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# Making European markets **great again?**

Many investors had expected Donald Trump's "Make America Great Again" agenda to help propel US equities to new heights. Instead, European equity markets have emerged from the doldrums to outpace their US counterparts in recent months. We think the dramatic turnaround underlines the importance of a diversified and agile approach that may be achieved by investing in a multi asset portfolio.

A recent rally in European stocks at the same time as an under-performance of their US counterparts has underlined a change in momentum in equity markets.



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## Key takeaways

- The revival in European equities signals some investors may be starting to rotate into the continent's equity markets from the US, but there's a long way to go as overall investors remain highly concentrated in US equities.
- The unwinding of the big tech trade in the US, coupled with the prospect of higher defence spending and reduced red tape in Europe have all helped to boost sentiment towards European stocks.
- We see the potential for European equities to continue to outperform their US counterparts, although conditions may change if the trade war between the two regions were to escalate.



**Navigating  
Rates**

Donald Trump's election as US president in November and his "America First" agenda had led some investors to believe that US equity markets would continue their strong run on the promise of further tax cuts and deregulation. But the reality has been quite different as the US administration has shifted towards an isolationist stance, using tariffs as a negotiation strategy. The shifting geopolitical and market landscape underlines, in our view, the importance of an active and diversified investment approach (a multi asset portfolio is one way of building diversification across equities and other asset classes).

The Stoxx Europe 600 index has risen around 6% so far this year, compared to a roughly 10% fall for the US S&P 500. The performance is unusual considering the weaker market environment and it contrasts with a 15-year period in which US equities, fuelled by superior earnings, have left other markets trailing, culminating in price to earnings ratios soaring to 1.9 times the level of the rest of the world.

But, at least for now, investor focus has switched to European equities. We think several factors are behind the shift:

- **Unwinding of the US big tech stocks trade:** US tech stocks have faced a challenging few weeks after Chinese artificial intelligence start-up DeepSeek in late January announced advances that investors worried could threaten the outlook for demand for high-end semiconductors. The announcement triggered broader uncertainty about the long-held belief that US tech firms will continue to grow exponentially and have a competitive advantage from their investment capabilities. Given that the Magnificent Seven club of US giant tech stocks account for around a third of the S&P 500's market capitalisation, some investors have started to question concentration risks and seek growth opportunities elsewhere in financial markets.
- **US tariffs, tax cuts and deregulation:** a majority of investors believed that US equities would continue to motor ahead of other markets as they did during the first term of Mr Trump's first administration. Instead, questions have emerged about how easy it may be for Mr Trump to achieve his aim to make huge cuts to taxes, government spending and regulation. The recent announcement of 25% tariffs on imports from Canada and Mexico, and a 20% levy on China, have also failed to revive US stocks. Instead, Mexico, Canada and China have retaliated with their own tariffs on US goods. The result? US equities slid in recent days.
- **European defence spending:** warmer US relations with Moscow and the potential threat of the US leaving

NATO have galvanised European officials to prioritise spending on defence as part of a move to carve a more independent European policy and boost economic growth. The German government, for example, is negotiating with the Green party to approve a 500 billion euro special infrastructure fund, which would likely significantly raise infrastructure spending. Once Germany's debt levels align closer to the rest of the EU, moves towards closer integration and even joint debt issuance among the bloc may become more likely. All these factors should help propel European growth stocks, in our view, even at the risk of overall higher interest rates on government bonds in the region.

- **European deregulation:** with the Trump administration moving to relax corporate regulations, Europe may need to reform some existing rules to remain competitive. Less red tape would be positive for companies and overall growth. Many rules have been postponed already, such as those governing ESG reporting and CO2 levies on vehicles. More are likely to come if European policy makers follow recommendations made last year by former Italian premier Mario Draghi to launch a "new industrial strategy for Europe" to stop the union falling behind the US and China. Considering the huge amount of regulation in the EU compared to other major economies, even a marginal reduction of red tape could have a substantial impact on growth and productivity.

### Concentration risks underline the value of diversification

In response to recent events, investors have started raising allocations to European equities, with large inflows into equity funds across the industry, especially from commodity trading advisers. But there is a long way to go in terms of closing the gap as Europe remains heavily under-owned, globally and historically. The overall concentration of investor holdings in the US remains high: US equities constitute around 71% of the MSCI All Country World Index.

In this environment, we see several opportunities in Europe – both within equities and fixed income – in addition to possibilities within defence, as well as chemicals and construction, if a peace deal emerges between Russia and Ukraine:

- **Banks:** lenders are in the sweet spot of recent developments. Robust earnings and the prospect of economic stimulus has led to strong momentum for the banking sector. Valuations are still reasonable compared to the US and merger activity could gain traction.

- **Automobiles:** with risks surrounding tariffs now priced in, the sector looks under-owned and cheap. Yet the sector is gathering momentum and should receive a further lift if the European economy reaccelerates.
- **Government bonds:** until planned fiscal packages materialise, we expect inflation in Europe to remain weaker than in the US, leading us to favour European government bonds tactically. French government bonds could profit from speculation about the prospect of a more coordinated bond issuance at the EU level.

Greater optimism about a European cyclical recovery and policy change may also boost prospects for the euro. We think the changing outlook could lead to upward

momentum for the euro versus the Swiss franc and reduced downward pressure on the euro against the dollar.

Even though a short-term reversion is possible after recent market movements, we see potential for further momentum for European markets in the months ahead. The outlook may improve further in the event of a permanent Russia-Ukraine ceasefire, leading to expectations of a lowering in energy prices and an easing in risk premiums. Continued policy uncertainty and worsening economic data in the US may give investors further reason to favour Europe. Of course, the picture could change if Mr Trump delivers on his threat to impose 25% tariffs on the EU, escalating the trade war. But overall, we think recent equity market shifts give fresh impetus to building an active and diversified approach to asset allocation.

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