Rothschild & Co
Asset Management

Quarterly Strategy Q2 2026 – European Equities

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The Gradual Normalisation of the Energy Shock Allows European Equities to Reconnect with Their Fundamentals

The second quarter of 2026 marked an important turning point for European equities. Following the correction at the end of March, driven by concerns over a prolonged energy shock, markets gradually regained visibility as geopolitical tensions in the Middle East eased and energy prices declined. Brent crude ended the quarter at USD 72.9 per barrel, broadly in line with pre-conflict levels. This easing enabled investors to refocus on the medium-term supportive factors underpinning European markets: still reasonable valuations, resilient earnings momentum, a gradual improvement in economic activity and the progressive emergence of fiscal support, particularly in Germany and the defence sector.

The quarter was not without volatility, however. Markets first rebounded sharply from their late-March lows before entering a more mixed environment characterised by persistent inflationary pressures, cautious central banks and significant sector rotation. In the United States, resilient economic activity and a robust labour market reinforced expectations of a Federal Reserve that remains highly attentive to inflation risks. In Europe, growth remains fragile, but leading indicators have shown signs of stabilisation. Against this backdrop, European equities benefited from a decline in the energy risk premium, a less adverse growth outlook and investor positioning that remains relatively underweight the region.

A Resilient Global Economy, Yet Central Banks Remain Constrained

The US economy continued to demonstrate resilience during the second quarter. Consumer spending remained broadly robust, while the labour market, although slowing, did not experience a sharp deterioration. This resilience came at a cost, however: inflation remains above the Federal Reserve's target, limiting its ability to ease monetary policy rapidly. The US environment continues to be characterised by elevated inflation, with CPI reaching 4.2% in May, while the first Federal Reserve meeting chaired by K. Warsh was interpreted as more hawkish than expected, with policymakers reiterating their commitment to price stability.

In the euro area, conditions remain more fragile, although several developments point towards stabilisation. First-quarter GDP was revised down to -0.2%, but business surveys improved towards the end of the quarter. The composite PMI rose back to 50 in June, while the manufacturing PMI remained above the expansion threshold at 51.4 despite a modest decline. Services activity, although still contracting, also improved, with the index rising from 47.7 to 49.4. While gradual, this improvement suggests that the energy and geopolitical shock has not, at this stage, derailed Europe's recovery trajectory.

European monetary policy nevertheless remains a key area of focus. The ECB raised interest rates by 25 basis points in June while maintaining a restrictive stance in response to the risk of broader inflation pass-through. Christine Lagarde's tone softened somewhat towards the end of the month following the announcement of the Memorandum of Understanding (MoU) between the United States and Iran, which contributed to easing energy prices. This combination of still-fragile growth, inflation dynamics that are less challenging than in the United States, and a central bank that remains cautious supports a scenario of gradual normalisation rather than an abrupt acceleration in economic activity.

Over the medium term, we continue to believe that Europe offers a more favourable macroeconomic entry point than it has in recent years. German fiscal support, rising defence spending and infrastructure investment could gradually create a more virtuous cycle: a recovery in investment, improved capacity utilisation, renewed business confidence and, ultimately, stronger consumer spending. This thesis was already at the heart of our 2026 outlook, which highlighted the scale of Germany's investment programme, increasing defence expenditure, the potential improvement in productivity and the possibility that European households may begin to spend part of their accumulated savings. In our view, these positive effects have been delayed by the conflict involving Iran but remain firmly intact.

European Markets Supported by Easing Energy Prices and Improved Market Dynamics

Equity markets experienced a strong rebound during the second quarter following the stress observed in early March, accompanied by substantial sector rotation. European indices benefited from lower energy prices and a reduction in the geopolitical risk premium. The STOXX Europe index gained 11.4% during the quarter, benefiting more than global indices from declining energy prices and improving macroeconomic visibility. Sector performance differed significantly. Technology stocks continued to benefit from enthusiasm surrounding artificial intelligence, with semiconductor companies delivering particularly strong gains. Supported by the semiconductor segment, the European technology sector rose by 33.9%. By contrast, the energy sector declined by 10.1% as lower commodity prices weighed on performance. Telecommunications were also under pressure, falling by 2%, amid growing competitive concerns linked to satellite operators following SpaceX's initial public offering.

This rotation highlights the market's sensitivity to two opposing forces: on the one hand, the continuation of the AI theme and associated investment in digital infrastructure; on the other, the normalisation of energy risk, which has reduced the relative appeal of sectors that had benefited from higher oil prices during the first quarter. Investors are nevertheless increasingly seeking to broaden their exposure beyond the direct beneficiaries of artificial intelligence, amid elevated market concentration and heightened volatility among stocks linked to AI-related capital expenditure. In this environment, European banks continue to benefit from attractive valuations, robust earnings momentum, an interest rate backdrop that remains supportive for net interest income, and strong shareholder return prospects. These factors have enabled the sector to rebound by almost 27.4% since the market low reached on 20 March[1].

Meanwhile, more domestically oriented and cyclical segments—including construction, materials, infrastructure, selected industrial companies and stocks exposed to defence spending—continue to offer catch-up potential should the gradual recovery scenario materialise.

European Valuations Remain Supportive, but Markets Now Need Earnings Confirmation

The European market’s main support continues to be its relative valuation. European equities were trading at around 14.9x forward earnings[1], a level that is admittedly above the historical median but remains below that of other major markets, particularly the United States. Expected earnings-per-share growth in Europe of around 15% for 2026[1] also provides reassurance for investors. Unlike the US market, where performance remains heavily concentrated around artificial intelligence and large-cap technology stocks, European equities offer more diversified exposure, with more balanced valuations and recovery potential across several sectors that remain out of favour. They also provide an alternative investment opportunity that is notably less dependent on the trajectory of the

US dollar. That said, valuations alone are not sufficient. Following the second-quarter rebound, further market gains will depend increasingly on companies' ability to deliver on earnings expectations. In this regard, the second-quarter earnings season will be particularly important. Bond markets also remain a key area of focus. Lower oil prices have eased short-term inflationary pressures, but central banks cannot yet declare victory. In Europe, the ECB remains vigilant regarding the risk of broader price pressures spreading throughout the economy. In the United States, weaker employment data released in early July temporarily reduced the likelihood of further interest rate increases, but also reignited questions about the appropriate balance between growth, inflation and monetary policy.

De-escalation in the Middle East Has Significantly Changed the Narrative

The most significant development of the quarter was arguably the geopolitical de-escalation that took place in June. The announcement of a Memorandum of Understanding (MoU) between the United States and Iran, signed in Switzerland on 20 June, initiated a 60-day period intended to pave the way towards a final agreement. While many uncertainties remain, particularly regarding nuclear issues, markets interpreted this initiative as a signal that global oil flows could gradually normalise and that energy-related inflationary pressures may continue to ease. Nevertheless, this improvement still requires confirmation. The MoU does not yet constitute a final agreement, and the geopolitical backdrop remains fragile. European gas inventories also remain below their long-term averages, warranting continued vigilance regarding energy prices ahead of the winter season.

In our central scenario, however, the continued easing of energy prices would allow investors to focus more closely on European fundamentals. Lower energy costs support corporate margins, alleviate pressure on households, improve consumption prospects and provide greater flexibility for the ECB. As such, they represent a key catalyst for the European investment case.

Normalisation After the Shock

Ultimately, European markets recovered as the energy risk premium declined, without undermining the region's fundamental investment case. Growth remains fragile, but leading indicators are stabilising; inflation remains a concern, but lower energy prices reduce the risk of a prolonged shock; and while central banks remain cautious, the prospect of a sustained period of more aggressive monetary tightening becomes less likely if disinflation continues.

Against this backdrop, we believe European equities retain several compelling strengths. They trade at more attractive valuations than US equities, offer exposure to sectors likely to benefit from European investment programmes, provide recovery potential across value and cyclical segments, and offer diversification away from the extreme

concentration of the US market around artificial intelligence. Earnings expectations for 2026 remain demanding, but achievable if energy costs continue to normalise and European fiscal support begins to materialise.

Nevertheless, the quarter serves as a reminder that the region remains exposed to several key factors: confirmation of de-escalation in the Middle East, stabilisation of energy prices, the ECB's ability to support the recovery without reigniting inflationary pressures, and the delivery of earnings expectations during upcoming reporting seasons. Should these conditions be met, European markets could continue to benefit from a powerful double tailwind: earnings growth and a gradual re-rating of valuations.

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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) Fuente: Rothschild & Co Asset Management, 31/07/2026.

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