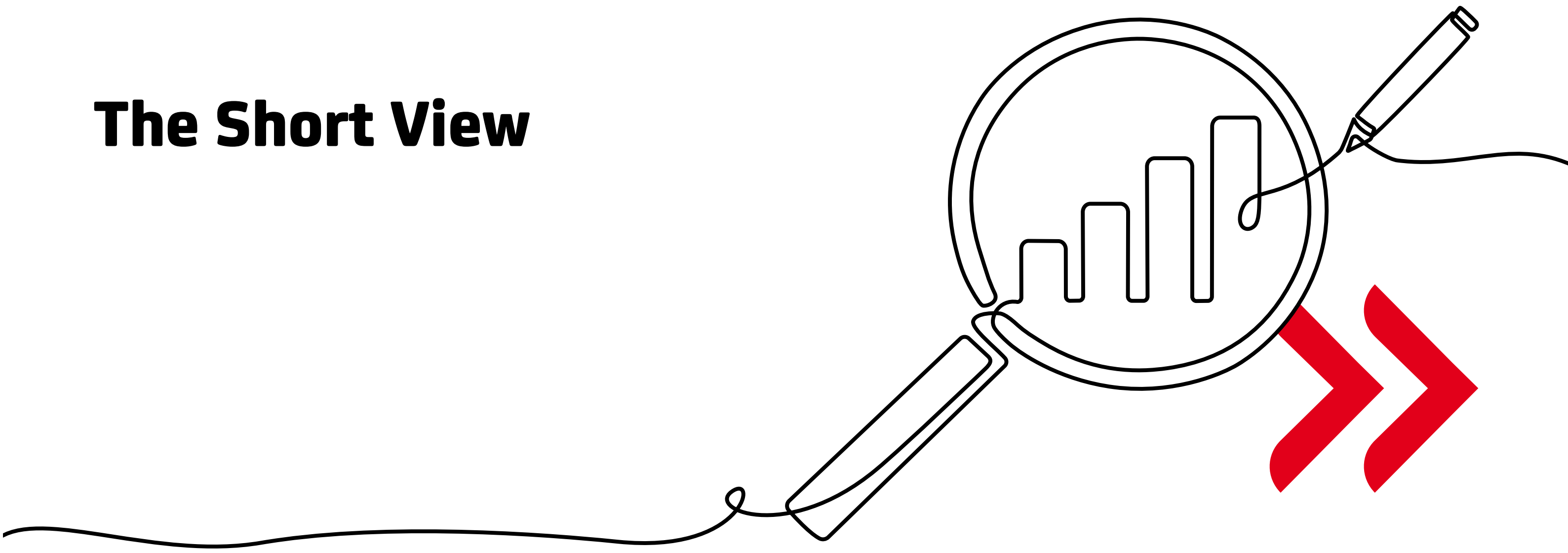
The Short View



The Short View offers insights on key macro and market stories and is designed to promote discussion and debate.

European equities' quiet revival

1 September 2026

European equities are increasingly challenging long-held investor assumptions. Earnings growth is accelerating, profitability is improving and performance has been stronger than commonly perceived. While Europe is still facing structural challenges in innovation, politics and capital allocation, its mix of resilient earnings, attractive valuations and strong cash generation make it an increasingly compelling equity market.

1. **European equities are delivering stronger earnings growth than widely assumed:** EPS growth is running at around 14% yoy, supported by a broad range of companies and reinforced by structural themes such as infrastructure, defence, electrification and AI investment.
2. **Profitability and market fundamentals have improved significantly:** Higher interest rates have strengthened bank earnings, margins have expanded and Europe offers attractive exposure to long-term growth sectors while maintaining relatively compelling valuations.
3. **Market perception lags reality:** European equities have kept pace with the S&P 500 since the start of 2025, benefitting from globally diversified business models, resilient earnings and a market structure that is better positioned than many investors realise.

For much of the past decade, the dominant narrative surrounding European equities has been one of structural stagnation. Investors often associate the region with weak economic growth, lower profitability, excessive regulation and chronic underperformance relative to the US. Yet recent market developments suggest that these assumptions might need to be revisited.

The reality is not that Europe has suddenly become a high-growth market. Nor has it solved its longstanding structural challenges. However, evidence increasingly points to a region whose equity markets are considerably stronger, more resilient and better positioned than conventional wisdom would suggest. The disconnect between perception and reality has become increasingly visible in earnings trends, profitability metrics, sector composition, market performance and valuation.

Reconsidering the growth narrative

One of the most persistent assumptions about Europe is that it lacks earnings growth. While it is true that EPS growth in Europe still trails that of the US, the direction of travel has changed meaningfully. After more than a decade characterised by low growth, recurring earnings stagnation and repeated downward revisions, European corporate earnings have started to regain momentum. The latest reporting season showed one of the strongest earnings acceleration phases seen in years, with earnings growth broadening across sectors, supported by improving business fundamentals. Consensus expectations currently point to broad-based EPS growth of around 14% for European equities in both 2026 and 2027, compared with approximately 15% in the US.

The gap is therefore far smaller than commonly assumed. The key point is not that Europe is suddenly growing faster than the US but rather that it is emerging from a prolonged period of near-zero earnings growth and is again generating positive and increasingly self-sustaining profit momentum. As the chart below illustrates, European EPS growth has reaccelerated noticeably after years of subdued performance. This shift is particularly important as changes in earnings momentum often matter more for equity markets than the absolute level of growth itself. Markets tend to reward improving trajectories, especially when expectations remain relatively low.

Europe's earnings recovery differs fundamentally from that of the US. Earnings growth in the US remains heavily concentrated around a small group of mega-cap technology companies, whose investments in AI and digital platforms continue to drive a significant share of overall index profits. Depending on the definition used, technology-related companies and the "Magnificent Seven" now account for around 40% of US market capitalisation, highlighting the degree to which earnings and market performance are concentrated in a relatively small segment of the market. In contrast, Europe's earnings improvement is considerably broader based. Industrials, financials, capital goods, defence, infrastructure-related businesses and a growing range of service sectors are all contributing to the recovery. This suggests that Europe's profit cycle is not dependent on a single theme, sector or a handful of companies, but is instead supported by a wider range of corporate business models.

The breadth of the recovery is particularly encouraging. While commodity and energy-related sectors have contributed positively, earnings growth remains healthy even when these industries are excluded. The median company within the STOXX Europe 600 continues to generate profit growth, indicating that the current earnings cycle is not merely the result of a narrow sector-driven upswing. Moreover, around 80% of European companies have recently experienced positive earnings revisions, an unusually high proportion that underlines the broad nature of the recovery. Such widespread participation typically makes earnings growth more resilient and sustainable over time.

Analysts have consequently revised earnings expectations higher for both 2026 and 2027. This marks a notable departure from much of the pre-pandemic period, when European earnings frequently disappointed and revisions were often negative. For investors, this shift is significant because earnings revisions have historically been one of the strongest drivers of relative equity performance. Rising earnings expectations tend to attract capital, support valuation expansion and reinforce positive market sentiment.

Several structural factors help to explain why Europe may be entering a more-favourable earnings environment. Unlike during the previous decade, which was dominated by ultra-low interest rates and weak pricing power, today's economic landscape increasingly rewards many of Europe's traditional strengths. Higher interest rates have improved profitability in the banking and insurance sectors, with financials accounting for roughly 25% of the MSCI Europe, making the region a meaningful beneficiary of a more normal interest-rate environment. Increased investment in infrastructure, electrification, reshoring, defence, energy security and industrial modernisation directly benefits companies where Europe enjoys global leadership positions (Industrials account for about 19% of the MSCI Europe). Many European firms occupy highly specialised niches with strong competitive advantages, global market-share leadership and significant pricing power. Moreover, Europe's corporate sector is unusually well positioned for a world that requires more physical investment rather than purely digital growth.

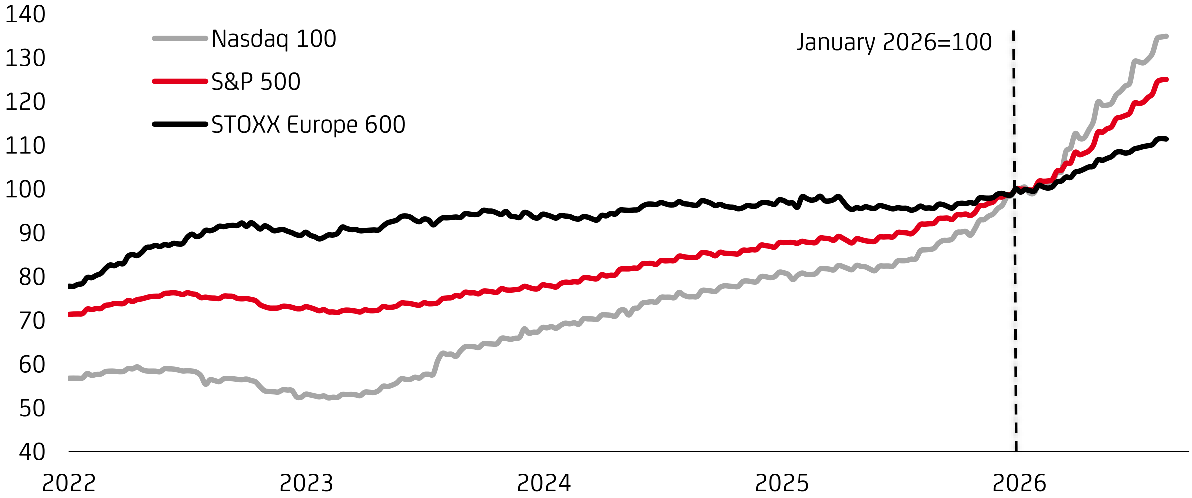
The transition toward energy independence, modernised infrastructure, supply-chain resilience and industrial automation creates demand for exactly the types of products and services provided by many European companies (see our *Short View – Industrials: the beneficiaries of converging investment cycles*, 27 August). As a result, Europe stands to benefit not only from a cyclical recovery but also from several long-term structural investment themes.

To be clear, Europe has not suddenly become a higher-growth region than the US. Rather, it is emerging from a prolonged period of earnings stagnation, creating scope for a meaningful re-rating if the recovery proves structural.

Investors should nevertheless be cautious about extrapolating the recent earnings momentum too far into the future. The critical question is whether Europe's earnings recovery proves structural rather than cyclical. While some of the recent acceleration reflects supportive macroeconomic conditions, a growing share is linked to longer-term forces such as defence spending, infrastructure renewal, electrification and industrial modernisation. The durability of these themes will ultimately determine whether Europe's recent improvement represents a temporary rebound or a more lasting change in the earnings outlook.

EUROPEAN EARNINGS MOMENTUM IMPROVES AFTER A LONG PERIOD OF DISAPPOINTMENT

EUROPE'S PROFIT CYCLE (12M FWD EPS) BECOMES BROADER AND MORE RESILIENT



Source: LSEG Datastream, The Investment Institute by UniCredit

Improving profitability: more than just a banking story

Another common perception is that European companies generate structurally weak returns. While European return on equity (ROE) remains below US levels, this comparison can be misleading because US profitability starts from an exceptionally elevated base. More important is the direction of travel: European companies have been strengthening earnings efficiency at a much faster rate than in previous decades, leading to a steady convergence with US levels. Since 2020, aggregate European ROE has risen from roughly 7.5% to an estimated 14% by 2027, while US ROE is expected to increase from about 18% to 21%.

Although Europe still trails in absolute terms, its rate of progress has been considerably stronger, significantly reducing the historical differential. Importantly, the investment case for Europe does not depend on matching US-style returns. The key question is whether corporate returns are moving higher. On that measure, the outlook has become increasingly constructive. After years of stagnation, European companies have entered a sustained recovery phase supported by both cyclical and structural forces.

The US continues to generate higher returns on equity, reflecting its greater exposure to highly profitable technology and platform businesses. Yet with profitability already near historic highs, additional gains are likely to be more incremental. Europe, in contrast, has emerged from an extended period of subdued performance, creating greater scope for expansion. Consequently, earnings quality and shareholder returns have improved more rapidly, even if absolute levels remain lower.

The most visible shift has taken place in the European banking sector. For more than a decade following the global financial crisis and the European sovereign debt crisis, banks weighed on overall market returns. Ultra-low interest rates compressed margins, earnings remained weak, and regulatory constraints limited capital distributions.

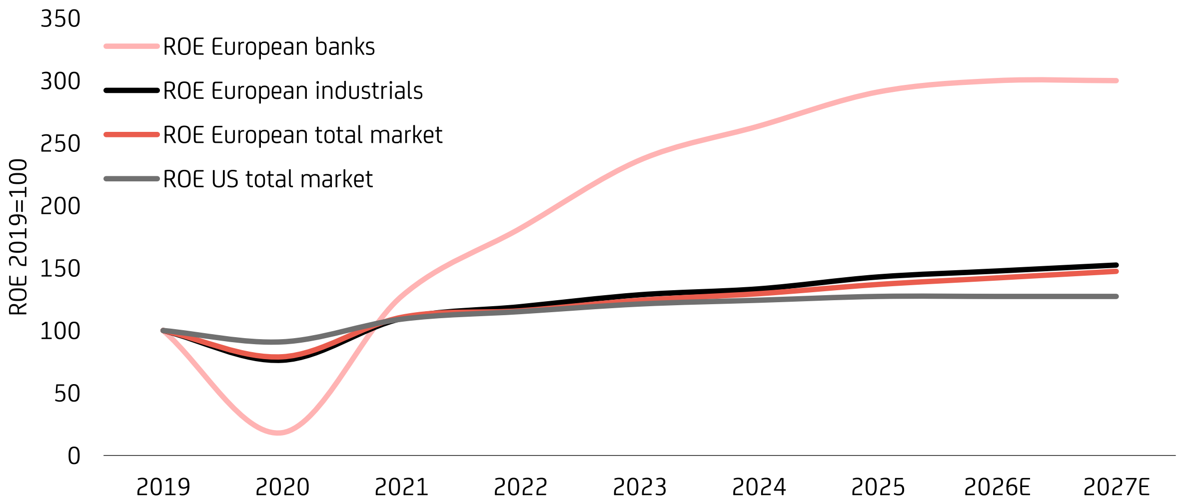
Much of that environment has now reversed. Higher interest rates, stronger balance sheets and robust capital generation have turned European banks from a structural drag into one of the largest contributors to market-wide returns. Equally important, the recovery is not confined to financials. Industrial companies, another cornerstone of the European equity market, have steadily enhanced returns as investment has shifted towards infrastructure modernisation, automation, electrification, defence, energy security and supply-chain resilience. Europe is home to many global leaders in industrial technology, engineering, automation and capital goods, positioning the region particularly well to benefit from this investment cycle.

This improving profitability extends beyond financials and confirms the broader earnings recovery discussed earlier. Banks are driving a powerful cyclical recovery, while industrial companies are benefiting from long-term structural tailwinds. Together, these sectors account for a substantial share of European market earnings and are helping to reshape the profitability profile of the broader equity market.

For investors, this distinction is crucial. Equity markets are often driven less by the absolute level of profitability than by changes in expectations and the direction of earnings revisions. Europe may still generate lower ROE than the US, but the trajectory is improving more rapidly. After years of stagnant earnings and subdued returns, the region is once again demonstrating a capacity for sustained profitability expansion.

THE RE-EMERGENCE OF EUROPEAN PROFITABILITY (ROE 2019=100)

US PROFITABILITY REMAINS SUPERIOR BUT EUROPE IS EXPERIENCING A STRONGER IMPROVEMENT IN RETURNS



Source: LSEG Datastream, Worldscope, The Investment Institute by UniCredit
Note: The chart shows the evolution of profitability (2019 = 100), illustrating the pace of improvement rather than the absolute level of ROE.

Performance has been better than perceived

In the decade following the global financial crisis, US equities generated substantially stronger returns and significantly outperformed most international markets. Yet more recent experience has been far less one-sided.

Since the pandemic, the gap between European and US equity performance has narrowed considerably. In fact, some European sectors have generated exceptional relative returns. For example, European banks (with a STOXX Europe 600 index weight of 17%) have been significantly outperforming the celebrated "Magnificent Seven" technology stocks since 2025 (see chart below).

Overall, European equities have kept pace with the S&P 500 since the start of 2025, despite navigating major headwinds such as tariff disruptions and renewed instability in energy markets.

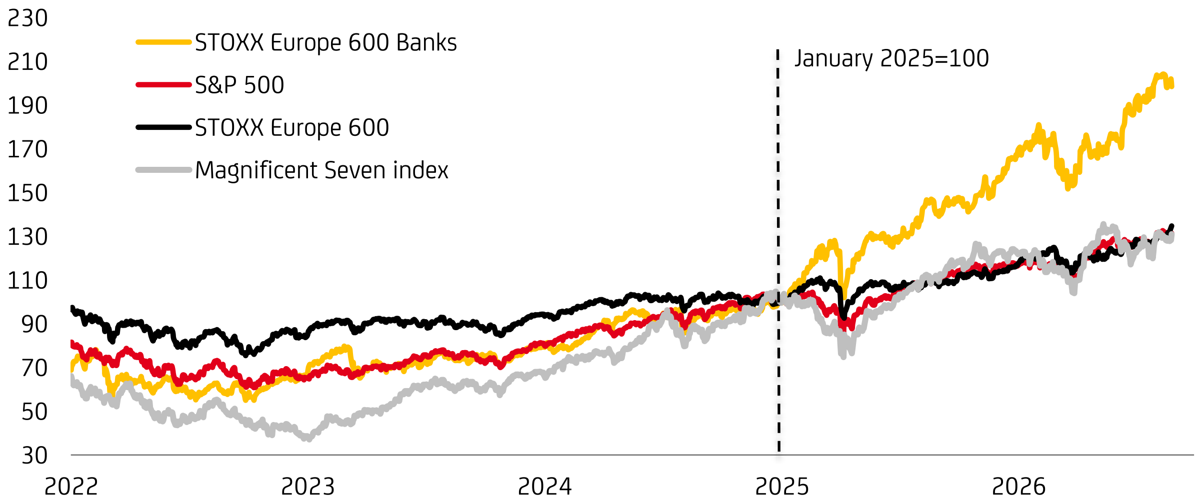
A particularly noteworthy development has been the improved relative performance of European technology companies. While the US continues to dominate digital platforms and hyperscale AI infrastructure, Europe's technology sector has benefited from stronger earnings momentum, attractive valuations and leading positions in semiconductor equipment, industrial software, automation, payment technologies and engineering-driven innovation. Companies such as ASML, SAP, Siemens and ASM International are increasingly viewed as critical beneficiaries of global AI and industrial digitisation investment trends. The combination of lower valuations and improving earnings expectations has enabled European technology stocks to narrow part of the historical performance gap to their US peers, with European IT outperforming so far this year.

Several factors help to explain this shift. US equities started off with very high valuations. Relative sector positioning has also favoured Europe, particularly given its larger weighting in financials. Questions have also emerged regarding the scale of capital expenditure being undertaken by large technology companies and the return on those investments.

Europe has also benefited from stronger fiscal support, particularly in Germany, declining risk premiums and renewed investor interest in industrial and infrastructure-related businesses. While political and fiscal risks remain, recent market performance challenges the long-standing assumption that Europe is structurally destined to underperform. At a minimum, the region appears more competitive and resilient than reflected in investor positioning and market narratives.

EUROPE'S COMEBACK ALREADY UNDERWAY

EUROPEAN BANKS HAVE OUTPERFORMED THE MAGNIFICENT SEVEN, WHILE THE BROADER MARKET HAS MATCHED THE S&P 500 SINCE 2025



Source: LSEG Datastream, The Investments Institute by UniCredit

Interestingly, technology – the largest sector in the US – has delivered a strong return of around 100% since 2022. However, banks – Europe's largest sector – have significantly outperformed the US technology sector, generating returns of approximately 325% over the same period.

China's rise does not necessarily mean Europe's decline

China's growing competitive presence represents a genuine challenge for parts of Europe, particularly for German manufacturing, chemicals and automobiles. Chinese companies continue to gain market share both within Europe and internationally, often supported by significant state assistance. However, investors frequently overestimate the vulnerability of the European equity market.

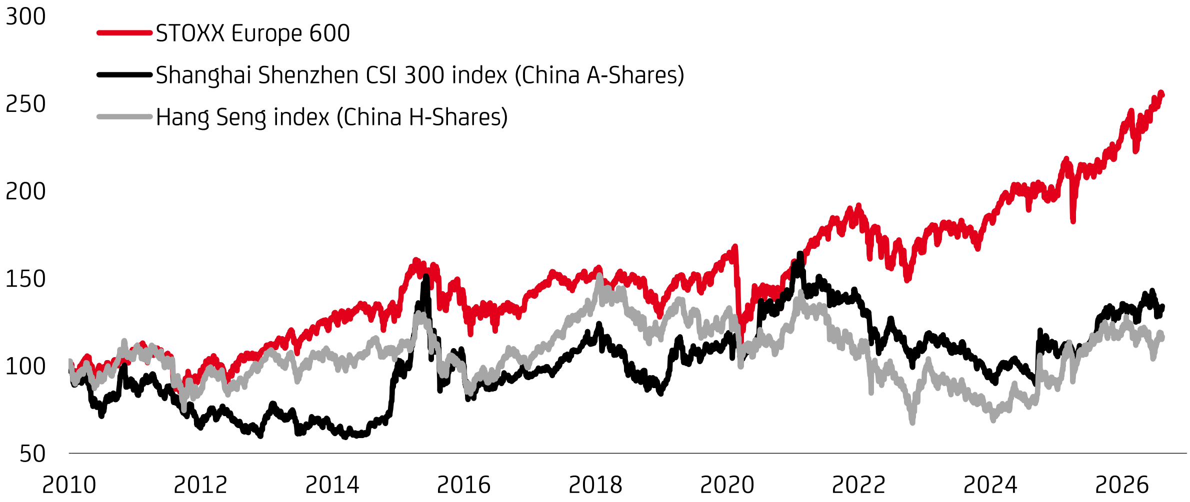
The key distinction is that the stock market is not the economy. The sectors most exposed to Chinese industrial competition have become progressively smaller components of European market capitalisation. While the automobiles sector remains economically important, declining profitability and low valuations have led to the sector now representing only a small share of the overall European equity market.

More broadly, the comparison with China highlights that economic growth and equity returns are not synonymous. Despite China's industrial expansion and increasing global competitiveness, Chinese equities have significantly underperformed European equities in recent years. This reflects not only valuation dynamics but also a combination of structural headwinds, including weakness in the property sector, subdued domestic demand, regulatory uncertainty and fragile investor confidence. For investors, profitability, shareholder returns, governance and valuations often matter more than headline GDP growth.

Europe's equity market is also more diversified than implied by many headline narratives. Its largest sectors include financials, pharmaceuticals, technology, energy, utilities, telecommunications, aerospace and defence, many of which are exposed to limited direct competition from Chinese exporters. While certain European industries face genuine challenges, the broader market has proven considerably more resilient.

EUROPE HAS CLEARLY OUTPERFORMED THE CHINESE MARKET, PARTICULARLY OVER THE PAST FIVE YEARS

STRONG ECONOMIC NARRATIVES DO NOT ALWAYS TRANSLATE INTO SUPERIOR SHAREHOLDER RETURNS



Source: LSEG Datastream, The Investment Institute by UniCredit
Note: A-shares refer to mainland Chinese equities listed in Shanghai or Shenzhen, while H-shares are mainland Chinese companies listed in Hong Kong. The two markets differ in investor composition, liquidity and valuation dynamics, with H-shares generally more accessible to international investors.

Europe may also benefit from an often-overlooked advantage: its ability to remain economically engaged with both the US and China. As geopolitical fragmentation and protectionism increase, this flexibility could become a valuable competitive strength, making openness an asset rather than a liability.

Higher energy prices: not always negative for European equities

Another frequently misunderstood issue is the relationship between energy prices and corporate earnings. Higher energy costs typically represent a negative shock for European economies as many countries remain dependent on imported energy. Economic growth can therefore suffer when energy prices rise sharply. However, the relationship between energy prices and equity market earnings is far more nuanced. European equity indices contain substantial weightings in energy producers, utilities and related sectors that often benefit directly from higher commodity prices. Financial institutions may also benefit through the inflation and interest-rate dynamics that frequently accompany energy-price increases. Importantly, many European companies also have sufficient pricing power to pass on higher input costs to their customers. In industries characterised by strong market positions, specialised products, long-term customer relationships or limited competition, higher energy expenses are frequently reflected in higher selling prices rather than absorbed through lower profit margins. As a result, the impact of rising energy costs on corporate profitability is often less severe than headline economic analysis might suggest.

Telecommunications, healthcare, media and several service sectors tend to experience only limited direct exposure to energy costs. Even many industrial companies have demonstrated a remarkable ability in recent years to preserve margins by passing on higher energy, transportation and raw-material costs through the value chain. The earnings experience following the energy crisis of 2022 highlighted that corporate pricing power was considerably stronger than many investors had anticipated.

The main losers in such a scenario are generally consumer-oriented businesses whose customers face reduced disposable income. The positive relationship between energy prices and earnings is not unlimited, however. Prolonged energy shocks that significantly impact overall demand can ultimately lead to pressure in a wider range of sectors. Nonetheless, the assumption that higher energy prices automatically translate into lower European corporate earnings is not supported by recent experience. The effect depends far more on sector composition, pricing power and competitive positioning rather than on energy prices alone.

Europe’s companies are more global than assumed

Investors often conflate Europe’s economic growth rate with the prospects for European equities. In reality, large European companies are highly international businesses. Only slightly more than 40% of STOXX Europe 600 revenues originate within Europe. The remainder comes from North America, Asia-Pacific markets and emerging economies around the world. As a result, corporate earnings depend at least as much on global demand conditions as they do on domestic European growth. This helps to explain why European equity valuations often display a closer relationship with US economic activity than with European economic indicators. Global growth, commodity prices, pricing power and investor sentiment frequently matter more than local GDP figures.

Moreover, while European growth remains modest by global standards, recent economic data have demonstrated greater resilience than expected. The region has absorbed tariffs, geopolitical tensions and energy disruptions more successfully than commonly anticipated, while recent economic indicators have shown signs of improvement.

Structural strengths and remaining challenges

The investment case for Europe should not be interpreted as a claim that all concerns have disappeared. Several important structural weaknesses remain. Europe continues to lack a sufficient number of high-growth companies relative to the US. The market contains comparatively few businesses capable of sustaining double-digit revenue growth over multiple years. This remains one of Europe’s most important competitive disadvantages and helps explain part of the region’s valuation discount.

Another challenge involves capital allocation. European households and institutional investors allocate a smaller share of their financial assets to equities than their US counterparts. Large pools of domestic savings remain outside public equity markets or are invested abroad. This contributes to lower market liquidity, fewer funding opportunities for growth companies and a weaker link between economic success and equity-market development. Progress is being made, with regulatory reforms increasingly aimed at encouraging investment in risk assets. However, change remains gradual.

Europe also continues to trail the US in several dimensions of AI investment and deployment. The region risks remaining primarily an enabler of the AI ecosystem rather than one of its principal beneficiaries. European companies occupy important positions in semiconductor equipment, industrial automation and enterprise software, but Europe has comparatively limited exposure to hyperscale cloud platforms, data-centre infrastructure, leading AI model developers and digital ecosystems, where a significant share of future profits may ultimately accrue. AI-related capital expenditure also remains substantially below US levels. This represents a meaningful structural disadvantage and may weigh on productivity growth and innovation over time.

There is, however, another perspective. While US technology leaders are committing enormous resources to AI infrastructure, investors are increasingly scrutinising both the scale of these investments and the returns they will ultimately generate. Europe’s greater emphasis on profitability and cash generation may prove advantageous in an environment where capital discipline becomes more important. Recent market performance suggests that investors are already paying greater attention to these trade-offs.

Perhaps the most important long-term challenge for Europe remains its relatively weak productivity growth. Fiscal stimulus, infrastructure spending and higher defence expenditure may support earnings over the medium term, but long-term equity returns ultimately depend on productivity gains, innovation and capital formation. Europe continues to lag the US across several of these dimensions, reflecting lower business dynamism, slower adoption of new technologies and a less-developed venture-capital ecosystem. Without a sustained improvement in productivity, Europe's earnings growth may ultimately struggle to match that of the US over longer time horizons.

Conclusion

The European equity market is neither a flawless opportunity nor a substitute for the growth engine represented by the US. Structural challenges remain, including political uncertainty, slower trend growth, weaker innovation ecosystems and relatively low domestic equity participation. Yet many widely held assumptions about Europe are no longer fully consistent with reality. Earnings growth has improved, profitability has strengthened, investor inflows have recovered and market performance has exceeded expectations. At the same time, the composition of the European market has evolved in ways that make it more resilient than commonly perceived.

Most importantly, Europe offers a mix that is increasingly valuable in today's investment environment: globally diversified businesses, attractive valuations, strong cash-flow generation and meaningful exposure to long-term themes such as infrastructure, defence, electrification, industrial investment and selected areas of digital transformation.

The European market may not attract the same attention as US technology, yet has quietly delivered a far stronger performance than many investors anticipated. The opportunity in Europe lies not in exceptional growth but in improving fundamentals, which remain only partially reflected in valuations and investor expectations.

Author
Christian Stocker, Lead Equity Strategist (UniCredit, Munich), christian.stocker@unicredit.eu

Editors
Edoardo Campanella, Director and Editor-in-Chief of The Investment Institute (UniCredit Milan), edoardo.campanella@unicredit.eu
Francesco Maria Di Bella, FI Strategist (UniCredit, Milan), francescomaria.dibella@unicredit.eu

UniCredit S.p.A
The Investment Institute by UniCredit, Piazza Gae Aulenti, 4, I-20154 Milan
www.the-investment-institute.unicredit.eu

Legal Notices

Glossary

Terms used in the report are available on our website: Our glossary.

Marketing Communication

This publication/video constitutes a marketing communication of UniCredit S.p.A., UniCredit Bank Austria AG, Schoellerbank AG and UniCredit Bank GmbH (hereinafter jointly referred to as the "UniCredit Group") is addressed to the general public and is provided free of charge for information only. It does not constitute investment recommendation or consultancy activity by the UniCredit Group or, even less, an offer to the public of any kind nor an invitation to buy or sell securities. The information contained herein does not constitute an investment research or financial analysis since, in addition to the lack of content, it has not been prepared in accordance with legal requirements designed to promote the independence of investment research, and it is not subject to any prohibition on dealing ahead of the dissemination of investment research.

UniCredit Group, including all its group companies may have a specific interest in relation to the issuers, financial instruments or transactions detailed herein. Relevant disclosures of interests and positions held by UniCredit Group are available at: Conflicts of interest. Any estimates and/or assessments contained in this publication represent the independent opinion of the UniCredit Group and, like all the information contained therein, are given in good faith on the basis of the data available at the date of publication, taken from reliable sources, but having a purely indicative value and subject to change at any time after publication, on the completeness, correctness and truthfulness of which the UniCredit Group makes no guarantees and assumes no responsibility. Interested parties must therefore carry out their own investment assessments in a completely autonomous and independent manner, relying exclusively on their own considerations of the market conditions and the information available overall, also in line with their risk profile and economic situation. Investment involves risk. Before any transaction in financial instruments please refer to the relevant offering documents. It should also be noted that:

1. Information relating to the past performance of a financial instrument, index or investment service is not indicative of future results.
2. If the investment is denominated in a currency other than the investor's currency, the value of the investment can fluctuate strongly according to changes in exchange rates and have an undesirable effect on the profitability of the investment.
3. Investments that offer high returns can undergo significant price fluctuations following any downgrading of creditworthiness. In the event of bankruptcy of the issuer, the investor may lose the entire capital.
4. High volatility investments can be subject to sudden and significant decreases in value, being able to generate significant losses at the time of sale up to the entire capital invested.
5. In the presence of extraordinary events, it may be difficult for the investor to sell or liquidate certain investments or obtain reliable information on their value.
6. If the information refers to a specific tax treatment, it should be noted that the tax treatment depends on the individual situation of the customer and may be subject to change in the future.
7. If the information refers to future results, it should be noted that they do not constitute a reliable indicator of these results.
8. Diversification does not guarantee a profit or protect against a loss.