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Asset Management



Quarterly Strategy Q1 2026 – European Equities



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The first-quarter correction has restored the relative appeal of European equities, whose valuations remain moderate. Nevertheless, the duration of the conflict in the Middle East and the resulting level of energy prices will be key factors in determining whether European equity markets can resume their upward trend.

The first quarter of 2026 was marked by a sharp resurgence of geopolitical tensions in the Middle East, which reignited fears of an oil shock and a temporary resurgence of inflationary pressures. This backdrop triggered a significant correction in European markets from the end of February onwards. However, in our view, this period of volatility does not, for the time being, call into question the fundamentals underpinning the European outlook: a gradually recovering economy, inflation returning to levels more compatible with monetary easing, and equity markets whose valuations remain significantly lower than those seen in the United States.

A global economy that remains resilient, despite the energy crisis

In the United States, the economy has continued to show remarkable resilience. Household consumption remained broadly healthy and the labour market stopped deteriorating, despite an environment that has become more uncertain. At the same time, rising energy prices linked to tensions in the Middle East have helped to reignite inflation

expectations and fuel the view that the Federal Reserve may remain cautious for longer than anticipated. Growth forecasts for 2026 remain robust, however, illustrating a persistent contrast between the resilience of economic activity and the resurgence of inflationary risks. In the eurozone, the picture is more mixed, but the underlying momentum remains encouraging. Leading indicators stabilised at the start of the year before being disrupted by the energy shock. The composite PMI[1], however, remained above the 50-point threshold and the manufacturing sector continued to recover, particularly in Germany. At the same time, growth forecasts for 2026 remain close to 1% despite revisions following recent events[2], suggesting not so much a relapse as a phase of gradual slowdown in economic activity.

This trend reinforces the view that Europe could gradually be entering a more favourable phase if these assumptions prove correct. The expected fiscal support, particularly in Germany, along with increased defence spending, is likely to fuel a more virtuous cycle for the European economy, through investment, improved utilisation of production capacity and, ultimately, greater confidence among households and businesses. The record-low unemployment rate in the eurozone and the recovery in new industria at tl orders in Germany are encouraging signs for this narrative.

For this to materialise, the de-escalation currently underway at the time of writing will, of course, need to be confirmed, thereby limiting the impact of rising energy costs to a temporary one; otherwise, the macroeconomic impact could weigh on this scenario.

European markets are being weighed down by geopolitical risks, but valuations have become more attractive again

It is, in fact, on the European markets that the geopolitical shock has been most clearly felt. Whilst the Eurostoxx was significantly outperforming the US markethe end of February, the rise in energy prices – to which Europe is more exposed – has reversed this trend. Ultimately, US and European indices posted comparable performances in euro with dividends reinvested over the quarter (-2.5% for the Eurostoxx and -2.7% for the S&P 500[3]), with the main European indices falling significantly in March, and a particularly sharp correction in the sectors most exposed to the economic cycle and energy costs, such as the automotive, consumer goods and property sectors. Conversely, energy-related sectors, and to a lesser extent telecommunications and utilities, held up better. Against this backdrop, in the eurozone, the value style[4] (+2.1%) once again outperformed the growth style[5] (-5.9%), benefiting significantly from the performance of the energy sector (+38.4%) over the period, which was buoyed by the rise in oil prices[3]. This rise also reignited expectations of short-term inflation, particularly in the United States. In Europe, the pressure observed on sovereign yields reflected a market that was more attuned to the potential consequences of a prolonged energy shock on the monetary policy path. This rise in interest rates has weighed more heavily on the segments most sensitive to duration, thereby penalising growth stocks.

However, this correction has had the effect of reducing valuations in the European market.

Indeed, the P/E[6] ratio for European equities has fallen to 13.9x expected earnings, compared with 20.5x for the US market[3]. The valuation gap between the two regions therefore remains very significant. Whilst US equities continue to command a high premium, particularly due to the focus on large-cap technology stocks and the artificial intelligence theme, the European market now appears to be more reasonably valued.

The most encouraging factor at this stage is that the market correction has not been accompanied by a significant downward revision of earnings forecasts. Earnings per share growth expectations for 2026 in Europe remain broadly around 10%[3], suggesting that the first quarter was primarily marked by a de-rating rather than a fundamental reassessment of the underlying scenario. Should the energy shock subside, earnings growth could therefore quickly become a supportive factor for the markets once again.

In the fixed income markets, the rise in oil prices has reignited expectations of short-term inflation, particularly in the United States. In Europe, the pressure observed on sovereign yields reflected a market paying closer attention to the potential consequences of a prolonged energy shock on the monetary policy path. This rise in yields weighed more heavily on the segments most sensitive to duration.

The ceasefire in Iran significantly alters the outlook for the quarter

Since the end of the quarter, the situation has improved somewhat following the announcement of a ceasefire in Iran. The subsequent fall in oil prices, along with the immediate rebound in European indices, illustrates how quickly markets reduce the energy risk premium once the prospect of extreme escalation recedes. In our view, this easing of tensions is a key factor for the coming months. Should this détente be confirmed, the main factor behind the quarter's correction could quickly lose momentum.

In this scenario, Europe would more clearly regain the factors underpinning its trajectory: better-controlled inflation than across the Atlantic, a monetary policy potentially more favourable to credit, a manufacturing sector on the mend, and structural fiscal support linked to new investment plans. In this context, earnings growth of around 10% in 2026 still seems possible to us, particularly due to favourable base effects[3], even if the energy sector will contribute more significantly, whilst current valuation levels suggest potential for a catch-up if geopolitical risk continues to ease.

Conclusion

Ultimately, the first quarter of 2026 appears to be more a period of external stress than a challenge to the European investment case. At this stage, rising oil and gas prices and pressure on interest rates have triggered a correction, but they have also made valuations somewhat more attractive. If the recent easing of tensions in the Middle East is confirmed, European markets could quickly refocus on their fundamentals: a more attractive

valuation starting point, sustained earnings momentum and a gradual improvement in the macroeconomic environment.

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[1]If the figure is above 50, it indicates expansion in activity; if it is below 50, it indicates contraction.
[2] Source: IMF, April 2026.
[3]Source: Bloomberg, 31 March 2026.
[4] The term ‘value’ strategy refers to an approach where investors seek out companies that are undervalued by the market at a given point in time; in other words, companies whose market capitalisation is lower than it should be given their earnings and the value of their assets. Value investors select stocks with low price-to-book ratios or high dividend yields.
[5] Investors who favour a ‘growth’ style focus primarily on a company’s earnings growth potential, hoping that its revenue and profit growth will outpace that of its sector or the market average.
[6]Price / Earnings : Ratio cours sur bénéfices.
[7] Depreciation.

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(1) Source: Rothschild & Co Asset Management, 31/07/2026.

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