

Special Report: **European Markets: A Shift in Global Investor Attention**



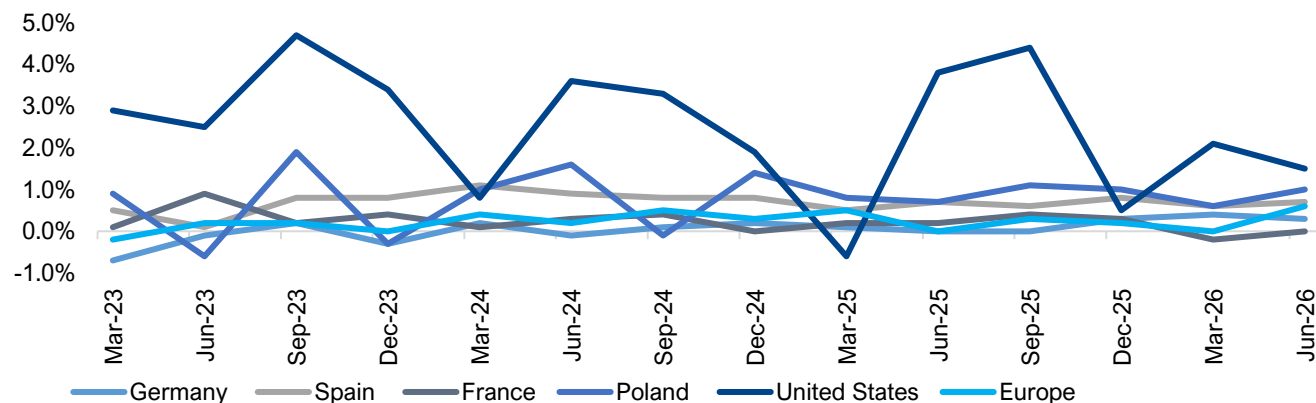
Table of Contents

1	Factors Driving European Market Traction	2
2	Current Scenario: European vs US Equity Markets	4
3	European Markets have an increased defense support	9
4	European Markets AI focus	10
5	Aranca View: European Equities	11

Factors Driving European Market Traction (1/2)

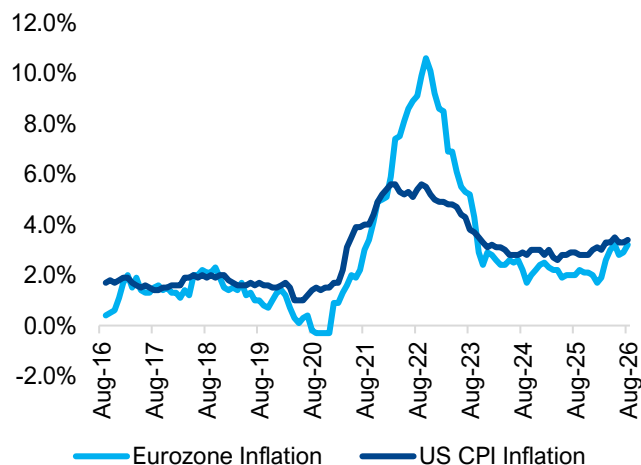
Lower interest rates and affirmative economic cues

Europe vs US GDP Growth Comparison (%) (QoQ)

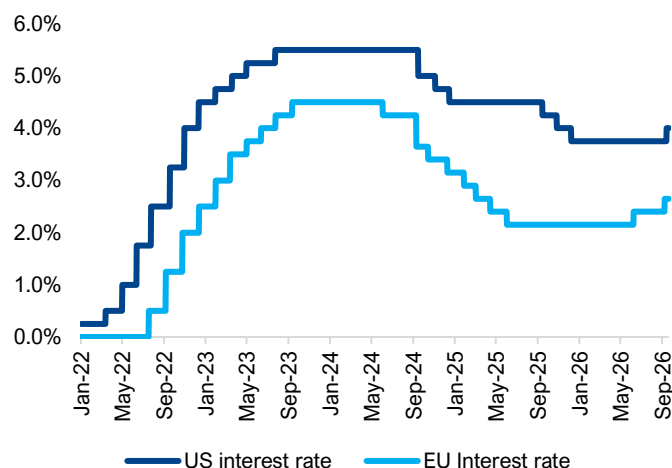


- **Growth Momentum Improves:** EU growth momentum is improving, with Q2 26 GDP growth revised up to 0.6% from 0.4%, led by Ireland and Germany.
- **European Equities Outlook Strengthens:** Growth revisions point to a more constructive outlook for European equities, despite US GDP growth remaining stronger at 1.5% qoq in June 2026.

US vs EU Inflation Rate (%)



FED vs ECB Interest rate (%)



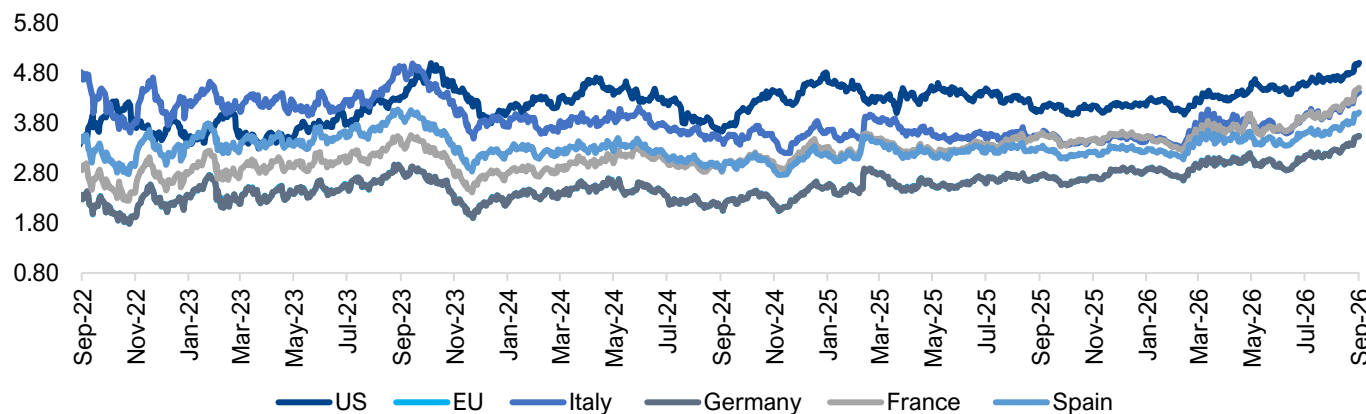
- **Lower Inflation Supports Consumers:** EU inflation remains relatively lower than in the US, supporting household purchasing power and economic stability.
- **Easier Financial Conditions Support Valuations:** Interest rates remain lower in the EU, providing relatively easier financial conditions and support for equity valuations.

Source: Aranca Research, Bloomberg

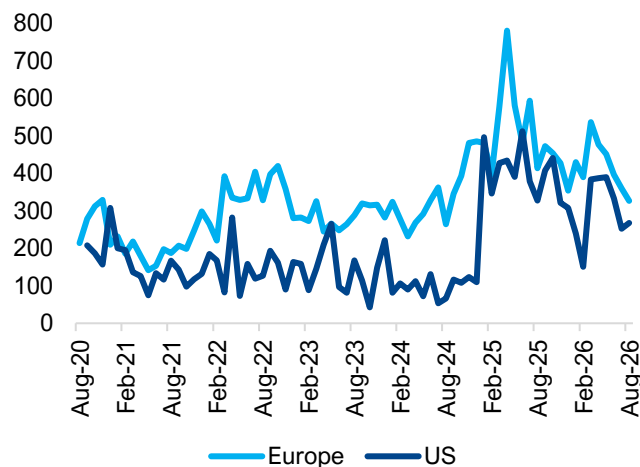
Factors Driving European Market Traction (2/2)

Bond yields remain low, followed with positive market sentiments

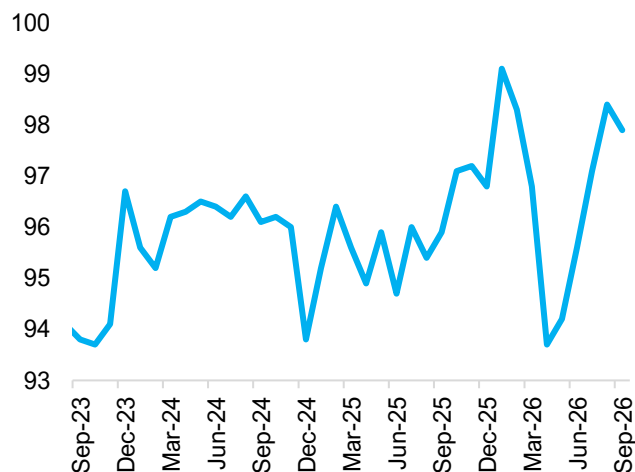
US vs EU 10 Year Bond Yields (%)



EU vs US Policy Uncertainty



Euro area Sentiment Index

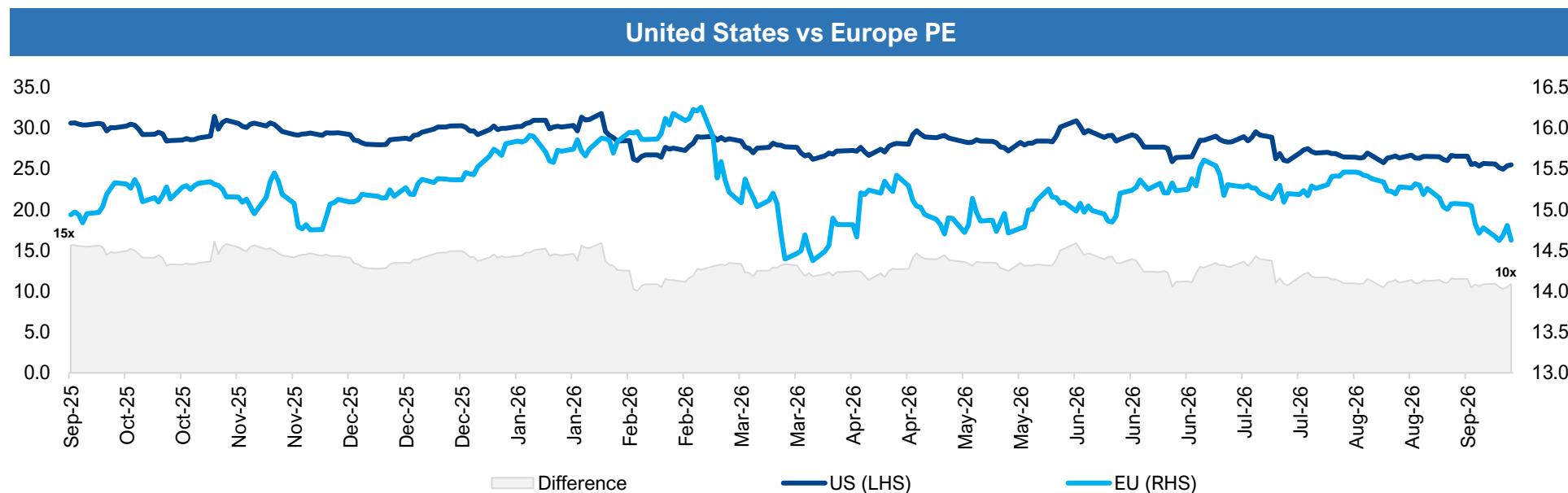


- **Lower European Yields:** European bond yields remain significantly below US yields, supporting relatively favorable financing conditions.
- **US Fiscal and Inflation Pressures:** US yields hit a 19-year high on Sept 15, amid oil-driven inflation concerns and weak Treasury auctions. Over \$10tn of debt also needs to be refinanced over the next 12 months.
- **Policy Uncertainty:** Rising policy uncertainty under the Trump administration has narrowed the US's traditional policy-stability premium over Europe.
- **Improving European Sentiment:** Euro area sentiment has improved, while Europe has been comparatively less affected by geopolitical tensions and could benefit from easing US-Iran tensions.

Source: Aranca Research, Bloomberg

Current Scenario: European vs US Equity Markets (1/5)

P/E Valuation: Valuation gap narrowed from 15x in Sept 2025 to 10x in Sept 2026

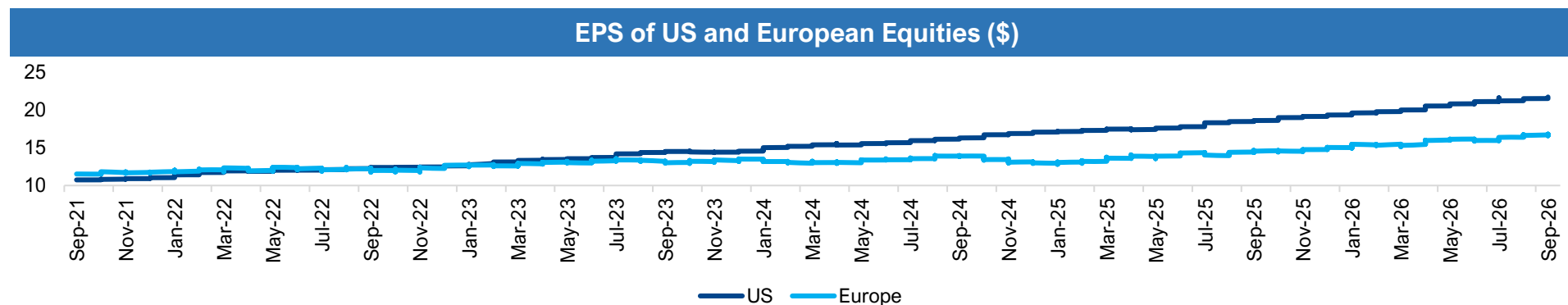


- European equities continue to trade at a valuation discount to US peers despite a strong earnings season, with 2Q26 EPS growth exceeding 20%, led by energy, industrials and real estate.
- The valuation gap is partly structural, reflecting Europe's higher exposure to banks and capital-intensive industries versus the US's concentration in highly profitable technology companies.
- Europe's outlook is improving as AI-driven productivity gains, higher defense and infrastructure spending, and investment in manufacturing, power grids and automation could support earnings growth.

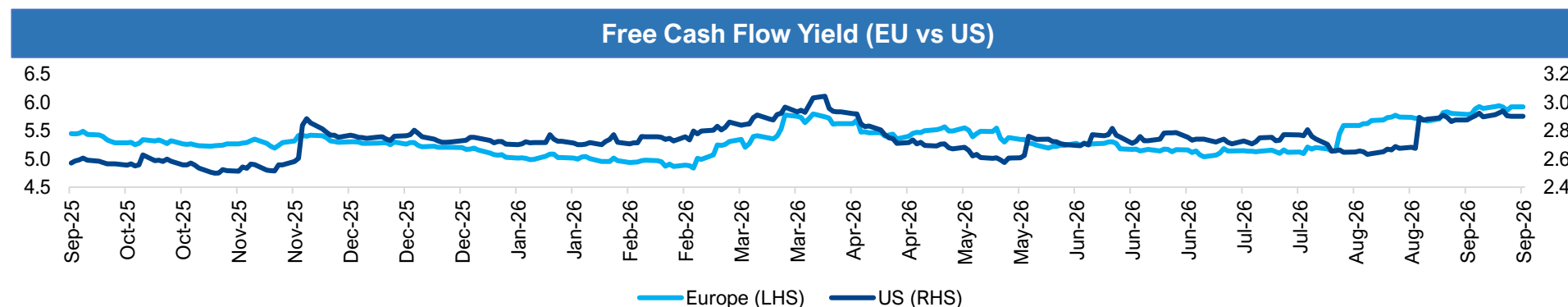
Source: Aranca Research, Bloomberg, EU-MSCI Europe and US-MSCI USA

Current Scenario: European vs US Equity Markets (2/5)

European FCF yield and EPS growth remains higher



- European EPS (1 BF) increased 4.2% in Q3 26 vs 2.9% for the US, indicating a broader recovery in earnings expectations across European markets.

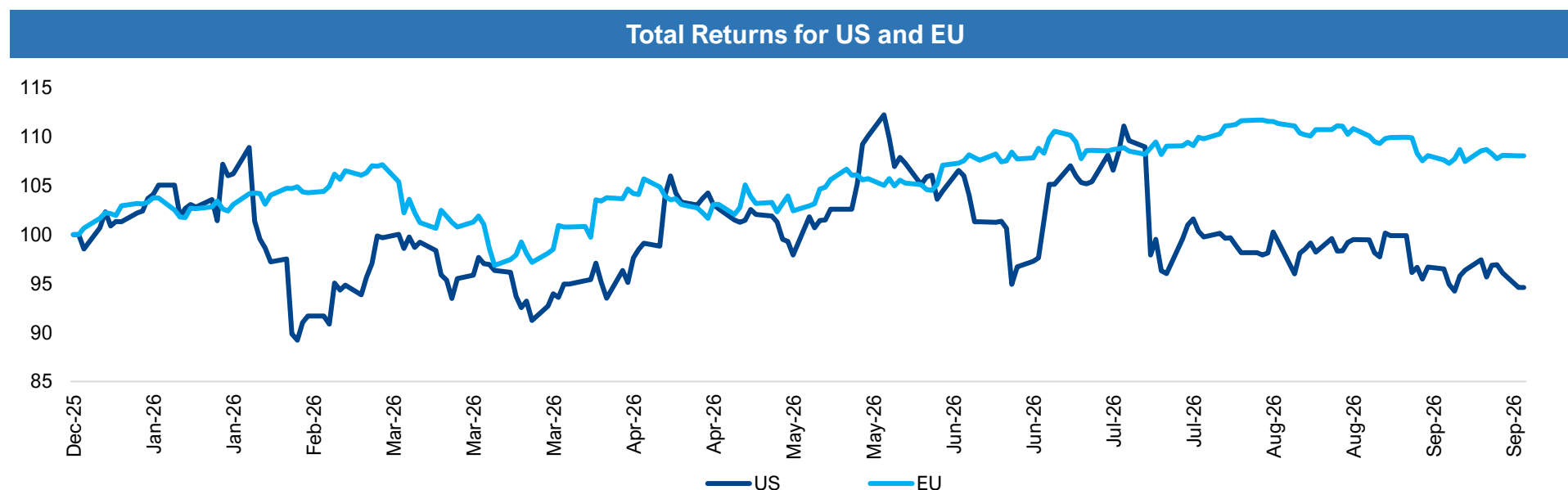


- Free Cashflow yield remained higher for European equities at 5.92% in Sept 2026, vs the US 2.9%.

Source: Aranca Research, Bloomberg, US-MSCI US and EU-MSCI EU

Current Scenario: European vs US Equity Markets (3/5)

US vs EU total market returns

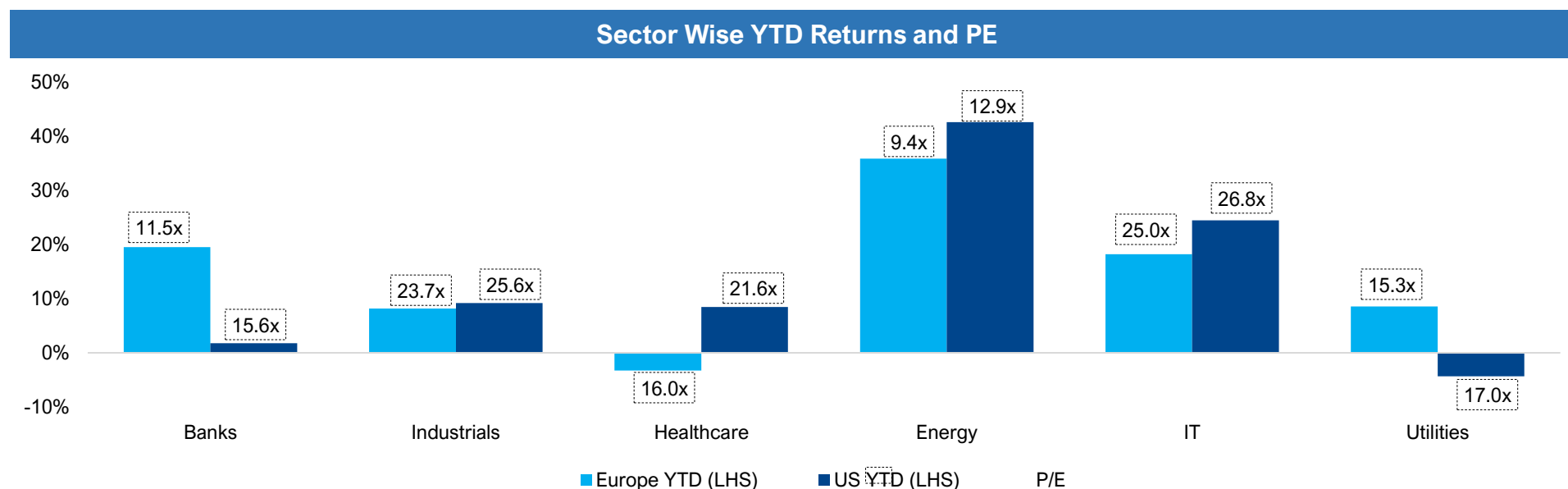


- **European Equities Widen Performance Lead:** Equities delivered an 8.0% YTD total return vs. a 5.4% decline for US equities, with the performance gap widening materially from mid-2026.
- **Broader Sector Exposure Supports Europe:** Europe's higher exposure to financials, industrials and defensive sectors, alongside strong defense-related spending, has supported relative performance.
- **US Market Remains Exposed to AI Concentration:** The US market's heavy concentration in mega-cap technology and AI stocks has increased sensitivity to elevated valuations and shifts in AI-related expectations.

Source: Aranca Research, Bloomberg, EU-MSCI Europe and US-MSCI USA

Current Scenario: European vs US Equity Markets (4/5)

Selective sectors are already outperforming the US

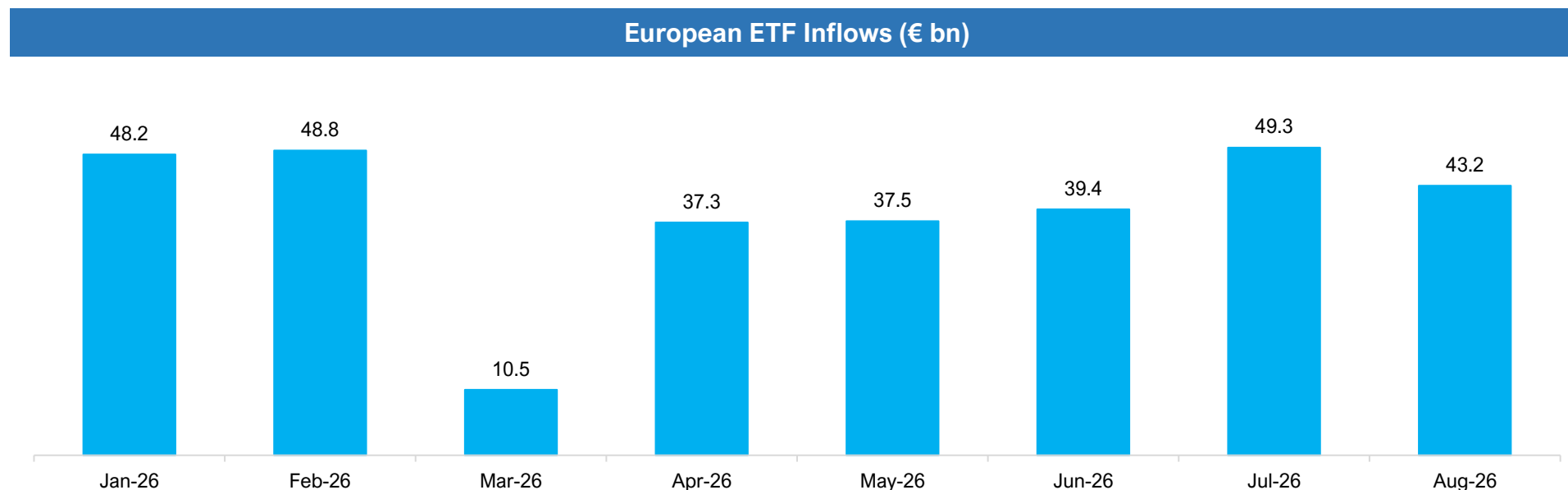


- European banking and utilities have outperformed US peers, but valuations remain cheaper, with banking up 19.5% vs 9.2% YTD (11.5x vs 15.6x P/E) and utilities up 8.6% vs 4.4% (15.3x vs 17.0x P/E), respectively.
- **Banking Sector:** Strong earnings, rising NII and improving profitability have supported the European banking sector, with European banks' ROE rising to 11.9% in 2025 from 8.9% in 2022.
- **Utilities:** Energy security, electrification and grid investment are supporting earnings growth for Europe, while European utilities continue to trade at a valuation discount to US peers.

Source: Aranca Research, Bloomberg, EU-MSCI Europe and US-MSCI USA

Current Scenario: European Equity Markets (5/5)

European ETFs funds inflows



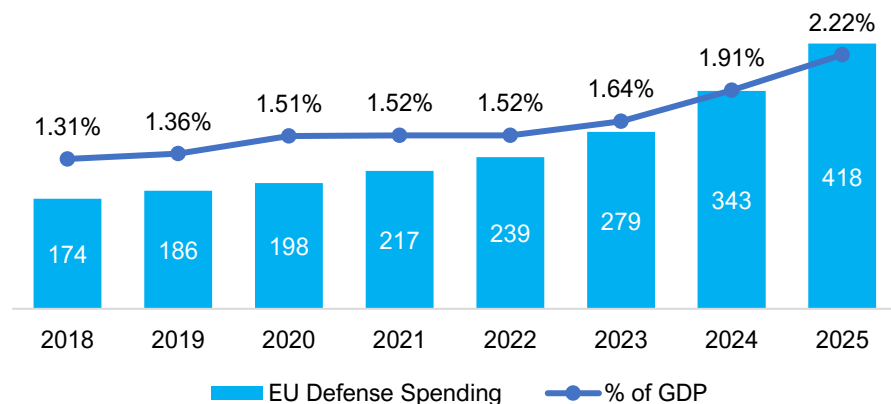
- **Strong ETF Inflows, Led by Renewable Energy and Utilities:** Europe's ETF market remains smaller than the U.S. market, reflecting its later introduction, seven years after ETFs were launched in the U.S. Nevertheless, European ETFs attracted €39.3bn of average monthly net inflows during the first eight months of 2026, implying €314.1bn of cumulative net inflows so far in 2026.
- **Flows Shift toward Thematic and Defensive Sectors:** Flows have been increasingly concentrated in thematic and defensive sectors, with renewable energy and utilities attracting a significant share of investor allocations, supported by the energy-transition theme and demand for infrastructure-related exposure.

Source: Aranca Research, LSEG

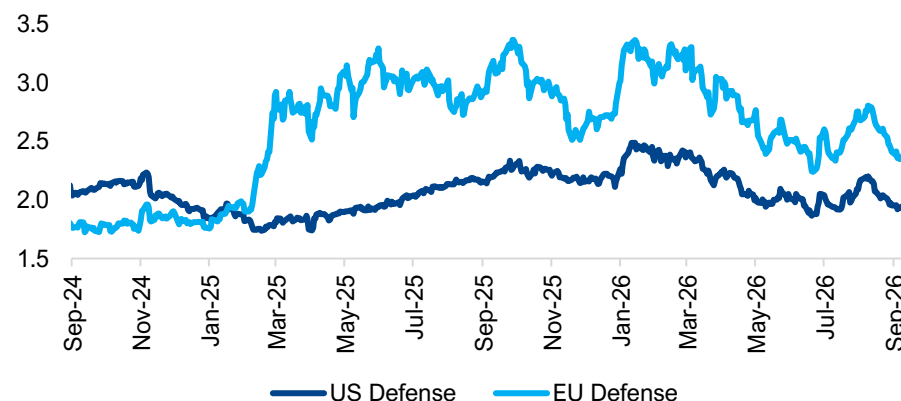
European Markets have an Increased Defense Support

Defense spending and re-rating of defense stocks

EU Defense Spending(€ bn) as a % of GDP



US vs EU (Price to NTM Sales)



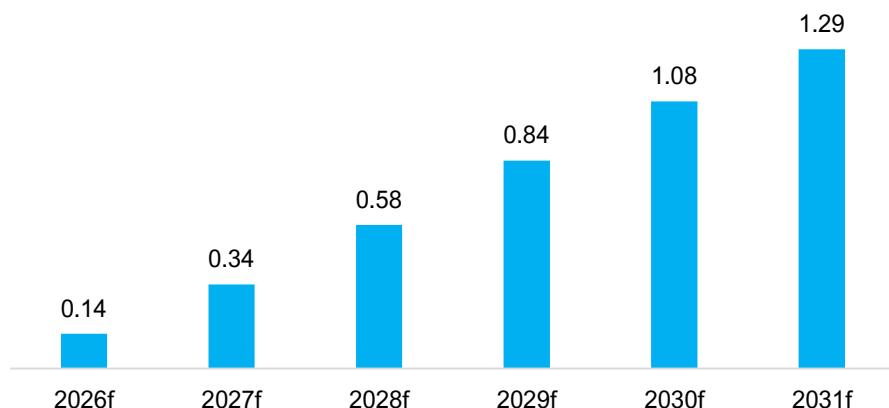
- Accelerating European Defense Investment:** Following the Russia-Ukraine conflict and NATO's higher defense-spending commitments, major European countries have accelerated defense investment, creating opportunities across the European defense sector.
- Rising Defense Spending Targets and Outlook:** In 2025, NATO members agreed to raise defense and security spending to 5% of GDP by 2035, with European defense spending already reaching ~€418bn.
- Spending is projected to increase further to ~€490bn by 2027f and ~€547bn by 2029f.
- European Defense Stocks Re-rate on Higher Spending Target:** European defense stocks have re-rated following NATO's 5% GDP defense-spending target, with NTM P/E valuations at 2.45x versus 1.95x for US peers.
- Stronger Orderbooks Support the Sector's Growth Outlook:** Rising defense budgets have supported stronger orderbooks across European defense companies, while heightened geopolitical uncertainty continues to underpin the sector's outlook. Overall European defense spending is expected to increase to around €800bn in the long run.

Source: Aranca Research, Bloomberg, European Defense Agency

European Markets AI focus

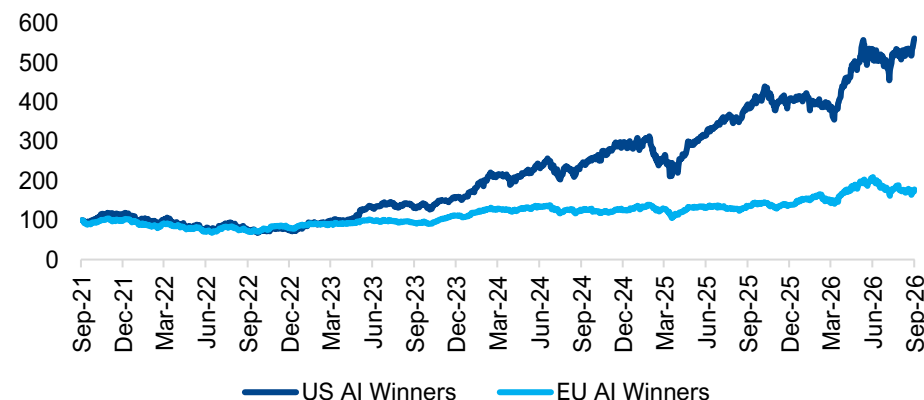
Becoming increasingly AI ready markets may re-rate as AI capex follows

Capex Impact due to Accelerated Adoption (\$ tn)



- **Policy Drag:** EU data restrictions and local barriers, including Amsterdam's 2025 ban on new data centers, are expected to constrain European AI investment.
- **Long-Term Gap:** Cumulative capex is projected at \$5.6tn through 2050 under current policies, vs. \$6.92tn with accelerated AI adoption.
- **Near-Term Upside:** Stronger policy support could lift cumulative capex to \$1.29tn by 2031, vs. \$1.16tn in the current scenario.

US vs EU AI Indexes*



- **US AI Stocks Continue to Outperform European Peers:** Early AI adoption, aggressive capex and strong AI infrastructure investment have supported US outperformance and premium valuations.
- **European AI Stocks Offer Long-term Re-rating Potential:** As AI adoption and corporate investment accelerate, European companies could attract greater investor interest and see pockets of valuation re-rating as the AI cycle broadens.

Source: Aranca Research, Bloomberg, PWC, * Index has been rebased to 100,

Aranca View: European Equities

Lower valuations, rising inflows and defense spending support a selective positive stance

OUR TAKE

European equities offer scope for further gains as investor allocations rise and higher defense spending supports earnings. Lower P/E multiples vs. US peers add to the appeal, with stock selection focused on sustainable earnings growth.

POSITIVE
WITH SELECTIVITY

THREE DRIVERS OF THE INVESTMENT CASE

LOWER P/E



Discount to US equities offers room for selective re-rating

RISING FUND INFLOWS



Improving investor allocations support demand for European equities

HIGHER DEFENSE SPENDING



Larger budgets support order books and multi-year revenue visibility

WHERE ARANCA SEES OPPORTUNITY?



PREFERRED EXPOSURES

Earnings and cash flow support

- Banks with resilient profitability and disciplined capital returns
- Utilities benefiting from grid investment and electrification
- Defense suppliers with strong order books and execution



WARRANTS CAUTION

Valuation discipline remains essential

- Some valuation discounts reflect sector mix and slower growth
- Defense re-rating may already price in part of the spending uplift
- Inflows can reverse if earnings or policy delivery disappoint



WHAT WOULD CONFIRM IT?

Evidence of durable improvement

- Sustained equity fund inflows across successive periods
- Positive earnings revisions and strong cash conversion
- Defense commitments converting into orders and revenue

Source: Aranca Research



2500+

Global clients

500+

Strong, professional team across
multi-disciplinary domains

120+

Sectors and sub-sectors
researched by our analysis

80+

Countries where we have
delivered projects

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