Rothschild & Co
Asset Management

How can we benefit from the eurozone's new impetus?

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Changes in the geopolitical context have given a new impetus to Europe, thanks to the renewed unity of the Eurozone and the end of fiscal austerity in Germany. This new situation should be of particular benefit to the Value style and to the member countries of the European Union, in sectors that will benefit from this impetus. Here are some explanations.

What has changed for Europe since the start of the year?

Two major events marked the European landscape in the first quarter of 2025, redefining its economic and strategic outlook.

On the one hand, the return of Donald Trump to the White House, accompanied by a declared desire to disengage militarily from NATO, acted as an electroshock. Faced with this pressure, Europe was able to stand united, rediscovering a form of unity around the defence of its sovereignty. The result: the launch of the ReArm Europe defence plan by the European Commission, with a budget of 800 billion euros, and a relaxation of budgetary rules to allow Member States to finance this joint effort.

On the other hand, the election of Chancellor Friedrich Merz marked a historic turning point in Germany. Berlin put an end to its policy of budgetary rigour, breaking with the famous Schuldenbremse[1], and announced a 10-year, €500 billion infrastructure plan, in addition to its contribution to the ReArm Europe plan. The scale of this budgetary commitment is unprecedented: in terms of effort, it is equivalent to the combination of the Marshall Plan and the reunification plan.

For some economists, this new European '*whatever it takes*' could have an annual impact of +1.5% on German growth and +0.8% on that of the Eurozone by 2030. A dynamic that could well redefine the economic trajectory of the Old Continent.

Can Europe continue to outperform the United States?

Since the start of the year, the Eurostoxx has returned 14.1%, compared with -5.5% for the S&P 500 [2]. The performance of these two indices is equivalent over three years (Eurostoxx at +50% and S&P 500 at +52%)[2], and while the spotlight has remained on the Magnificent 7 [3] (+111% over 3 years)[2], the performance of banking stocks in the eurozone has been much better over the same period (+179%) [2]. This is a strong sign of the renewed dynamism of certain European sectors in the face of the US technology giants.

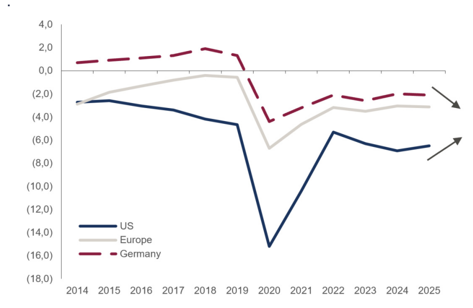
However, it is the future that most interests us. On this point, the trajectories of the United States and Europe seem to diverge. On the other side of the Atlantic, Donald Trump is having to deal with a deficit that has become difficult to sustain, forcing him to make some tricky economic decisions. Conversely, the eurozone now has unprecedented room for manoeuvre, thanks to Germany's past budgetary rigour and reinforced by the recent European rearmament plan. This dynamic could well anchor Europe's long-term outperformance against the United States.

In the shorter term, the monetary policy environment also works in Europe's favour. Inflation, which is more moderate than on the other side of the Atlantic, has enabled the ECB to lower its rates to 2.25% [4], with three cuts already since the start of the year. The Fed, meanwhile, is maintaining a restrictive monetary policy, with rates still around 4.5% [4]. This differential creates a more favourable context for growth in Europe.

Finally, investment flows confirm this renewed interest. Neglected since the invasion of Ukraine, the eurozone is once again attracting international investors. The movement is still modest - recent inflows account for only a quarter of the cumulative outflows since March 2022 [5] - but the trend has begun. With valuations still attractive and macroeconomic momentum now shifting in Europe's favour, the conditions seem ripe for an acceleration in these flows.

US / Europe / Germany budget balance

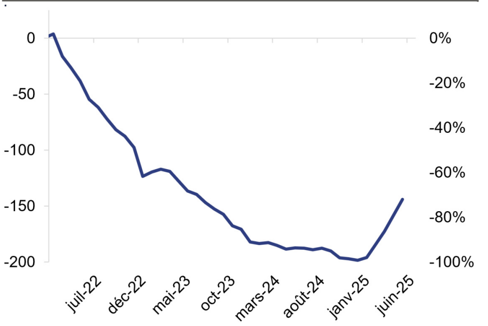
in % of GDP



Source : BNP Paribas Exane, 27/04/2025

Equity inflows Europe excluding UK

in billion of dollars



Source : Bloomberg, Rothschild & Co Asset Management, may 2025

Why do you think the eurozone is more attractive?

Over the last five years, the eurozone has gone through two phases of relative underperformance compared to the rest of Europe: i/ In the first half of 2022, due to the immediate repercussions of the Russia-Ukraine conflict ii/ Between April and August 2024, due to the political uncertainties weighing on its two main economies, Germany and France.

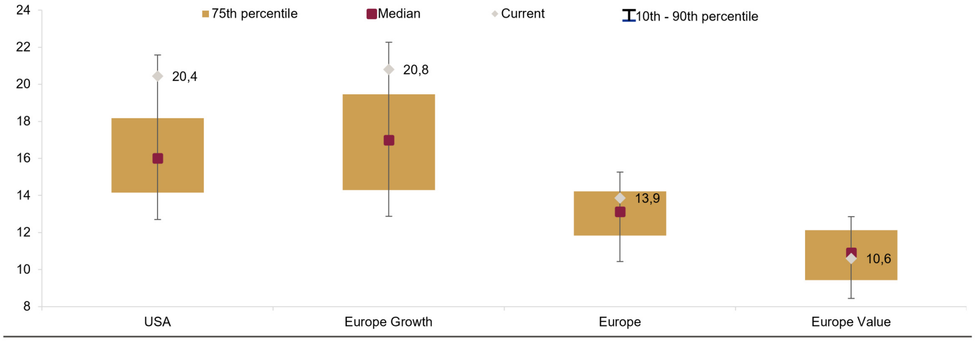
Despite these occasional episodes, the eurozone has outperformed Europe as a whole over 1, 2, 3 and 5 years. This resilience testifies not only to the solidity of its economic base, but also to the relevance of its union.

There is still room for improvement in this union, but it is being strengthened by the current geopolitical challenges, particularly those posed by Donald Trump's return to power. In this respect, the massive stimulus plan by Germany, the largest economy in the zone, and the rearmament of the European Union are both structural and exceptional support factors. These initiatives will naturally have a positive impact on activity across the continent, but their effects will be mainly concentrated in the Eurozone, whose union they will also strengthen.

In addition, there are two potential catalysts that could further reinforce this trend: i/ The signing of a peace agreement in Ukraine, whose reconstruction is estimated to cost between 500 and 1,000 billion dollars[6]. Beyond the direct impact on economic activity, a normalisation of geopolitical conditions could encourage a re-rating of valuations in the region ii/ Possible budgetary support in China, still on hold, which would directly benefit the Eurozone, the China’s main trading partner.

Valuation ranges

(MSCI Regions) over a 20-year timeline



Source : Goldman Sachs, 19/04/2025

Could the Value style benefit from this new environment?

Over the last twenty years, the Value[7] management style has tended to outperform the Growth[8] style when the European market has outperformed the US market. This correlation is explained in particular by the sector structure of the two zones: Europe remains more exposed to the industrial and financial sectors, while the American indices are dominated by technology stocks. This trend has been confirmed again since the start of the year, with value outperforming growth by more than 13 points [9].

Moreover, if we go back to the end of 2020 - the period marking the return of better post-Covid economic visibility - the gap now exceeds 28 points [10]. This situation can be explained in particular by the normalisation of interest rates and its direct corollary, the improvement in the profitability of the financial sectors. However, despite this momentum, the valuation premium for growth stocks remains high: around +95% compared with Value stocks, compared with a pre-Covid average of around +65% [10]. In our view, this premium should continue to be normalised, especially as we are now operating in a totally different interest rate and monetary policy environment from that which prevailed during the decade following the financial crisis.

In the short term, this should be achieved through the steepening of the yield curve, which should continue to support the financial sectors. In the medium to long term, the aforementioned stimulus plans are structurally positive for activity in the eurozone, and will support growth in Value-cyclical sectors such as construction, raw materials and industrial equipment manufacturers. The revitalisation of the region will provide increasingly favourable conditions for financial sectors, given their highly domestic nature. R-co Conviction Equity Value Euro is positioned to capture this momentum, with broad exposure to all these sectors.

Learn more about the fund(s)

R-co Conviction Equity Value Euro

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(1) Debt brake.
(2) Source: Bloomberg, 16/05/2025
(3) The Magnificent 7 are the seven largest US technology stocks: Microsoft, Nvidia, Tesla, Meta, Apple, Alphabet and Amazon.
(4) Source: Bloomberg 16/05/2025
(5) Source: EPFR, Goldman Sachs Global Investment Research, 16/05/2025
(6) Source: BNP Paribas Exane, 27/03/2025
(7) A value strategy is one in which the investor seeks out companies that are undervalued by the market at a given time, i.e. whose stock market valuation is lower than it should be in view of the company's results and asset value. Value investors select stocks with low price-to-book ratios or high dividend yields.
(8) Growth investors focus primarily on the earnings growth potential of companies, hoping that their sales and earnings growth will outstrip that of their sector or the market average.
(9) Source: Bloomberg, 19/05/2025 - performance to 16/05/2025
(10) Source: Goldman Sachs, 19/05/2025.

Disclaimers

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