

EUROPEAN EQUITIES OUTLOOK 2024

# Are European equities set to surprise again in 2024?

The past year turned out differently to how many predicted. Indeed, 2023 was a good year for stocks, with double-digit performance for most segments – incorrect forecasts regarding inflation were largely responsible for this, while geopolitical events had a less significant impact than expected. Energy prices have returned to late 2021 levels and, while central banks are treating falling inflation cautiously, if this trend is confirmed then a reversal in interest rate policy will surely follow. However, money supply (in terms of central bank balance sheets) remains an issue and this may well be used as an argument to delay rate cuts.



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What can we expect in 2024? Inflation will continue to fall, but more slowly, and central banks will start cutting interest rates by mid-year, at the latest. However, investors should keep in mind that levels as low as 2021 are not seen as desirable, and this will curtail the potential for rate cuts.

Not all stocks were able to benefit from the inflation and broader market environment. Once again, the big technology stocks, especially in the US, drove market performance; however, small caps underperformed, and value also lagged growth. Gold and the Dow Jones were winners, but the DAX and MSCI World were significantly better. Furthermore, the concentration of market returns was extreme in 2023 – the top seven companies in the US generated almost 45% of market return, compared to less than 10% in Europe, 34% in Japan, and 44% in the MSCI

## Key takeaways

- Inflation to continue falling, albeit more slowly, and rate cuts are likely from mid-year onwards
- Considerable uncertainty remains, but analyst estimates see European firms earning around 6% more in 2024 than 2023
- Several sectors – including banks, automotive, and energy – are offering interesting valuations
- The trajectory of equity markets in 2024 will likely take its lead from the changing interest rate environment

World. And who could have predicted that bonds would also perform well? The final few weeks of last year were particularly helpful here, yet these movements on the bond markets were still not enough to recover from the previous two years.

One key question is how long the trend favouring large US tech stocks will last; if it continues, growth will continue to outperform value. However, this does not affect the entirety of the market; value offers a wide selection of stocks with high potential that, in addition to good dividends, also show great potential from their undervaluation. Small caps are also interesting; in addition to strong undervaluation, the growth character of many smaller companies also comes into play here.

### The macro trajectory – fending off recession

The word recession remains on everyone’s lips. Are we in one, will one come, and if so, how severe will it be? Global GDP (gross domestic product) growth figures for 2023 will settle at over 2.5%, driven by the US and some emerging markets. Developed markets show a more positive picture than expected, with Europe certainly growing but being slowed down by Germany. And China

was able to make a positive contribution to global growth in 2023, albeit with weaker momentum than originally hoped.

The consensus for 2024 sees things changing – Europe will be stronger and the US weaker. But is the consensus correct? While the base effect speaks for Europe and against the US, employment figures in both show a different picture. In addition, elections in the US and the UK will also shape macro developments and cause uncertainty in the lead up to year end.

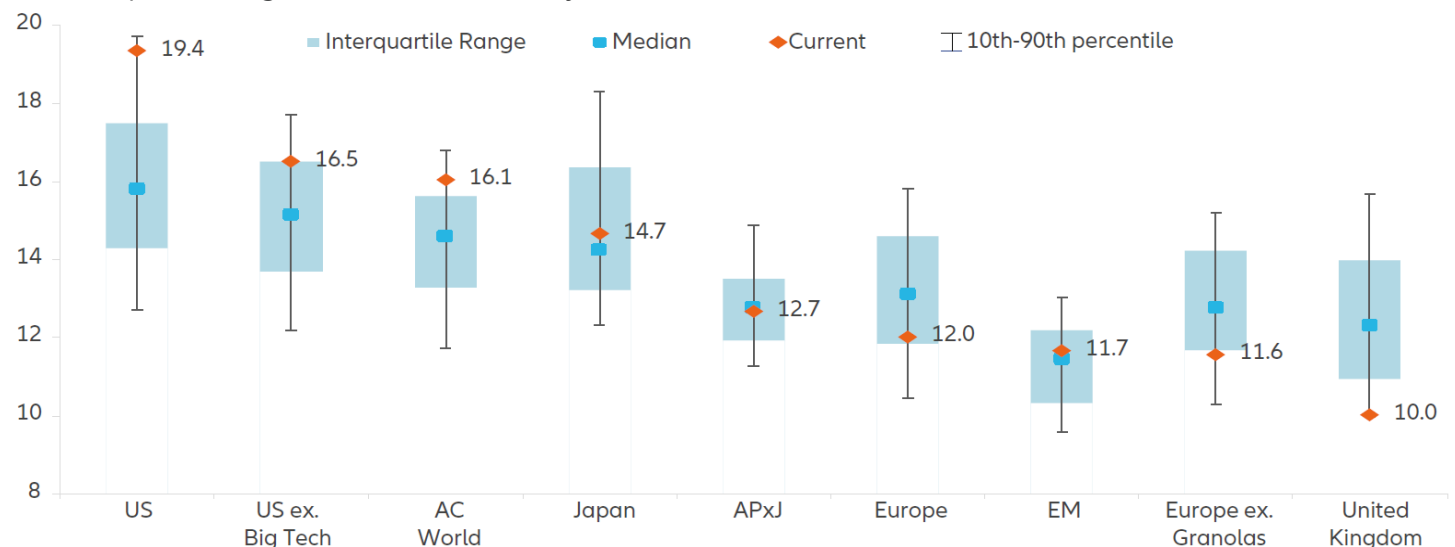
Japan will also continue to deliver positive growth, while China will continue to find its own way out of the crisis, taking whatever measures it deems necessary to stabilize its economy. Furthermore, falling interest rates should provide additional growth potential for emerging markets. This could, in turn, help European companies, especially industrial stocks.

### A positive picture for earnings and valuations

2023 was difficult but successful for most companies; while earnings have increased overall, certain sectors have seen valuations increase particularly significantly.

**Exhibit 1: The geographical spread of valuations across regions remains significant**

12m fwd P/E, MSCI regions; data for the last 20 years



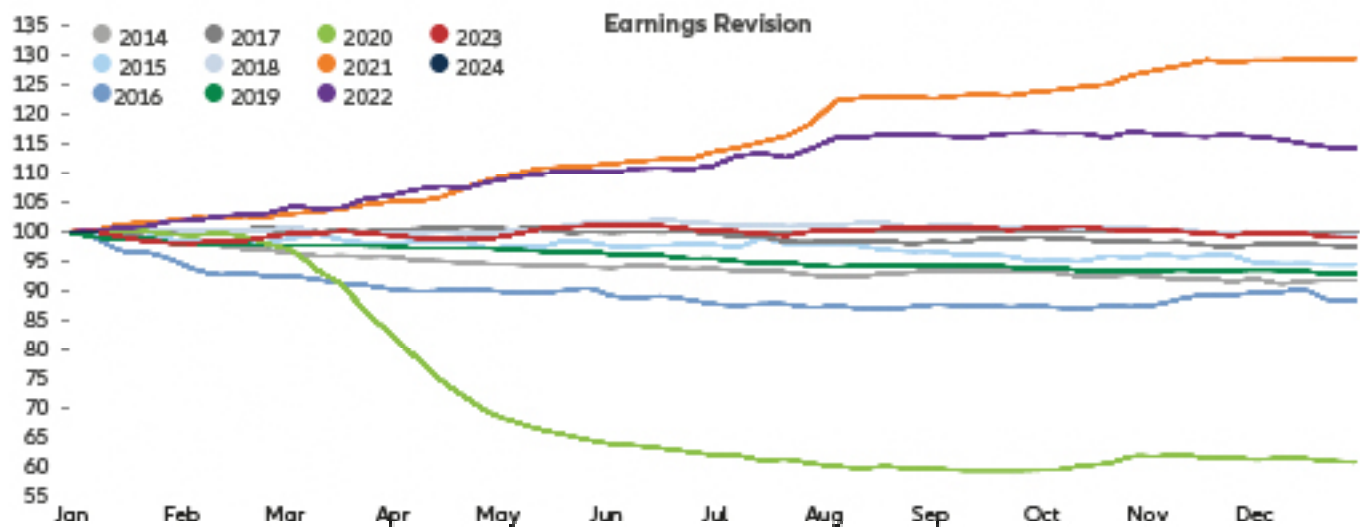
Sources: Factset, Goldman Sachs Global Investment Research, Jan 24

As the charts shows, the parts of the market dominated by the big US seven are expensive. When including these stocks, valuations seem high; without them, the picture is somewhat different. Indeed, the most attractive markets are Europe and the UK. Overall, companies were able to generate quite robust results in 2023, despite the many uncertainties.

What can we expect for 2024? Companies are communicating cautiously, and the many unanswered questions are contributing to uncertainty. Inflation, interest rates, and geopolitics all make it difficult to formulate an accurate forecast. Using analysts' estimates as the best guide, companies in Europe will earn 6% more next year than in 2023. In addition, small caps in Europe and the UK remain very interesting in terms of valuation.

**Exhibit 2: STOXX Europe 600 EPS revisions and earnings sentiment**

In EUR



Source: FactSet, STOXX, Goldman Sachs Global Investment Research, Jan 2024

Of course, earnings estimates should still be read with caution. Large upward revisions – often seen at the beginning of the year – are then frequently eliminated over the following months.

**Sector focus – seeking opportunities**

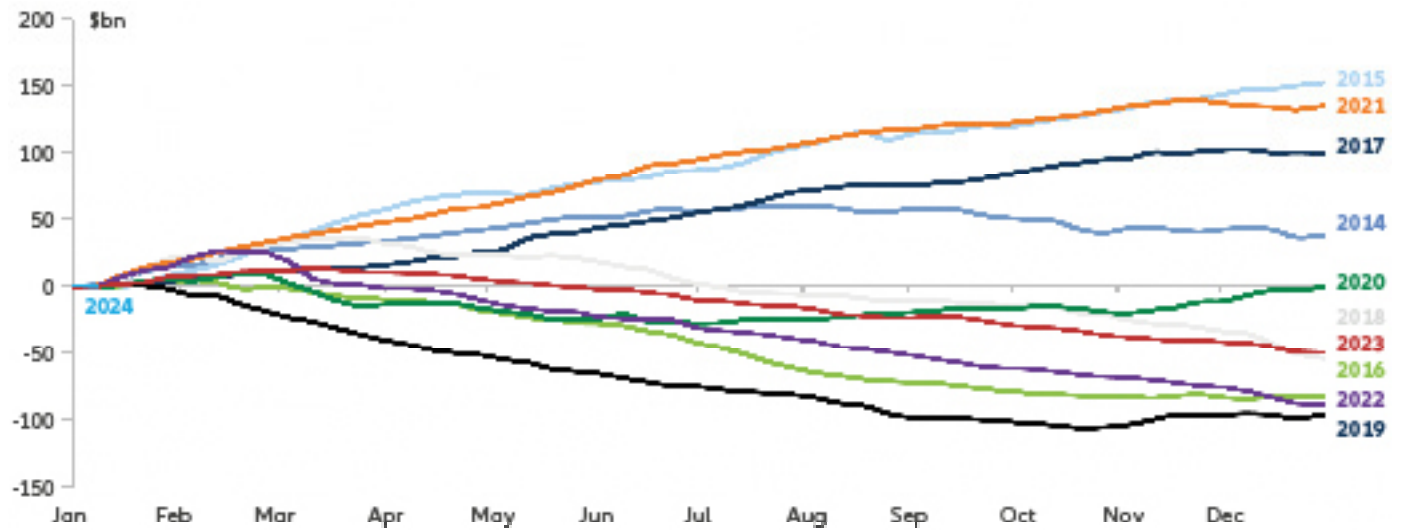
Several European sectors offer potential. Banks had a good year in 2023 but remain cheap. The same applies to automotives, though the earnings trend here is declining. Energy stocks are also cheaply valued compared to their historical levels, while technology and luxury stocks look rather expensive. At first glance, chemical stocks do not seem attractive, yet lower energy prices and the foreseeable end of destocking will lead to an improvement in earnings and more interesting valuations here.

What can we expect for 2024? While, as mentioned, banks remain cheap and have further potential for higher valuation, we should expect declining interest margins and some headwind after very strong earnings in 2023. Cyclical stocks, such as chemicals, will benefit from better conditions. More defensive stocks, such as insurance, consumer staples, and health care will also benefit, yet may be less in demand in such a market situation.

We should also consider changes in the flows of liquid assets. As the graphic below clearly shows, 2022 and 2023 were years where global investors reduced exposure to Europe. This was due to geopolitics, but also the worsening earnings of European companies compared to other regions.

**Exhibit 3: Calendarised flows from Global investors into European equity funds**

Weekly flows, EPFR country flows



Sources: EPFR, Haver Analytis, Goldman Sachs Global Investment Research, Jan 2024

While the geopolitical outlook has not changed, the earnings situation of most companies has improved significantly compared to 2022, contributing to interesting valuations in Europe. A good benchmark for this is the stable dividend yield on the European market, which currently stands at 3.7%.

In 2024, stock markets will continue to be dominated by interest rates. If inflation figures continue to show a downward trend, central banks will take advantage of the situation to lower rates. Falling interest rates can help growth stocks, with a positive impact on their valuation, yet will also be a boon to other undervalued segments, such as small caps. Here, investors can benefit from convincing growth rates combined with a positive valuation.

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