Europe is back! Make Europe Great Again

Anthony Bailly
Head of European Equity

Vincent Iméneuraët
European Equities Portfolio Manager

Far from the post-U.S. election consensus, since the beginning of the year, Europe appears to be taking its revenge on Wall Street.

The strong outperformance of the European market accelerated following concerns over the potential loss of U.S. military support. As often happens when faced with adversity, Europe has tightened its bonds and responded with unity, demonstrating a will to break free from U.S. defence oversight. The European Union has launched a vast plan to rearm the region, and the new German Chancellor has proposed leveraging fiscal flexibility to override budgetary constraints, implementing both a German infrastructure stimulus plan and significant military expenditures.

This fiscal support, likely to boost European growth, has exceeded expectations and has been well received by European markets. This is reflected in the 10.1% rise in the Eurostoxx since the start of the year[1]. The STOXX Europe 600 index has also benefited, albeit to a lesser extent, with a 7.8% increase[1]. The prospect of peace in Ukraine, though its terms remain undefined, could further support this trend.

European bond markets have strongly reacted to this paradigm shift, notably with a significant rise in Bund yields, marking the end of Germany's austerity era. Meanwhile, the ECB has continued normalising its key interest rate, leading to a steepening of the yield curve.

Additionally, China's ambitious economic targets, supported by greater fiscal flexibility and a 5% growth objective for the year, have acted as another supportive factor for Europe, which stands to benefit indirectly from these developments. The recent stabilisation of property market prices lends credibility to a crisis recovery scenario, fuelling a rebound in Chinese markets.

At the same time, U.S. indices have turned red, with the S&P 500 down 4.3% year-to-date in dollars terms and 8.6% in euros terms, as the U.S[2]. dollar and all "Trump trades"[3] took a hit. Investors are no longer solely concerned about tech sector valuations, which are being challenged by China's rising AI competition—though the Nasdaq has suffered more than the S&P, with a 13.5% drop in euros[2]. Now, they question whether the new U.S. president will simply break economic growth. His lack of clarity in decision-making has created uncertainty, impacting U.S. consumer confidence. The market downturn also weighs on the wealth effect, and concerns about the inflationary nature of import tariffs are beginning to surface.

On a sectoral level, these developments have benefited European domestic industrial sectors that had been largely overlooked, particularly construction, chemicals, and raw materials. The industrial goods sector continued to perform well, driven by defence stocks—major beneficiaries of the announced measures. The banking sector also profited from its domestic exposure, the yield curve steepening, and the expected positive macroeconomic impact of the stimulus plans. This dynamic has already led some economists to significantly revise their eurozone growth forecasts upwards from 2026. Conversely, sectors exposed to U.S. consumer spending have come under pressure, particularly consumer goods. Investors are concerned about the health of the world's largest economy and early signs of declining consumer confidence, following President Trump's wavering stance on import tariffs.

For all these reasons, the early-year consensus favouring U.S. equities is being seriously challenged. The strength of U.S. economic growth is now in question, while at the same time, European cohesion around a major rearmament plan and Germany's infrastructure stimulus are driving European indices higher. The valuation gap is narrowing, with Europe recovering some of its past underperformance. This shift has been sudden, as the Eurostoxx has now caught up with the U.S. market since early 2023. Two key questions now arise: Have we entered a new era of prolonged European outperformance? Can European markets hold up if a downturn begins across the Atlantic?

Europe's valuation discount still reflects the region's structural deficiencies. However, cyclical factors—such as excessive German austerity and significant private-sector deleveraging, which have constrained investment and productivity—are beginning to fade. Political shifts in Germany, greater European energy independence, and large-scale investment plans will create long-term tailwinds. While the new Trump administration poses immediate risks to Europe, it also forces the continent to react swiftly.

Investors are acknowledging this new reality and are starting to reallocate into European markets, which are expected to play a more prominent role in portfolio allocations. The eurozone, previously underweighted, should benefit from significant capital inflows that could support indices. However, despite the recent rebound, fund flows remain modest for now. The €10 billion of inflows into European equities since early 2025 represents only 3% of the outflows recorded since early 2022[4]. If Europe's portfolio weightings were to be meaningfully rebalanced, the positive flow dynamics should logically continue.

Furthermore, recent market movements have led to a narrowing of the valuation discount between European and U.S. equities, from 43% at the end of 2024 to 33% as of 7 March[5]. The gap remains significant, and while the performance catch-up between the U.S. and Europe is already underway, European EPS[6] growth prospects now appear more favourable. This should lead to further gains in European valuations, which remain close to their historical average of 14.2x, compared to 21.3x in the U.S., where valuations remain elevated.

Completed writing on 13 march 2025

Check this document on our website

[1] Source: Bloomberg, 06/03/2025. Performance calculated in euros, dividends reinvested.
[2] Source: Bloomberg, 06/03/2025. Performance calculated with dividends reinvested.
[3] Market movement in reaction to Donald Trump's policies.
[4] Source: Bank of America, March 2025.
[5] Source: Goldman Sachs Research, Weekly Kickstart, 10/03/2025.
Earnings Per Share.

Disclaimer

About the Asset Management's division of Rothschild & Co

As the specialised asset management division of the Rothschild & Co group, we offer personalised asset management services to a broad client base of institutional investors, financial intermediaries and distributors.

Our development is focused on a range of open-ended funds, marketed under five strong brands: Conviction, Valor, Thematic, 4Change and OPAL, leveraging our long-term expertise in active management with conviction as well as in delegated management. Based in Paris and established in 9 European countries, we manage more than 38billion euros and employ nearly 170 people.

More information at: www.am.eu.rothschildandco.com

France

29, Avenue de Messine
75008 Paris
+33 1 40 74 40 74

Belgium – Netherlands – Luxembourg

Rue de la Régence 52
1000 Bruxelles
+32 2 627 77 30

Switzerland

Rothschild & Co Bank AG
Rue de la Corraterie 6
1204 Genève
+41 22 818 59 00

Italy

Passaggio Centrale 3
20 123 Milano
+39 02 7244 31

Germany - Austria

Börsenstraße 2 - 4
Frankfurt am Main 60313
+49 69 299 8840

Spain

Paseo de la Castellana 40 bis
28046 Madrid
+39 02 7244 31

Visit our internet site

Follow us on LinkedIn