly lower, but significant sector divergence

In equity markets, the third quarter was characterised less by a broad directional move than by significant sector rotations. While the Stoxx 600 ended the quarter down 1.1%,[1] this masks extremely dispersed performances across sectors.

Renewed tensions in the Middle East and higher oil prices notably benefited the energy sector, up 12.5%,[1] making it the best-performing sector of the quarter. This environment also supported basic resources, which rose 6.0%, and the chemicals sector, up 3.8%. Finally, banks gained 6.3%, benefiting in particular from a higher interest rate environment.[1]

At the other end of the spectrum, rising bond yields heavily penalised several rate-sensitive sectors. Construction and materials declined by 9.7% during the quarter, real estate by 8.2% and utilities by 5.1%. Consumer-related sectors also came under pressure, with consumer products falling 8.3% and food and beverages declining 7.5%.[1] Technology, despite considerable intra-quarter volatility, ended the period down only 1.2%. This relative stability masks an 11.8% correction in July, followed by a rebound over the subsequent two months.[1]

This sector dispersion illustrates the increased sensitivity of European markets to three key variables: energy prices, interest rates and corporate earnings prospects.

Artificial intelligence remains at the center of market rotations

The artificial intelligence theme continued to play a major role in relative performance during the quarter, albeit with significantly greater volatility.

Following the strong gains recorded in the first half of the year, semiconductor stocks experienced a substantial correction in July. This reflected profit-taking, elevated valuation levels, concerns regarding the returns generated by investments made by hyperscalers, and the progress achieved by Chinese players in developing open-source models.

This correction was nevertheless followed by a rebound in August that accelerated further in September. Upward revisions to the sector's earnings outlook reignited investor interest in the theme, illustrated in particular by ASML's 10.0% gain during September alone.[1]

These pronounced fluctuations highlight a market that continues to assign a substantial premium to AI-related growth prospects, while becoming increasingly sensitive to valuation levels and companies' ability to translate investment spending into earnings growth.

Earnings momentum remains the key support for European markets

The half-year earnings season was one of the quarter's main sources of support. Results were generally favourable in both Europe and the United States and enabled markets to better absorb rising geopolitical, energy and monetary risks.

This factor has become increasingly important following the rally seen in the first half of the year. Future index performance will now depend more heavily on companies' ability to meet earnings expectations in an environment where interest rates and energy costs have once again become more restrictive.

Valuations also remain highly differentiated across regions and sectors. Technology stocks continue to reflect elevated growth expectations, whereas sectors most exposed to interest rates, consumer spending or financing costs experienced greater pressure during the quarter.

It is worth noting that the strong growth in earnings per share, both for the current financial year (+19.1%) and for 2027 (+8.9%), constitutes the main explanation for the resilience of European markets.[1] Such earnings growth is unusual for Europe, particularly as forecasts have been revised upwards throughout the year despite the volatile environment described above. This has allowed the Stoxx 600 to trade on a 13.9x P/E multiple, which remains reasonable relative to other developed markets and has returned close to its historical median.

Persistent risks for year-end, but also grounds for optimism

As the fourth quarter approaches, several factors will be critical: developments in geopolitical tensions and energy prices, the trajectory of inflation and long-term yields, the fiscal position of several European countries, the stance adopted by central banks, and companies' ability to confirm their earnings outlooks. The implementation of German fiscal support measures nevertheless provides a degree of cushioning for economic growth.

Should geopolitical tensions ease, Europe, which has been underweighted in asset allocations largely due to its energy dependence, could regain favour among investors. Furthermore, the lesser concentration of indices around AI-related stocks compared with US markets may also enhance the region's relative attractiveness if concerns surrounding this theme were to resurface.

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[1] Source : Bloomberg, 30/09/2026
[2] The P/E (Price-to-Earnings ratio, also known as the PER) is a financial indicator that measures a company's valuation relative to its earnings.

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