Europe Equity Market Outlook: 2025 Q2

Bracing for volatility.

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Market Overview

The tariff-induced market rout has opened up opportunities in Europe.

An Escalating Trade War Could Upend Europe's Macroeconomic Environment

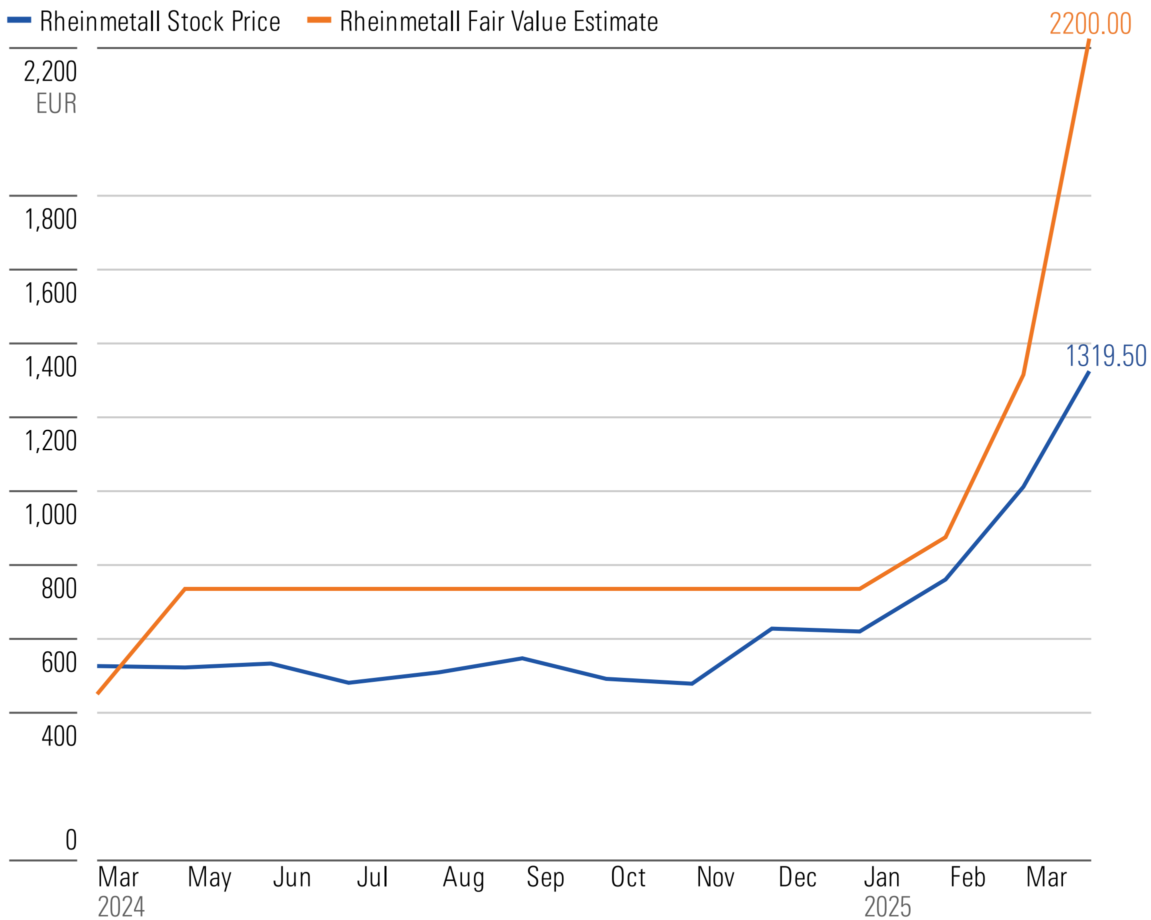
In the last quarter, we spoke about an improving macroeconomic situation in Europe. An escalating trade war with the US has cast a large shadow over this. We are mindful that this situation could be quickly resolved, but it is likely to get worse before it gets better.

Inflation in Europe stands at 2.3%, having fallen modestly over the last quarter. It is now within touching distance of the European Central Bank's 2% target. The gap in growth expectations for this year between Europe and the US has narrowed significantly. Last, interest rates fell by 50 basis points in the last quarter, which should go some way to stimulating the economy in the coming months.

Although the risk from tariffs increased over the last quarter, the other risk we had mentioned, the German elections, has been turned on its head, with the German parliament already agreeing to a EUR 500 billion infrastructure fund. This could go a long way to boosting not just German equities, but possibly the broader European economy.

One positive from the deterioration of relations between the US and Europe has been the realization that Europe must become more self-reliant. A potential for increased spending in segments like defense has massively boosted prospects for stocks like Germany's Rheinmetall, with valuations rocketing as a result.

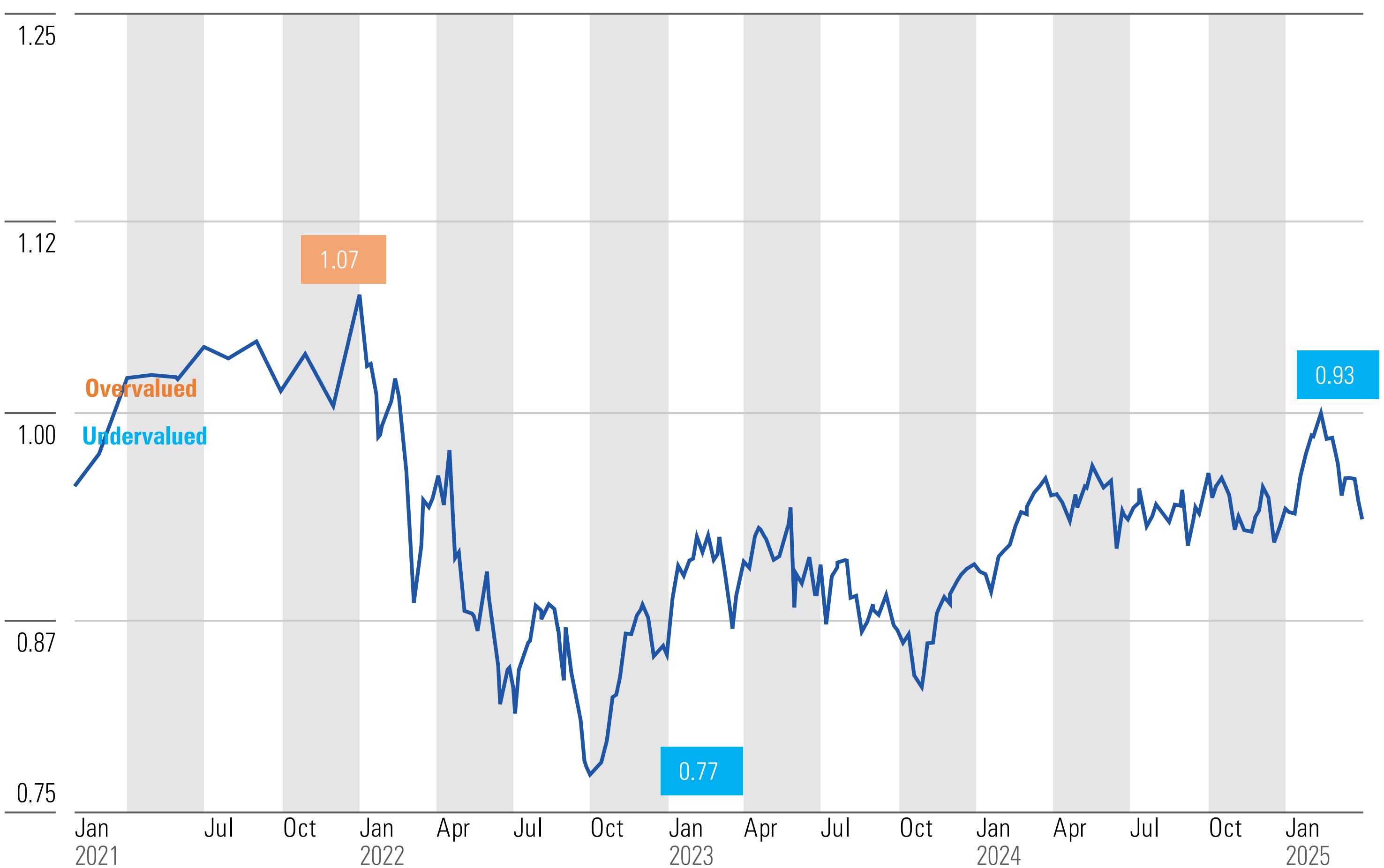
Increasing Government Spending Boosts Prospects for European Stocks



Source: Morningstar. Data as of March 24, 2025.

European Equities Offer Modest Upside

Intrinsic Value-Weighted Price/Fair Value Estimate for Morningstar Europe-Domiciled Coverage



Trump's "Liberation Day" tariff announcements have triggered a plunge in European equity markets. This has brought an almost fairly valued market into a position where we see some upside once again. European equities now trade at a 7% discount to our fair value estimates.

The macroeconomic environment has been improving in Europe, with the recently announced German infrastructure package giving markets further cause for optimism. The recent tariff announcements, if employed for any serious length of time, however, could materially change the picture here for the worse.

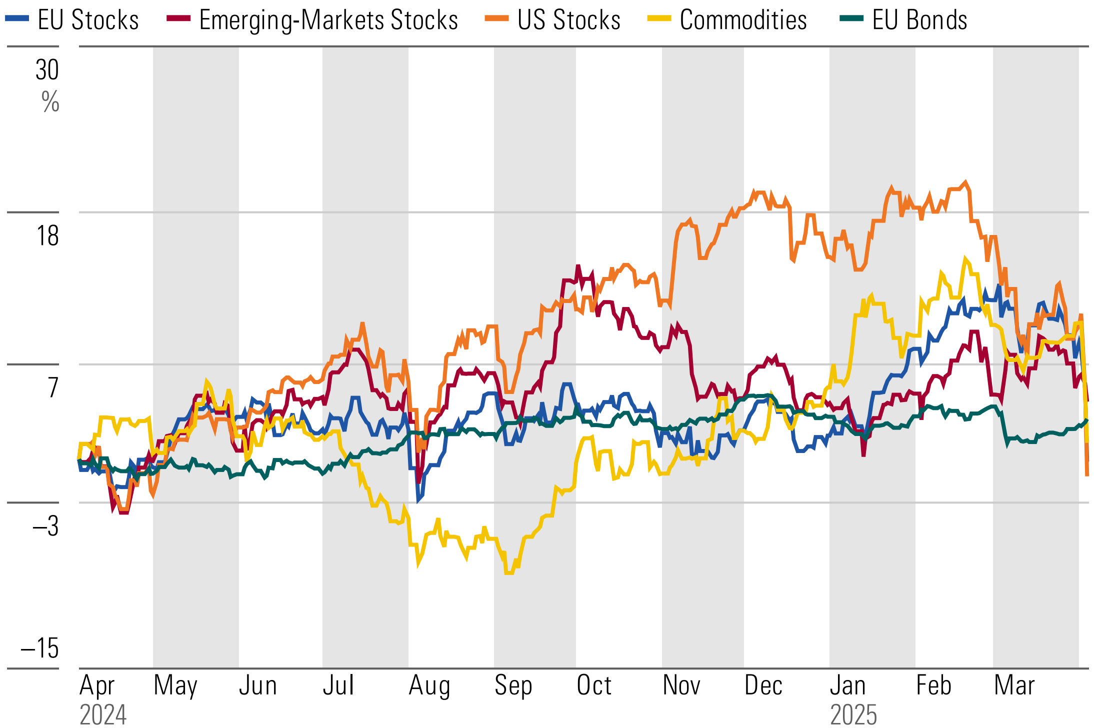
Source: Morningstar. Data as of April 4, 2025.

European Equities Dragged Down by Geopolitical Events

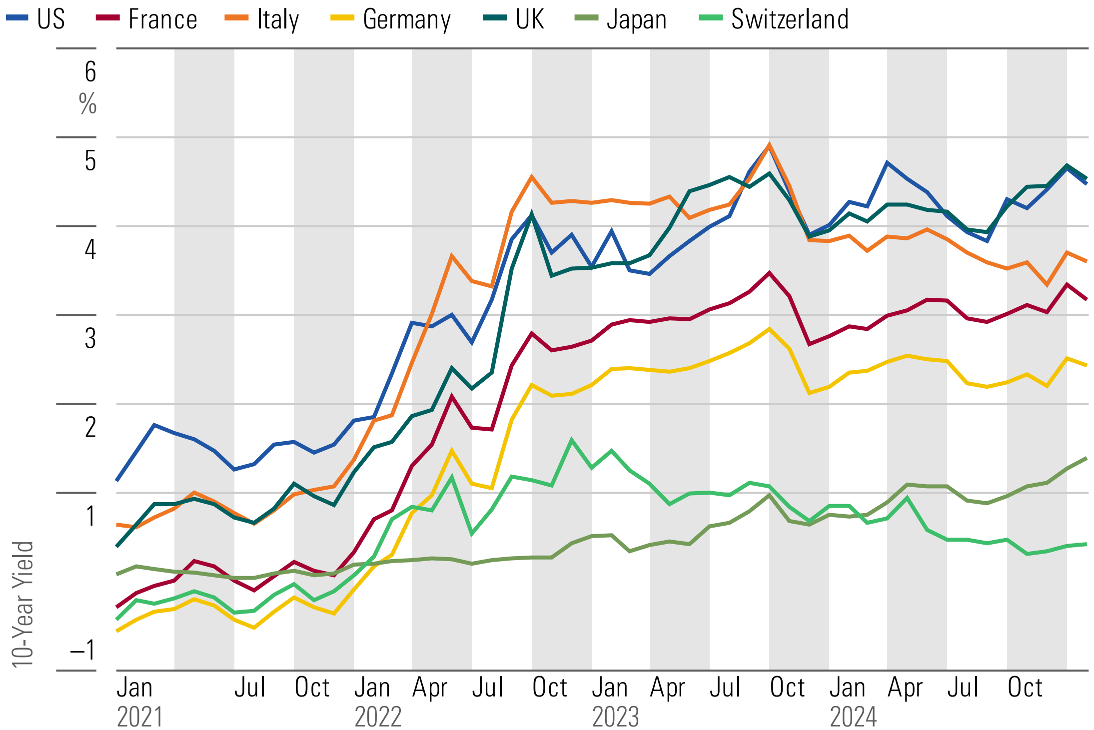
European equities had just begun to outperform the global market before the escalation of the trade war caused a market fall in line with other regions.

Bond yields are spiking once again as upside risks to inflation rise, particularly in the US. This comes largely on the back of the effects of the escalating tariff war.

Trailing 12-Month Performance of Major Asset Classes



Global Sovereign Benchmark 10-Year Yields

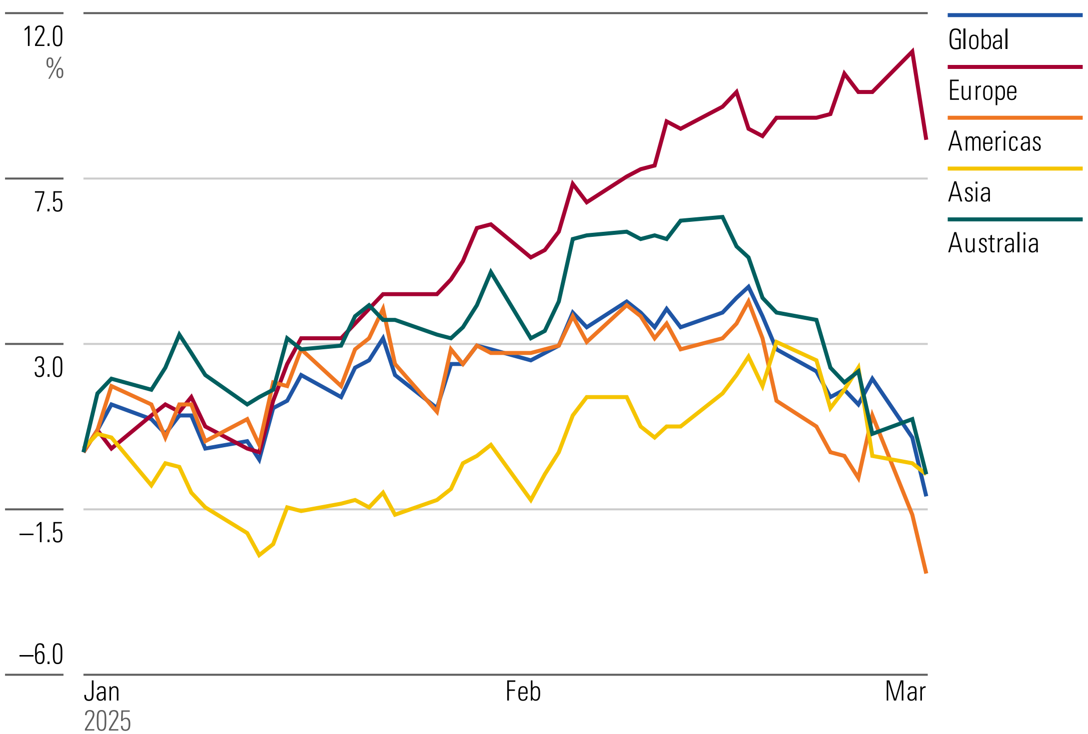


Source: Morningstar Direct. Data as of April 4, 2025.

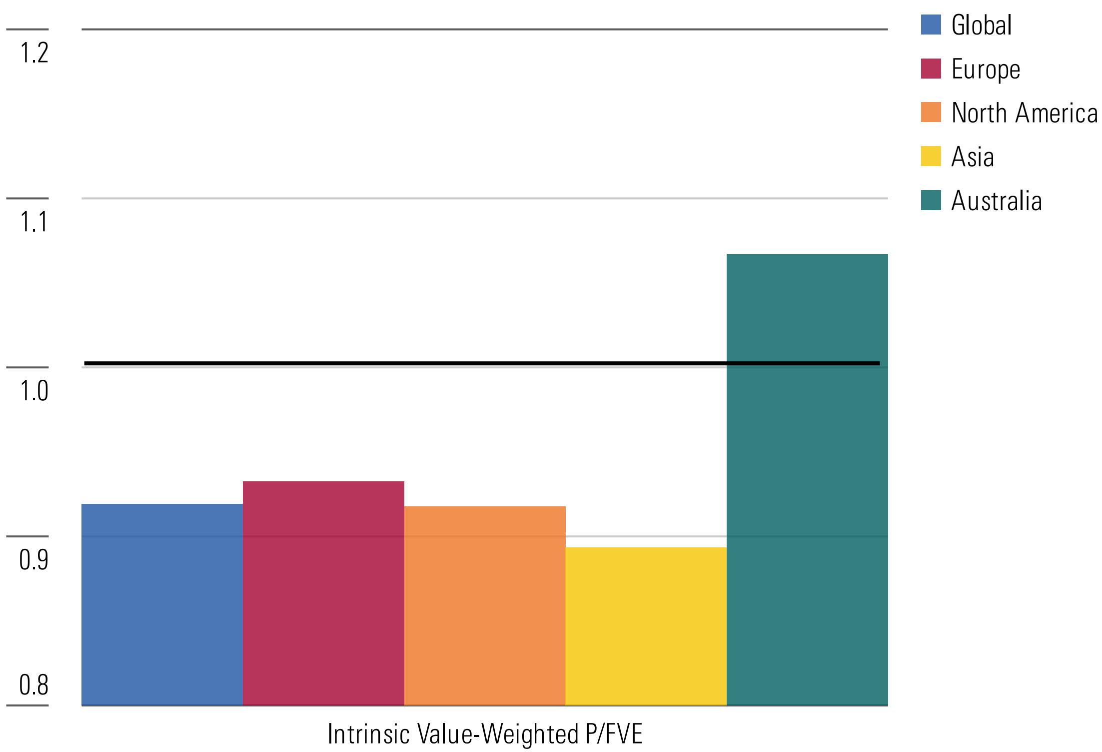
A Volatile First Quarter for Equities, Valuations More Attractive

Despite the pullback in global equities, Europe is still outperforming year to date. Valuations have become more attractive as prices have fallen, but on a relative basis, other regions, like the US, now offer more upside potential.

Regional Price Movements Over the First Quarter



Intrinsic Value-Weighted Price/Fair Value Estimate for the Regions



Source: Morningstar. Data as of April 4, 2025.

Small Cap and Mid-Cap Offer the Most Upside

The general market offers modest upside in Europe and the US, but if we delve a bit deeper, we can find more upside in areas like small-cap and mid-cap stocks. This discrepancy in valuation between large cap and small cap/mid-cap is even more pronounced in Europe than in the US.

Investors in Europe Still Favor Large-Cap Stocks With Growth Mostly Overvalued

Europe Intrinsic Value-Weighted Price/Fair Value Estimate

Size	All	Style: Value	Core	Growth
All	0.93	0.89	0.97	0.94
Large	0.94	0.90	0.98	0.95
Mid	0.86	0.80	0.90	0.86
Small	0.71	0.67	0.76	1.06

US Intrinsic Value-Weighted Price/Fair Value Estimate

Size	All	Style: Value	Core	Growth
All	0.92	0.85	0.96	0.96
Large	0.92	0.85	0.96	0.95
Mid	0.94	0.88	0.94	0.99
Small	0.79	0.72	0.82	0.89

Overvalued
≥ 1.10
1.05 to 1.10

Fairly Valued
1.01 to 1.05
0.99 to 1.01
0.95 to 0.99

Undervalued
0.90 to 0.95
≤0.90

Source: Morningstar. Data as of April 4, 2025.

Sector Valuation Overview

Valuations have shifted around materially in the first quarter.

Strong First-Quarter Gains Have Almost Been Erased by Escalating Trade War

Gains, which were as high as 10% at one point in the first quarter have been cut back significantly as the European market reels from the most recent round of US-imposed trade tariffs.

Exposed sectors like consumer cyclicals and technology have been hit the hardest, both down more than 7% in the first quarter. The utilities sector has been the standout performer, up more than 14%, as investors flock to safety.

The utilities sector has also been one of the strongest performers over the last 12 months, alongside communication services and financial services. The latter is up almost 30% over the period.

Sector Price Movements

Sector	TTM% Change	Trailing Quarter % Change
Aggregated European Market	3.5%	3.5%
Cyclical		
Basic Materials	(6.2%)	(1.1%)
Consumer Cyclical	(13.8%)	(7.9%)
Financial Services	29.3%	12.9%
Sensitive		
Communication Services	23.8%	8.6%
Energy	(3.1%)	4.9%
Industrials	9.3%	4.1%
Technology	(11.3%)	(7.1%)
Defensive		
Consumer Defensive	5.0%	6.1%
Healthcare	(4.4%)	(1.2%)
Utilities	23.2%	14.4%

Source: Morningstar. Data as of April 4, 2025.

Attractive Opportunities Exist Across Most Sectors

The valuation picture has shifted significantly since the last quarter. Sectors like healthcare, industrials, and consumer cyclical have become markedly cheaper. Consumer cyclicals, a front-line sector in the tariff war, is the cheapest sector in Europe, offering close to 30% upside to our fair value. Unusually, there is not a single sector in Europe that we deem to be overvalued.

US trade policies will undoubtedly have an important role to play in dictating the prospects for many sectors this year. But with risk comes opportunity and we believe many potentially exposed areas offer attractive upside potential.

Morningstar European Coverage: Average Price/Fair Value Estimate by Sector

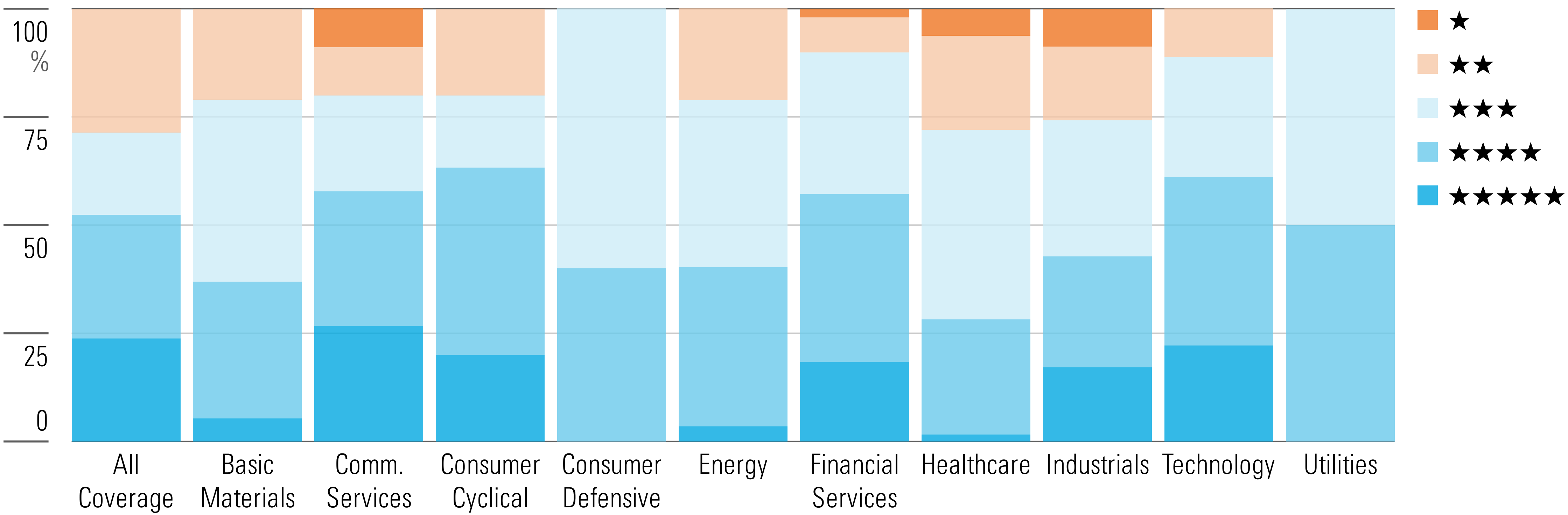
Cyclical Sectors	Average Price/Fair Value	Sensitive Sectors	Average Price/Fair Value	Defensive Sectors	Average Price/Fair Value
Consumer Cyclical	0.77	Comm. Services	0.99	Consumer Defensive	0.88
Financial Services	0.99	Energy	0.87	Healthcare	0.80
Tech	0.79	Industrials	0.93	Utilities	0.93

Source: Morningstar. Data as of April 4, 2025.

4-Star and 5-Star Opportunities Are Available Across the Board

More than half the stocks under our coverage are either 4- or 5-star stocks currently, with little more than a quarter of stocks in overvalued territory. Five-star stocks are present in all, but two sectors, highlighting the dispersion of opportunities.

Star Rating Distribution by Sector



Source: Morningstar. Data as of April 4, 2025.

Communication Services

Javier Correonero | javier.correonero@morningstar.com

The Sector Is Now Fairly Valued After a Strong 12 Months

Defensive Qualities Come to the Fore

In times of tariff threats, the defensive characteristics of the European telecommunications sector proved attractive to investors. The sector rallied slightly ahead of the market in the first quarter. Deutsche Telekom, Tele2, and BT Group were among the best performers.

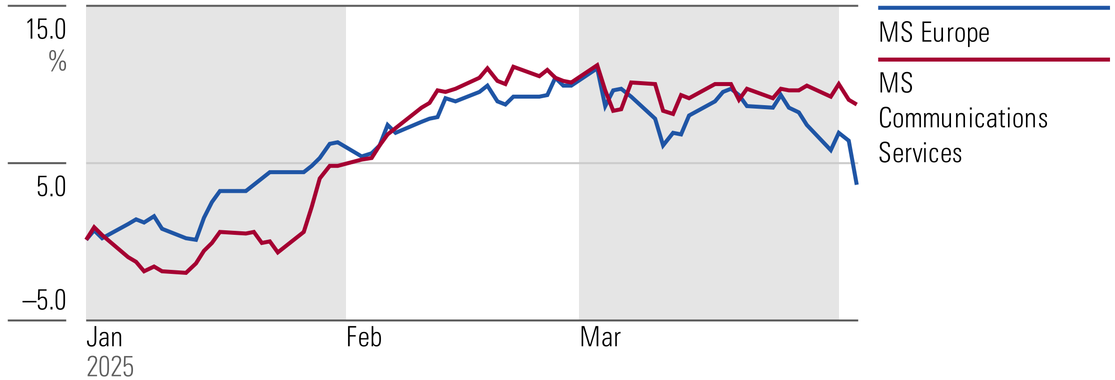
New Year's Rally Brings Down Average European Telecom Dividend Yield

The average dividend yield has fallen to 5.5%, from 6.3% on Dec. 31, 2024, and 6.7% one year ago. However, many rich dividend payers, like Proximus for instance, are doling out dividends that are not covered by free cash flow generation.

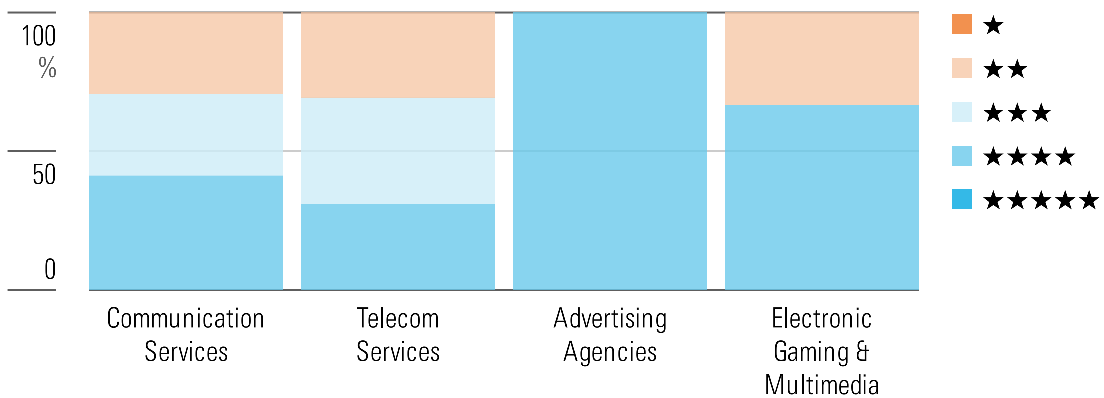
Streamlined European Telecom Firms Relatively More Attractive

Cost-cutting and better free cash flow guidance are helping the sector. We tend to prefer streamlined firms, given their simpler corporate structure and higher cash flow visibility. Most of our coverage sits in 3-star and 4-star territory. Operators like KPN, Tele2, and Deutsche Telekom remain our favorites.

Communication Services vs. Morningstar European Index



Communication Services Star Rating Distribution by Industry



Europe Is Waking Up to Geopolitical Tensions; the Telecom Sector Needs Radical Change

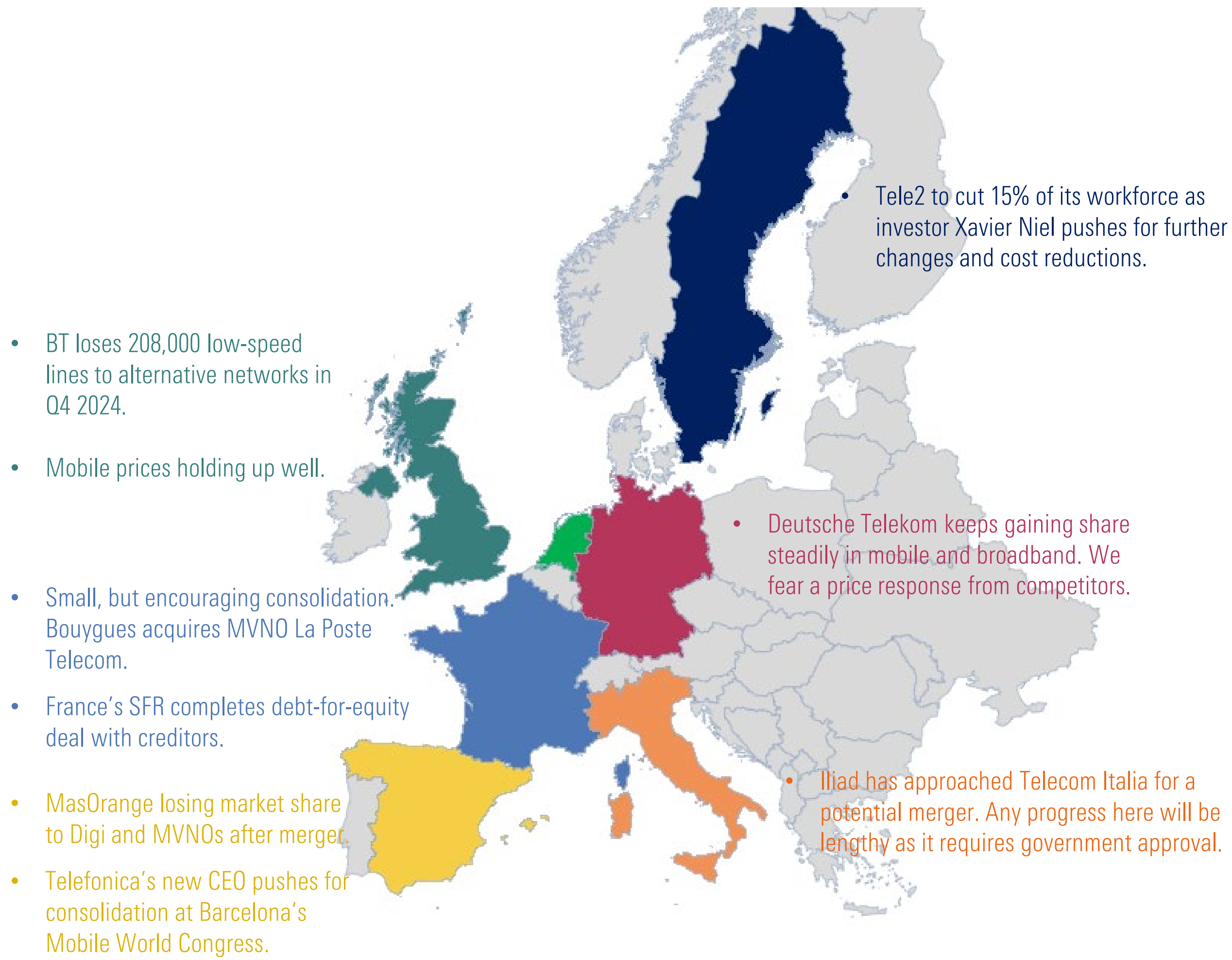
Europe is coming to terms with the renewed protectionist outlook from the US. Important figures like former European Central Bank president Mario Draghi are calling for consolidation among European telecoms, citing a lack of scale compared with international counterparts. The CEOs of Telefonica, Vodafone, and Deutsche Telekom are also pushing for deregulation.

We see major barriers to scale in the form of:

- Regulatory layers, with each country having a regulator.
- Networks in different stages of development across the region.
- Countries auctioning spectrum separately.
- Governmental vetoes to mergers and acquisitions.
- Culture and language differences, making tie-ups more complex

Pan-European firms like Telefonica, Orange, and Vodafone have realized few cross-border efficiencies over the last two decades. In our view, the regulatory landscape would need to be turned upside down to make cross-border mergers value-accretive for shareholders.

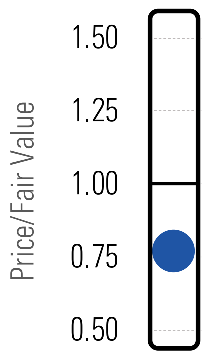
News Flow in the First Quarter of 2025



Sources: Morningstar, La Repubblica, Telecompaper.

Communication Services | Top Picks

Infrastrutture Wireless Italiane **INW**



Market Cap
EUR 10 Bil

Moat
Narrow

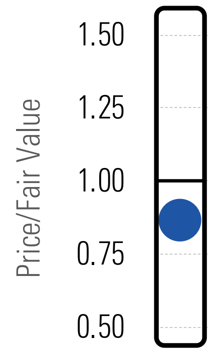
Rating
★★★★★

Yield
5.7%

P/FV
0.77

P/E
21.6x

BT Group **BT.A**



Market Cap
GBP 21 Bil

Moat
Narrow

Rating
★★★

Yield
5.1%

P/FV
0.86

P/E
9.3x

Source: Morningstar. Data as of April 4, 2025.

Consumer Cyclical

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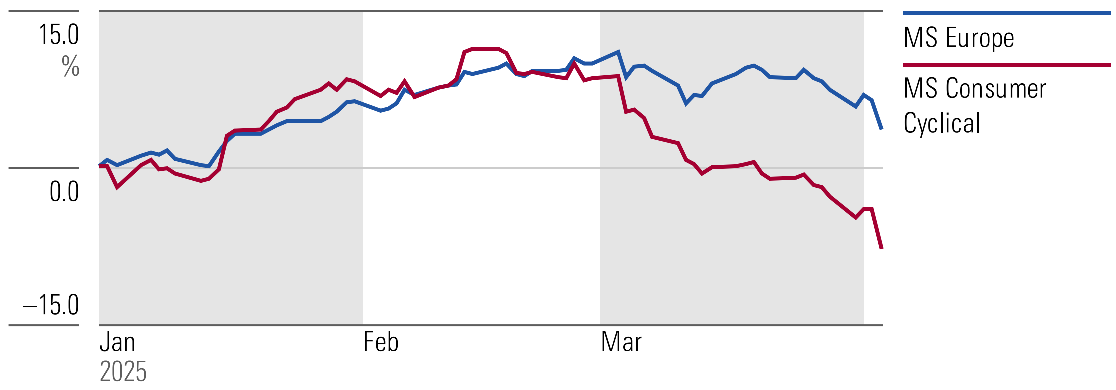
Autos and Homebuilders Offer the Best Value

Opportunities in Apparel Are Disappearing
While there are still pockets of undervaluation, most of the luxury goods sector is now trading at elevated levels. We see value in the turnaround stories in the sector, such as Kering, and stocks highly geared to Chinese demand, such as Swatch. We view most other stocks as expensive. Our former Best Idea in the sector, online apparel player Zalando, has caught up with our fair value estimate and no longer looks compelling.

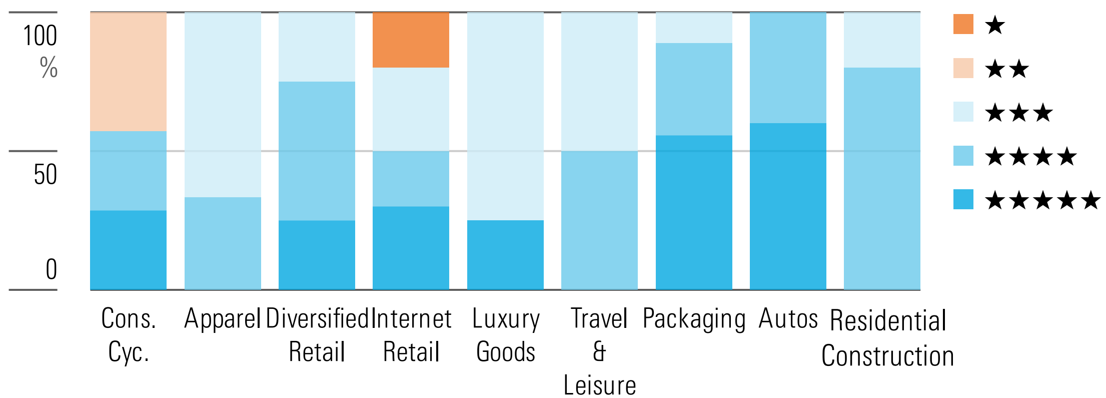
UK Homebuilders Are Hot Property at These Levels
The profound negative reaction to a rise in UK bond yields has once again left UK homebuilders at compelling valuations. The UK government's October budget halted UK homebuilders' positive momentum in 2024, but they remain committed to increasing homeownership and removing planning impediments that have hamstrung UK homebuilders. We see opportunities for investors across our UK homebuilder coverage, with all stocks trading in 4-star or 5-star territory. Persimmon remains our top pick given it offers the greatest leverage to a recovering UK housing market.

Tariff Risks Remain, but European Autos Are Turning a Corner
We believe a bumper product rollout, including several affordable electric vehicles, starting end-2024, by the European auto OEMs will improve their ability to compete in their home bases. Volkswagen, BMW, Mercedes-Benz, Stellantis, and Porsche have large exposure to US trade tariffs. If tariffs are passed on to the consumer, we see second-round effects of lower volumes hitting operating margins.

Consumer Cyclical vs. Morningstar European Index



Consumer Cyclical Star Rating Distribution by Industry



Source: Morningstar. Data as of April 4, 2025.

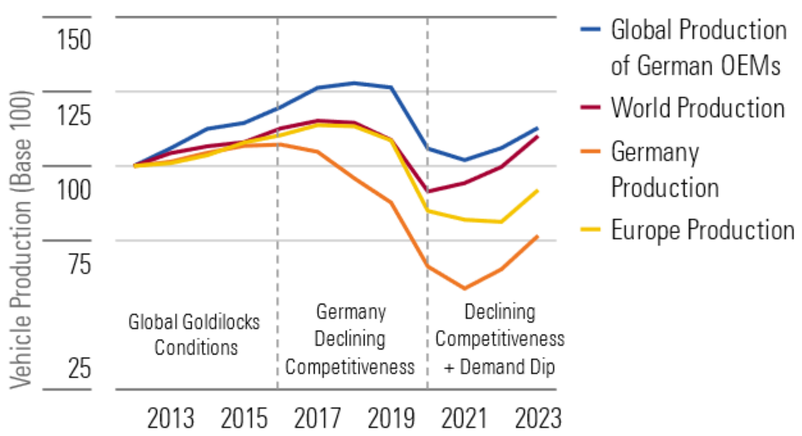
Supportive Regulatory Environment a Tailwind for German Auto Manufacturers

The EU Commission released its Industrial Plan for the Automotive Industry in March, outlining steps to boost the competitiveness of the industry. Positively, the commission revised the timeline in which automakers are required to meet EU targets for a sharp decline in CO2 emissions. Most original equipment manufacturers had built hundreds of millions in penalties into their 2025 earnings forecast, the majority of which is likely to be permanently reversed. Greater support for a local battery value chain and charging infrastructure is also included.

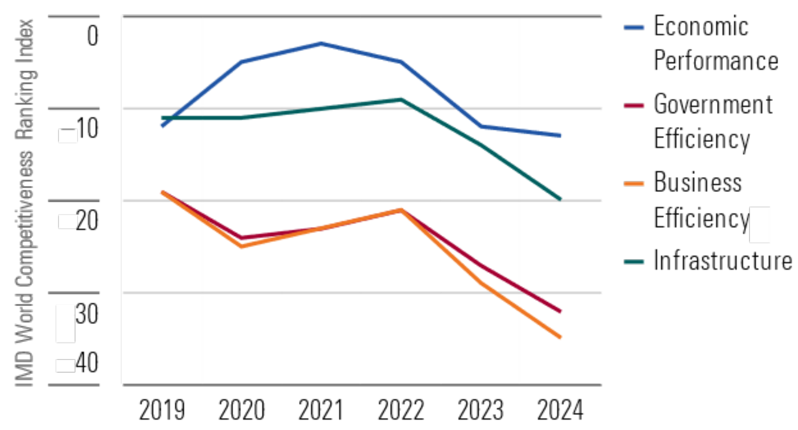
Germany's incoming government has promised to slash electricity costs and has carved out a fifth of its EUR 500 billion infrastructure fund for green initiatives, from which the electric mobility industry should benefit.

European automakers have poured billions into transitioning their production base to EVs. Supportive policy here could improve margins materially in the segment.

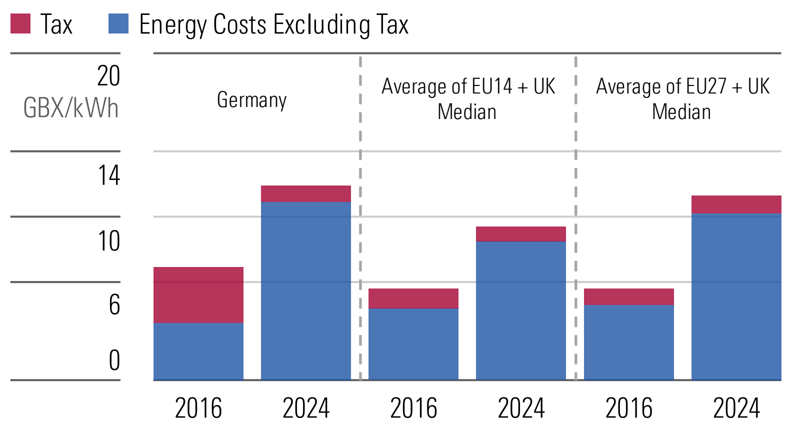
Germany's Vehicle Production Has Deteriorated…



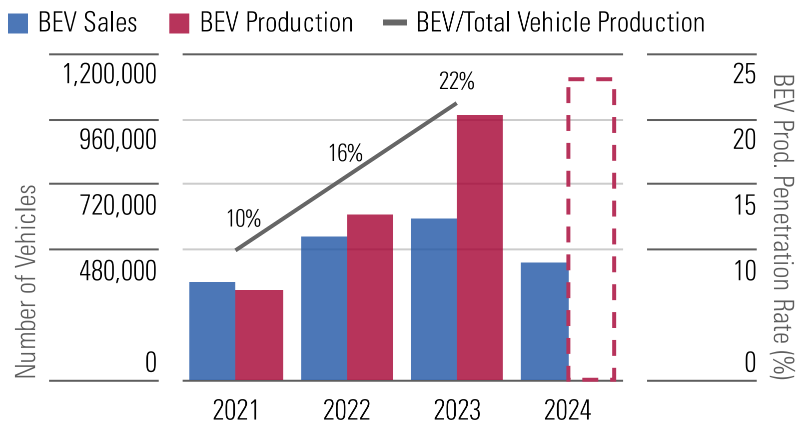
… Along With the Country's Competitiveness



Germany's High Energy Costs Are Very Apparent



German Production Has Moved to EVs



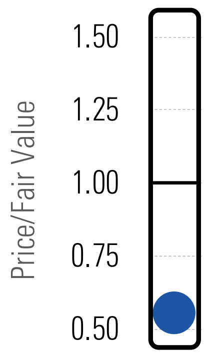
Source: ACEA, Wards Intelligence, the UK's Department for Energy Security and Net Zero, IMD World Competitiveness Center, Annual company reports. BEV=battery electric vehicle.
Note: 2024's EV production is until November 2024.

Consumer Cyclical | Top Picks

Persimmon **LON: PSN**

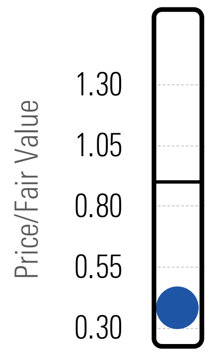
Market Cap	**Moat**
GBP 5 Bil	None
Rating	**Yield**
★★★★★	5.3%
P/FV	**P/E**
0.51	12.2x

Renault **RNO**



Market Cap	**Moat**
EUR 14 Bil	None
Rating	**Yield**
★★★★★	6.3%
P/FV	**P/E**
0.55	4.4x

Kering **KER**



Market Cap	**Moat**
EUR 23 Bil	Narrow
Rating	**Yield**
★★★★★	3.3%
P/FV	**P/E**
0.38	17.3x

Source: Morningstar. Data as of April 4, 2025.

Consumer Defensive

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Sector Remains Undervalued as Consumers Increasingly Shop Around

Consumer Defensive Index Lagging the European Index

Morningstar Consumer Defensive Index's performance has overtaken the broader Morningstar European Index over the last few weeks. Investors are concerned about consumer resilience in the face of potentially sticky inflation and an uncertain global trade environment.

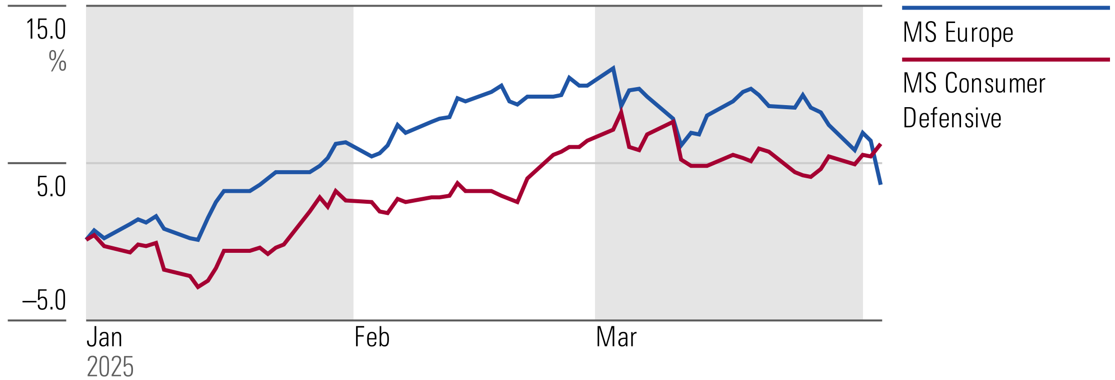
Sticky Inflation and Private-Label Advances Weighing on Volumes

Consumers are still grappling with the compounding effect of consecutive years of substantial price increases, with renewed fears of further price hikes, given the threat of tariffs and the potential for stagflation. At the same time, private labels and other challenger brands have seen a shift in perception away from "discount" or "cheap," often delivering a compelling value proposition. We think this means consumers are becoming more selective in their purchases and searching for ways to get more value for money. Volumes are yet to meaningfully recover across the sector, with many operators expecting a difficult first half of 2025, given depressed consumer sentiment. To get through this tough period companies will have to focus on differentiating their products, through quality and innovation.

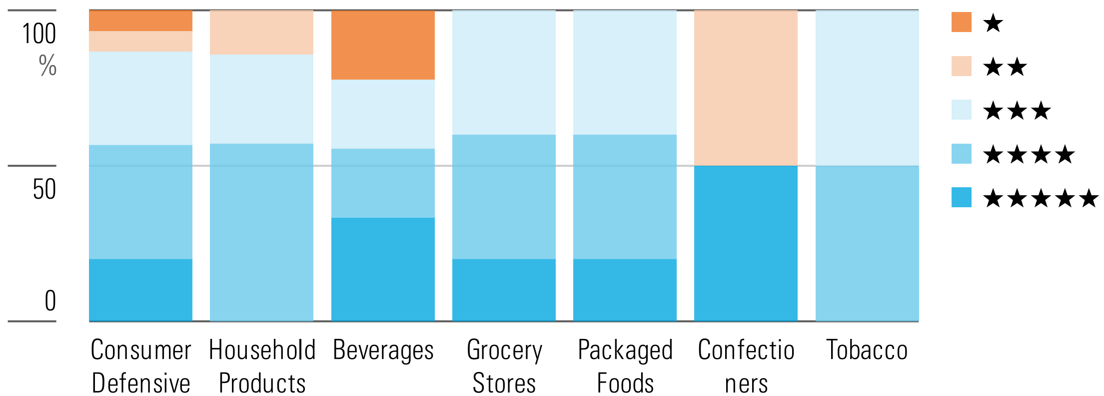
Opportunities Can Still Be Found Across the Sector

Opportunities exist across many categories, especially beverages. Investor confidence in brewing companies has been low given the postpandemic demand reset. Leading brewers, like Heineken, have recently reported an improvement in earnings, signaling a recovery. With consumers increasingly prioritizing value, we also see discounters and warehouse clubs outperforming the market.

Consumer Defensive vs. Morningstar European Index



Consumer Defensive Star Rating Distribution by Industry



Source: Morningstar. Data as of April 4, 2025.

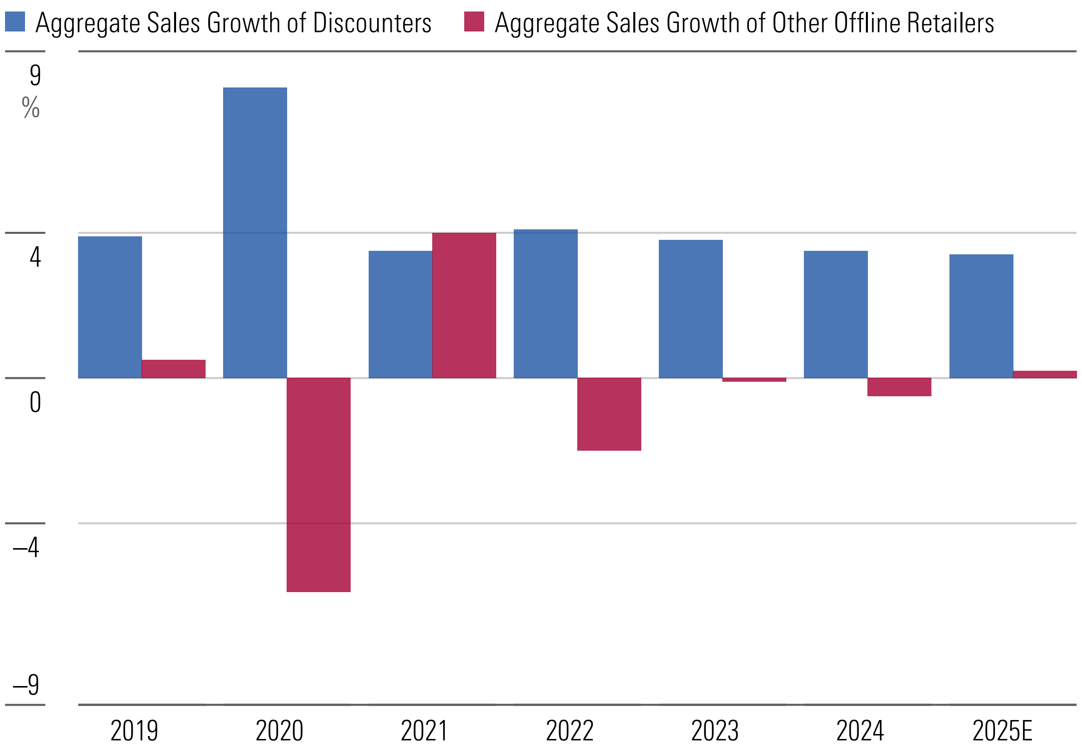
Discount Channels and Private Label Have Benefited From Consumers Seeking Value

The cost-of-living crisis over previous years led to increased demand for "discount" or "value" retailers. Warehouse clubs, discounters, and variety stores have performed well against mainstream retailers and this trend is expected to continue in 2025.

Private-label penetration has risen steadily across markets due to its perceived value. Grocers have increased private-label investments to improve their quality and range. Europe has the biggest level of private-label penetration at over 35% of total retail sales.

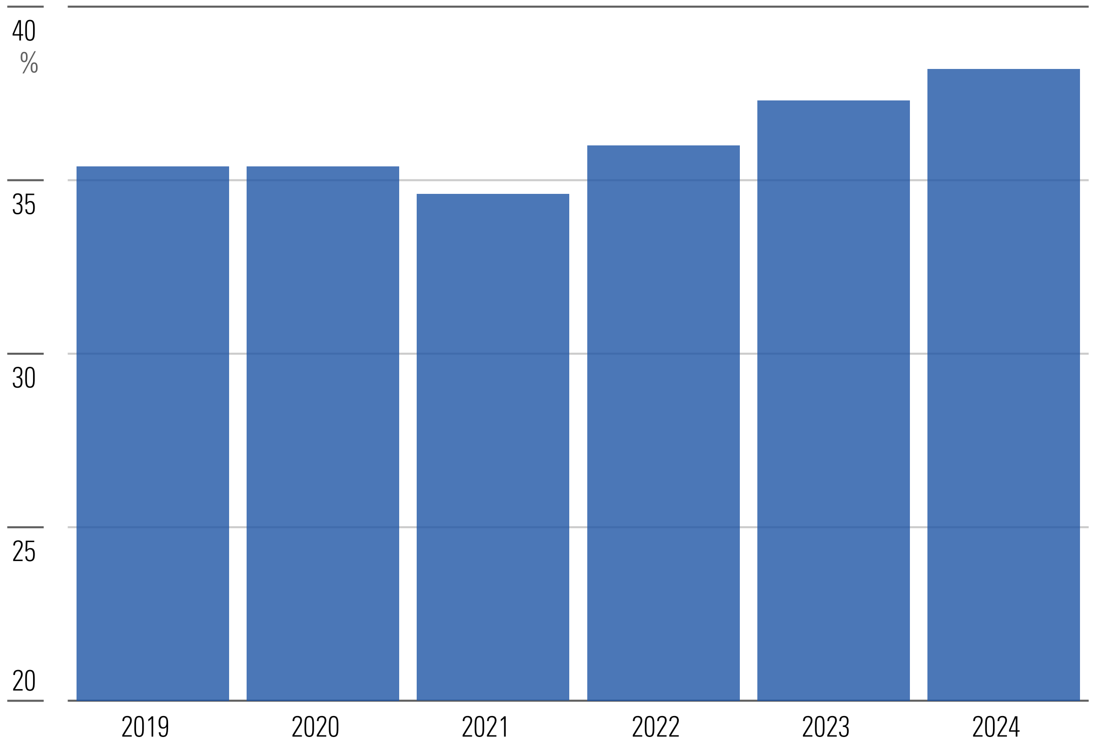
Discount Channels Have Continued To Gain Share Following the Pandemic

The global discount channel has increased by around a 5% five-year CAGR to 2024.



Private-Label Value Share of Fast-Moving Consumer Goods in Europe 2019-24

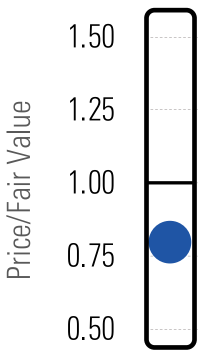
We expect private label to hold or gain share over 2025.



Source: Euromonitor Discounter Report (March 2025); Nielsen private label analysis (November 2024).

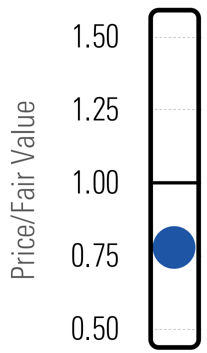
Consumer Defensive | Top Picks

Heineken **HEIA**



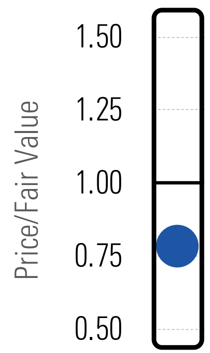
Market Cap	**Moat**
EUR 46 Bil	Wide
Rating	**Yield**
★★★★	2.6%
P/FV	**P/E**
0.80	14.5x

British American Tobacco **BATS**



Market Cap	**Moat**
GBP 89 Bil	Wide
Rating	**Yield**
★★★★	7.9%
P/FV	**P/E**
0.78	8.7x

Reckitt Benckiser Group **RKT**



Market Cap	**Moat**
GBP 45 Bil	Wide
Rating	**Yield**
★★★★	4.1%
P/FV	**P/E**
0.78	14.6x

Source: Morningstar. Data as of April 4, 2025.

Energy

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Outlook Suggests Lower Oil Prices Are Coming

OPEC Will Gradually Add Back Oil Supply in April

After multiple false starts, OPEC will unwind its voluntary production cuts beginning April 1. The US Energy Information Administration's short-term energy outlook posits that gradual production increases and relatively weak oil demand could result in some downward pressure on oil prices over this period. US trade actions could further crimp fragile demand in countries like China. If the Russia-Ukraine conflict is resolved, a peace deal could put even more downward pressure on oil prices. Both factors could support EIA's outlook.

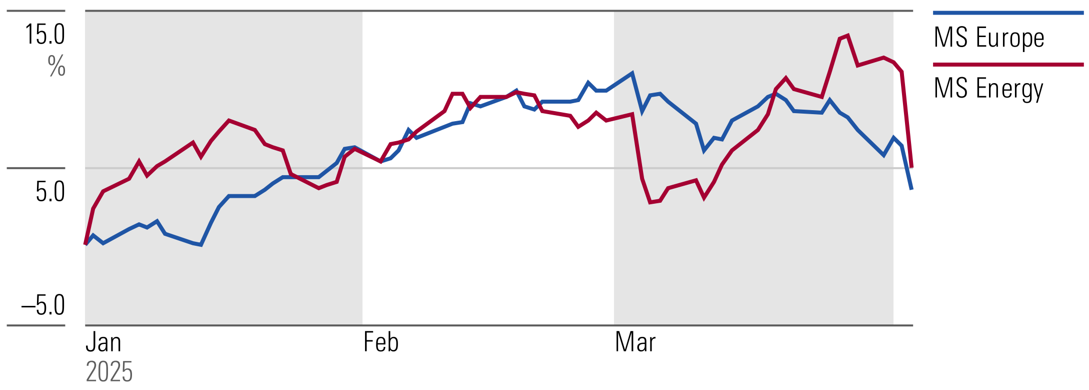
Mixed Macroeconomic Signals Increase Uncertainty in Short-Term Prices

Taking the other side of the argument, new US sanctions on OPEC member Venezuela, weakening sanctions on Russian oil tanker fleets, and US plans to accelerate crude purchases to refill its Strategic Petroleum Reserve, suggest potential upside pressure on crude prices in the short term.

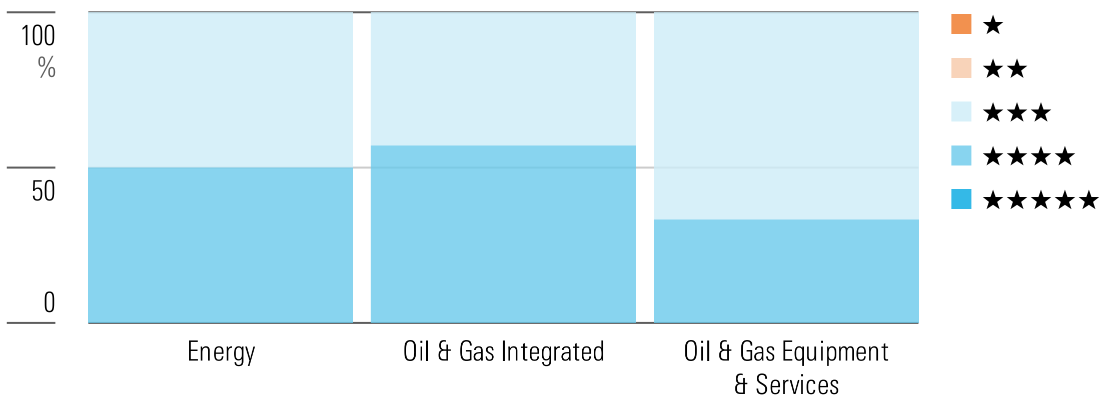
Our Valuations Suggest Opportunity, Primarily Among Integrated Players

Although prices have fallen, they remain above our midcycle price assumption of USD 60 Brent. Assuming those lower prices, we still see attractive investment opportunities among oil and gas-integrated players. Although a lower oil price in the near term would still likely pressure shares.

Energy vs. the Morningstar European Index



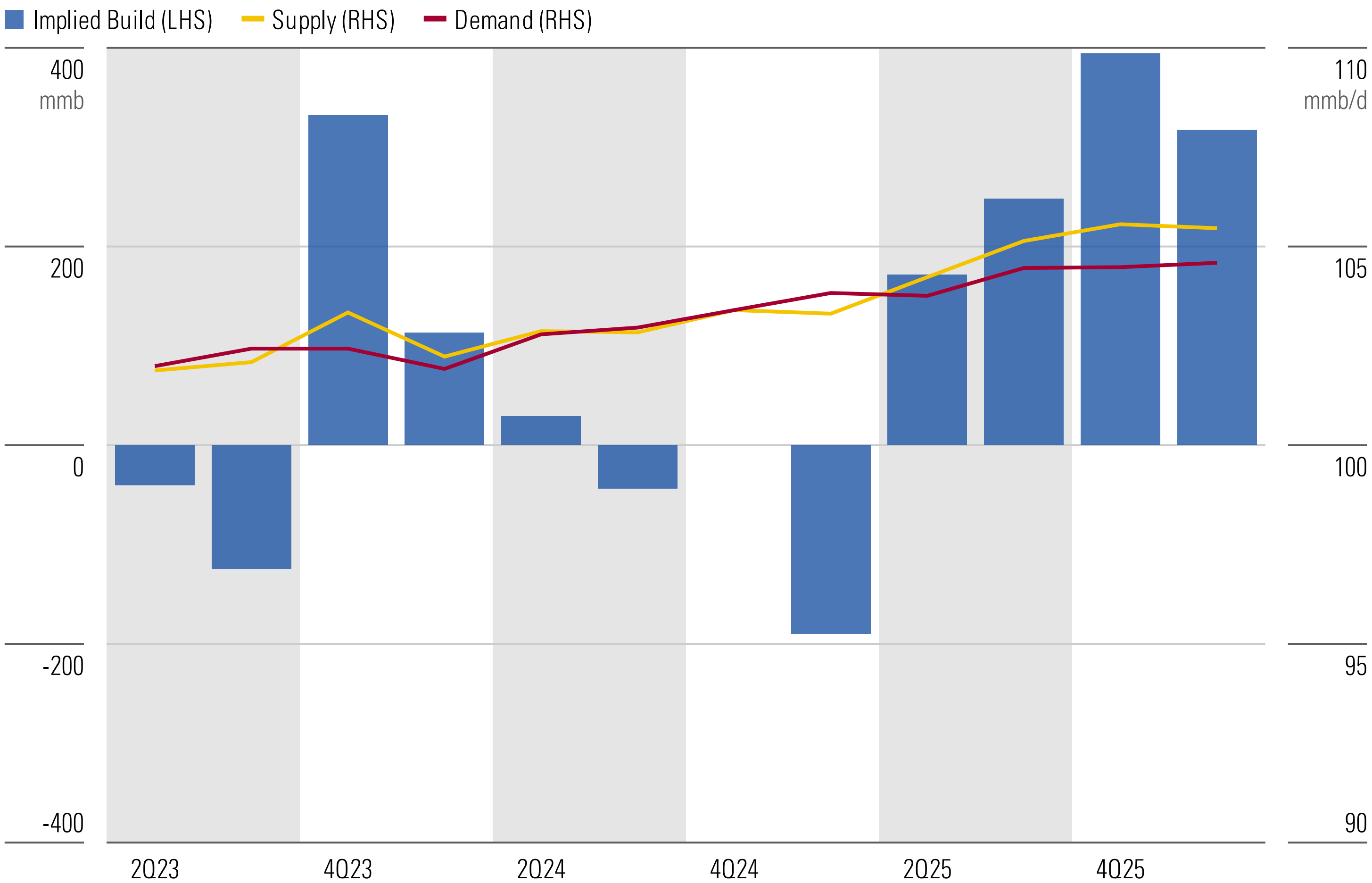
Energy Star Rating Distribution by Industry



Source: Morningstar. Data as of April 4, 2025.

EIA Projects a Worsening Supply Imbalance in 2025 as Demand Falters and OPEC Adds

EIA Expects Global Oil Inventories Will Increase in 2025 After 2024 Balance



The EIA sees a short-term draw on global oil stocks after a period of balance in 2024 that prevented the rebuilding of stockpiles. In the short term, this draw opens the potential for regional supply/demand mismatches. For the remaining forecast over seven quarters, constrained demand and renewed OPEC supply should attractively rebuild global stockpiles.

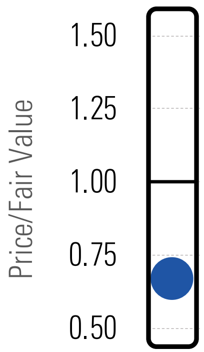
Refilling depleted government and commercial stockpiles could create a temporary floor under oil prices. If the mismatch persists, there is a limit to how much these purchasers can absorb. They may even defer if they believe lower prices are ahead.

After cutting production to balance supply/demand, OPEC looked ready to pounce on stable oil prices and raise production. That was before President Donald Trump injected massive uncertainty into economic markets. The only way to see its production increases balancing oil prices now is if stimulus efforts in the EU and China can offset a potential US economic slowdown, assuming there is no contagion.

Source: Energy Information Administration. Data as of March 7, 2025, 2025. LHS=left hand side; RHS=right hand side.

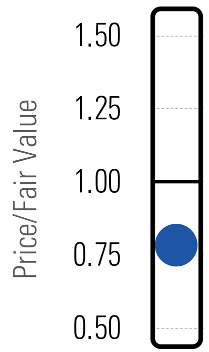
Energy | Top Picks

Schlumberger **SLB**



Market Cap	Moat
$47 Bil	Narrow
Rating	**Yield**
★★★★★	3.3%
P/FV	**P/E**
0.67	10.2x

TotalEnergies **TTE**



Market Cap	Moat
$130 Bil	None
Rating	**Yield**
★★★★	6.8%
P/FV	**P/E**
0.78	6.6x

Source: Morningstar. Data as of April 4, 2025.

Financial Services

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Financial Services Remain Attractive as Market Eyes Rate Cuts

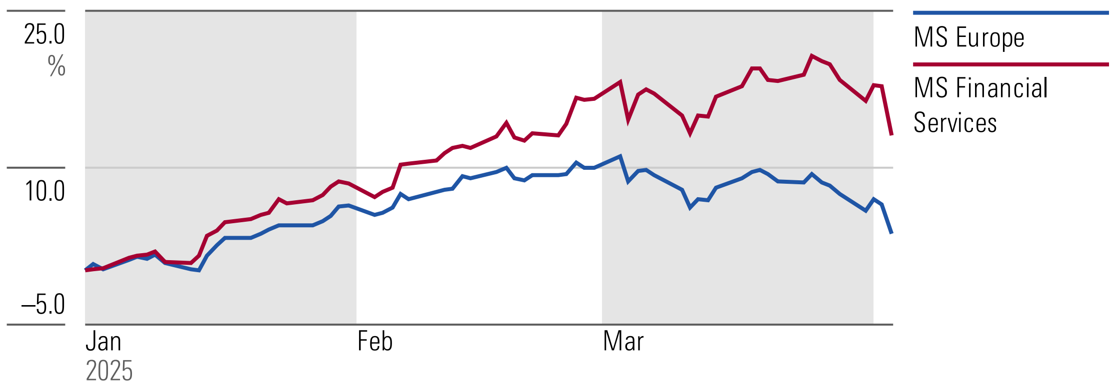
Interest-Rate Cuts Mean We Prefer Businesses With Better Discipline
As central banks continue to cut interest rates, we prefer financial service firms with a track record of superior standards of underwriting. For banks, that means prudent loans. For insurers, that means prudent assets and underwriting risks.

Payment Providers Remain Undervalued, but Investors Should Tread Carefully
Payment providers screen as cheap across our coverage, but performance and risks are diverging significantly among them. We advise investors to tread carefully in this industry. We believe the long-term drivers are still intact, offering good entry points for patient investors. We would avoid bottom-feeding and advise choosing quality at a good price instead.

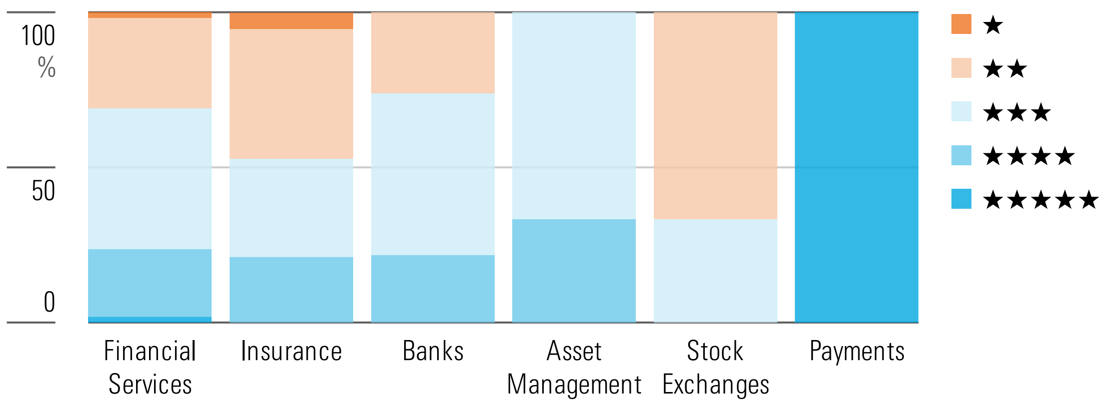
Banks With Low Funding Costs Are Winners in a Normalized Rates Environment
Higher interest rates have been good for European banks. Declining rates are leading to some margin compression, but profitability should remain materially above the levels in the last decade. We expect European banks with deposit-heavy funding to continue to outearn their cost of capital.

Insurers' Underwriting Becomes More Critical
As interest rates fall, most insurers will generate lower investment income. As growth tapers the focus will be on underwriting to maintain profit. We think investors can already see that in the reduction in Prudential's experience variances.

Financial Services vs. the Morningstar European Index



Financial Services Star Rating Distribution by Industry



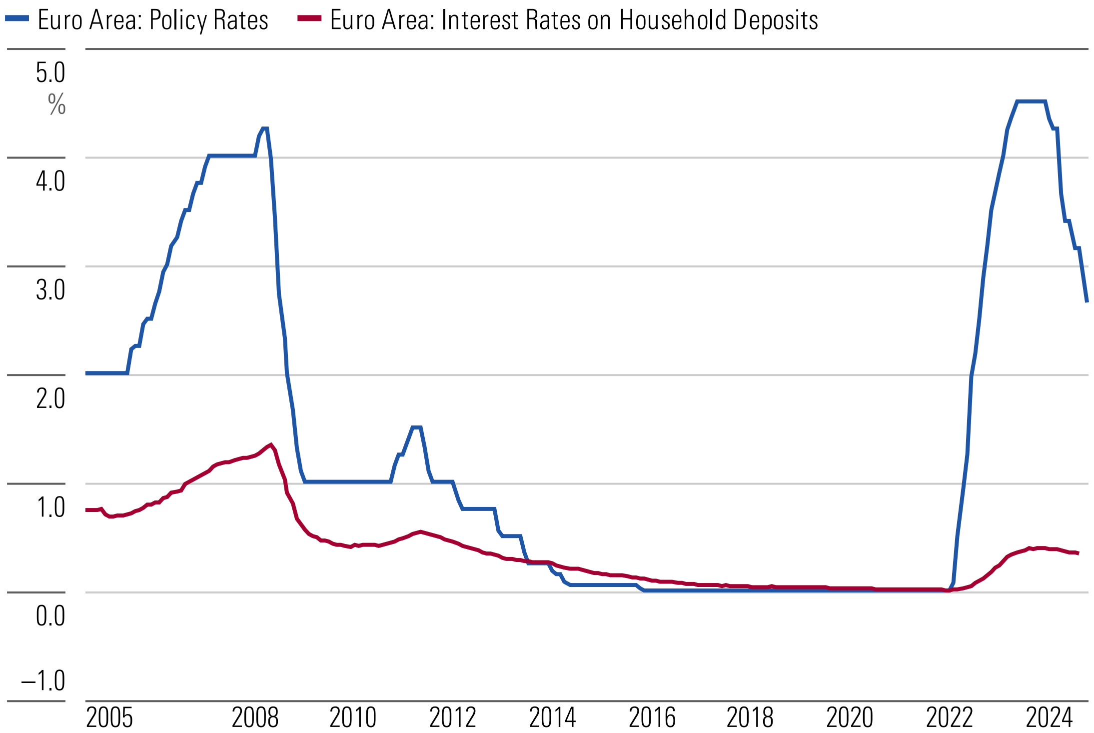
Source: Morningstar. Data as of April 4, 2025.

We Expect Banks and Insurers to Remain Profitable

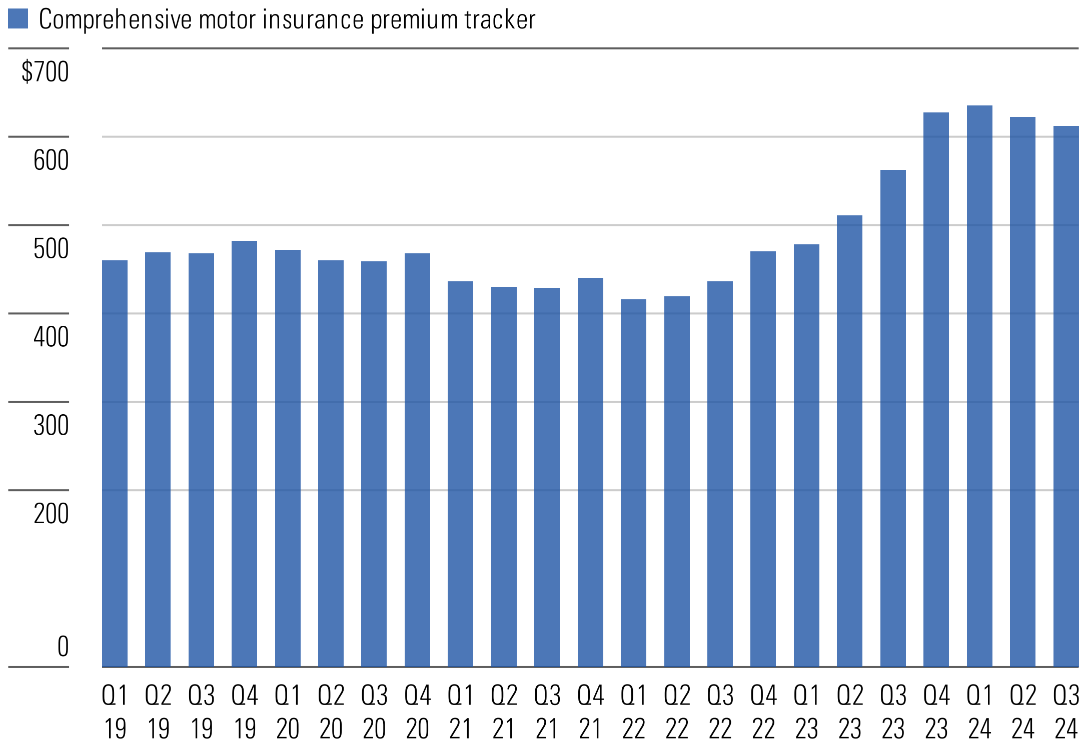
With tariff wars and increased fiscal spending likely to increase inflationary pressure across Europe, we anticipate interest rate cuts to slow. European banks will benefit from higher than previously assumed rates as well as potentially stronger economic growth.

Prudential's' full-year results showed a business that is growing, as premiums written across Asia have rebounded after the pandemic. We saw this with double-digit growth in new business profit in Prudential Hong Kong as mainland visitor numbers rebounded.

Deposit-Taking Finally Profitable Again for European Banks



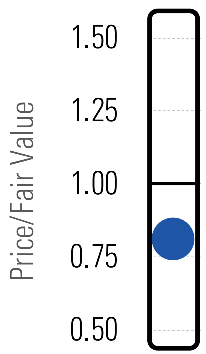
Mainland China Visitor Numbers to Hong Kong Continue to Rise



Source: European Central Bank, Haver, Hong Kong Census and Statistics Department. Data as of Jan. 25, 2025.

Financial Services | Top Picks

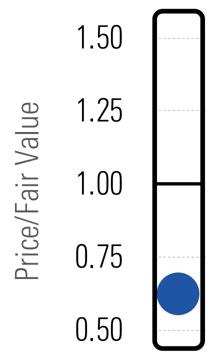
BNP Paribas



BNP

Market Cap	**Moat**
EUR 86 Bil	None
Rating	**Yield**
★★★★	7.4%
P/FV	**P/E**
0.81	6.8x

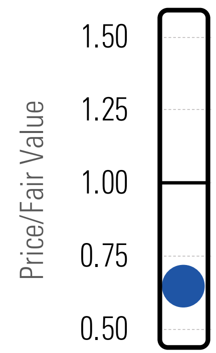
Prudential UK



PRU

Market Cap	**Moat**
$25 Bil	None
Rating	**Yield**
★★★★	3.4%
P/FV	**P/E**
0.62	7.3x

Adyen



ADYEN

Market Cap	**Moat**
EUR 44 Bil	Wide
Rating	**Yield**
★★★★	0.0%
P/FV	**P/E**
0.65	34.6x

Source: Morningstar. Data as of April 4, 2025.

Healthcare

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Pullback From US Election and Obesity Competition Leaves Sector Undervalued

Healthcare Was a Solid Performer in the First Quarter

Over the past 12 months, the Morningstar Healthcare Index has performed similarly to the Morningstar European Index. The sector outperformed the overall market in the summer of 2024, but underperformed late in the year on the back of disappointing results and data from obesity firms as well as broader uncertainty around US healthcare policy under Trump and Robert F. Kennedy Jr. Healthcare performed strongly in the first quarter and we expect the more defensive nature of the healthcare sector to support the group if economic concerns continue.

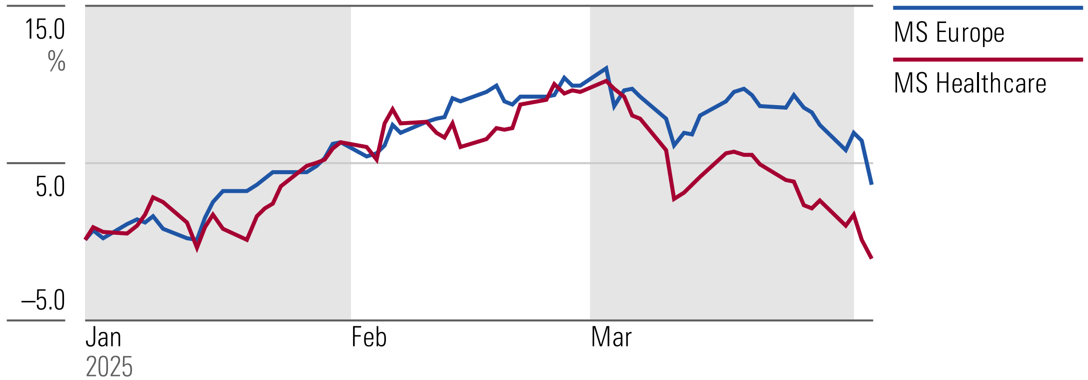
Valuations Still Look Broadly Attractive

The sector looks relatively undervalued overall, trading at a roughly 5% discount (on a market-cap-weighted basis) to our fair value estimates. We see several undervalued opportunities across biopharma (Novo Nordisk), medical diagnostics and research (Eurofins, Qiagen), and care facilities (Fresenius SE).

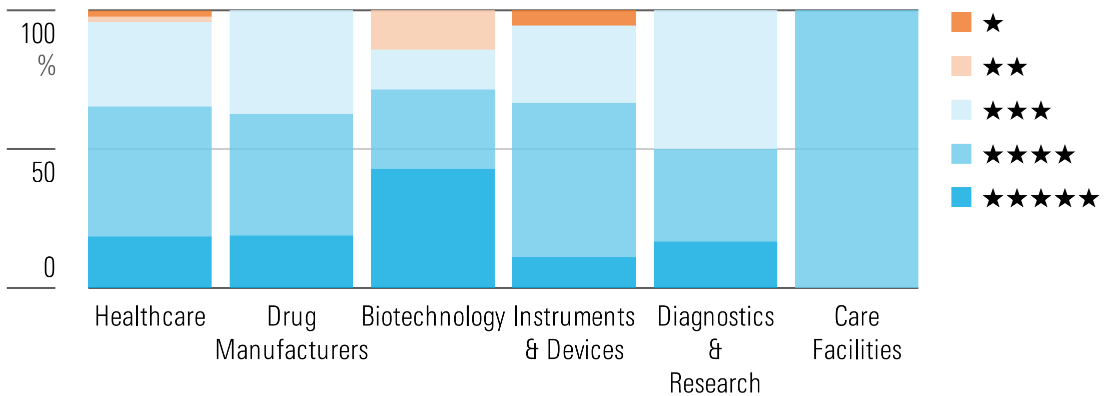
Regulatory Headwinds Add Volatility, but Are Manageable

Volatility has increased following the US election of Donald Trump as president and Kennedy's appointment as secretary of health and human services. While we have not made major valuation changes across healthcare industries, we see high uncertainty around many stocks, particularly in biopharma and healthcare plans. Within the obesity market, Novo Nordisk now trades at a discount to its fair value estimate as we still see strong competitive advantages despite Eli Lilly's growing market share.

Healthcare vs. the Morningstar European Index



Healthcare Star Rating Distribution by Industry



Source: Morningstar. Data as of April 4, 2025.

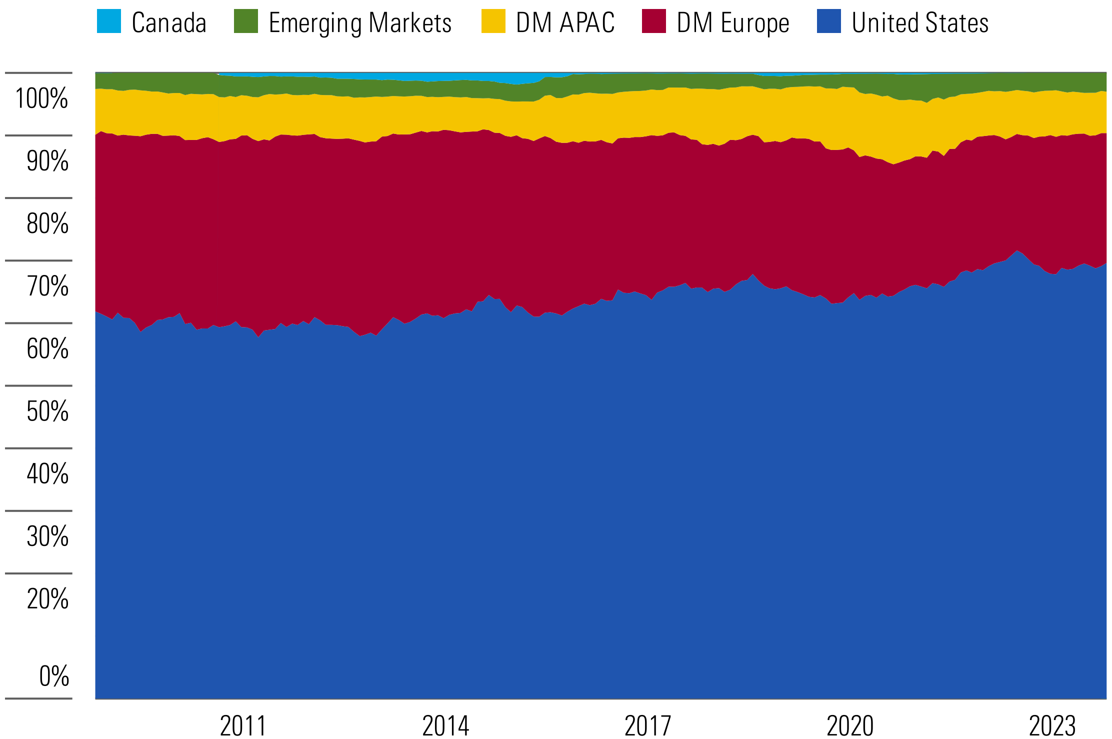
Global Healthcare Has Significant Exposure to US Policy Risk, but Medicare Negotiations Look Manageable

US healthcare is more than half of our investable healthcare equity coverage, as shown by its percentage of the Morningstar Global Healthcare Index (by market capitalization). This makes US policy risk a theme that is difficult for global investors to avoid.

The 10 drugs selected for Medicare negotiation in 2026 as part of the Inflation Reduction Act are likely to see additional discounts average roughly 15%, with the four drugs that potentially could be hit hardest, depicted in the graphic below.

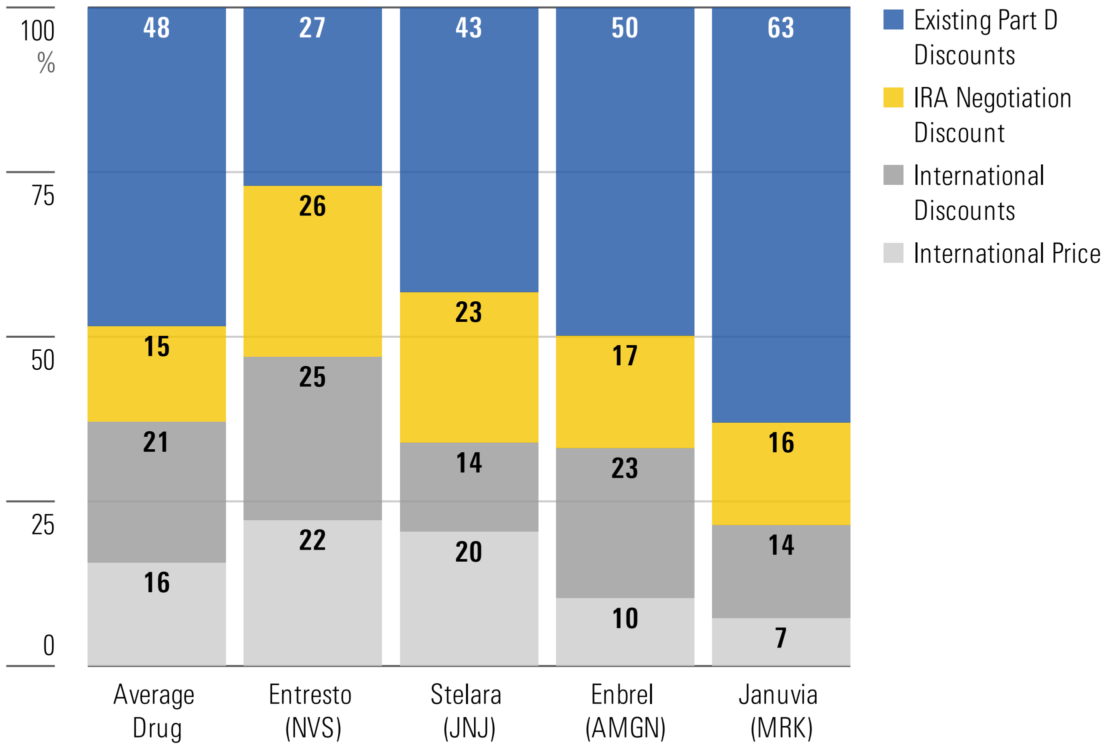
US Healthcare Exposure Has Grown More Dominant Over Time

US healthcare constitutes 69% of the Global Healthcare Index.



US Medicare Negotiations in 2026 Look Manageable

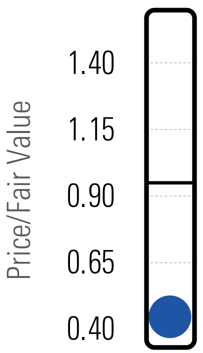
In European biopharma, Novartis' Entresto has the steepest expected discount.



Source: Left: Morningstar Direct as of Dec. 31, 2024. DM APAC=Developed Markets Asia-Pacific.
Right: Morningstar analysis with 2021 net Part D price estimates from Hernandez et al, 2026 negotiated prices from CMS, and international price data from Peterson-Kaiser Health System Tracker.
NVS=Novartis; JNJ=Johnson & Johnson; AMGN=Amgen; MRK=Merck.

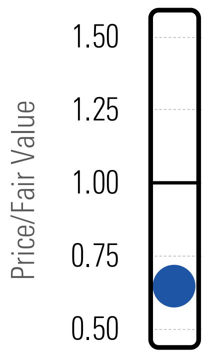
Healthcare | Top Picks

Bayer — **BAYN**



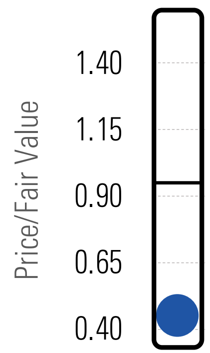
Market Cap	**Moat**
EUR 22 Bil	Narrow
Rating	**Yield**
★★★★★	0.6%
P/FV	**P/E**
0.45	4.5x

GSK — **GSK**



Market Cap	**Moat**
GBP 75 Bil	Wide
Rating	**Yield**
★★★★★	4.6%
P/FV	**P/E**
0.64	8.4x

Elekta — **EKTA B**



Market Cap	**Moat**
SEK 2 Bil	Wide
Rating	**Yield**
★★★★★	4.9%
P/FV	**P/E**
0.45	13.4x

Source: Morningstar. Data as of April 4, 2025.

Industrials

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Energy Transition Opportunities Largely Priced In; Business Services, Auto, and Defense Stocks Attractive

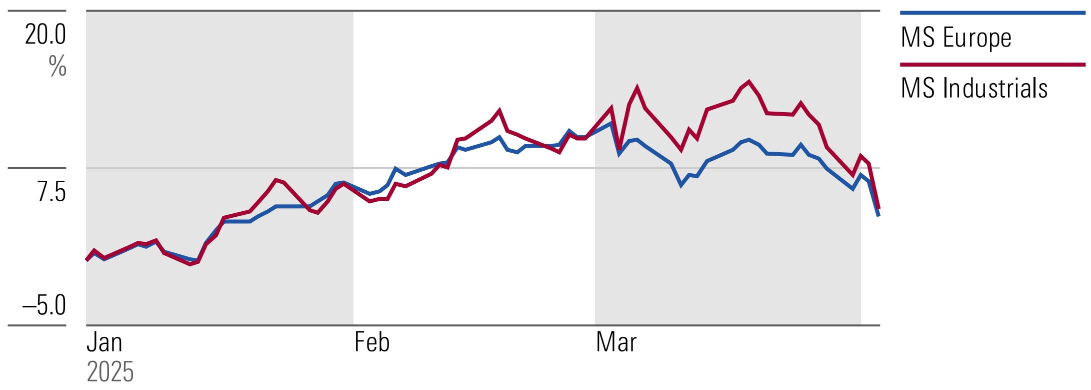
Sector in Line With the Broader Market in the First Quarter

European industrial stocks grew in line with the European market in the first quarter of 2025, with defense companies performing well for the second consecutive quarter. Looking forward, anticipated interest-rate cuts by the European Central Bank in 2025 are expected to stimulate economic activity, particularly benefiting cyclical sectors such as construction. Additionally, persistent secular growth drivers like the energy transition are expected to maintain strong demand across the industrial landscape, regardless of fluctuating macroeconomic conditions.

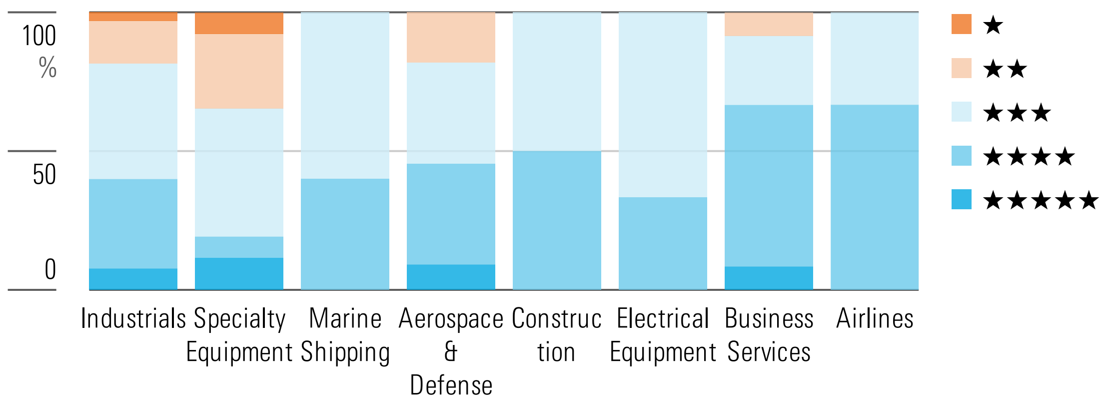
Business Services, Airlines, and Aerospace Stocks Are Attractive

We identify compelling investment opportunities in the business services sector, especially in testing, inspection, and certifications firms, benefiting from global tailwinds in sustainability testing and supply chain management. In the airline sector, European carriers, despite the considerable challenges they face, that demonstrate robust fleet management, operational efficiency, and strategic planning have the potential to transform these obstacles into competitive strengths. The persistent capacity constraints and ongoing industry consolidation offer a unique chance for strategically adept airlines to enhance their market standing and improve financial results in the upcoming year. European aerospace and defense stocks are poised to benefit from a continued global uptick in government defense expenditures.

Industrials vs. the Morningstar European Index

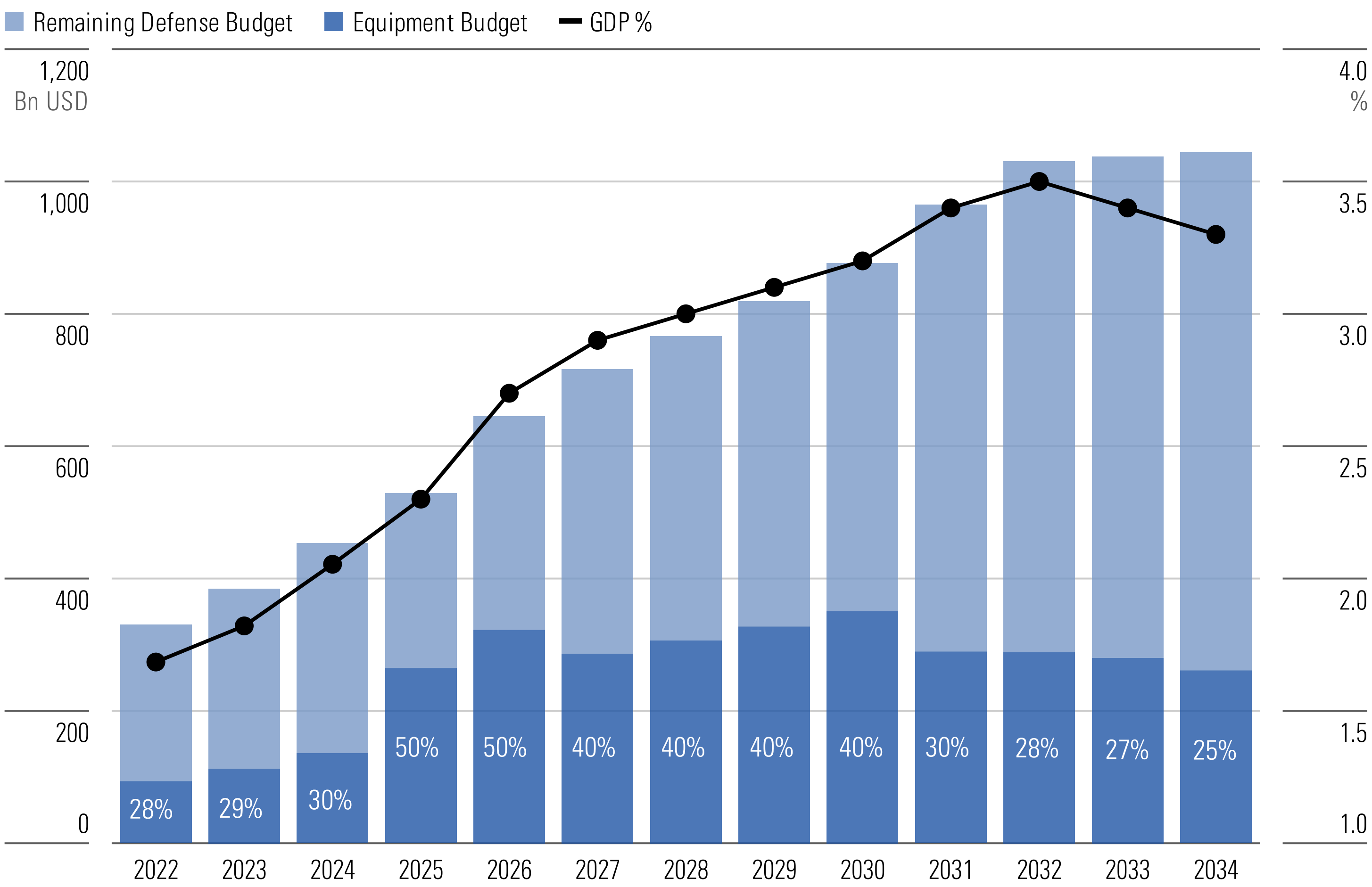


Industrials Star Rating Distribution by Industry



European Defense Stocks Surge on Expected Record-High Spending Commitments

European Countries' Defense Budgets Expected to Surpass 3% of GDP With Increased Share of Equipment



Supercycle to Unlock USD 1.8 Trillion Opportunity by 2030

Geopolitical tensions and recent developments are driving a new defense supercycle. These include discussions on a possible US pullback and mounting pressure on Europe to raise defense budgets,

As NATO Secretary-General Mark Rutte calls for spending above 3% of gross domestic product, we project European defense spending to gradually reach 3.2% of GDP by 2030 (USD 876 billion) and 3.5% by 2032, before stabilizing around 3%.

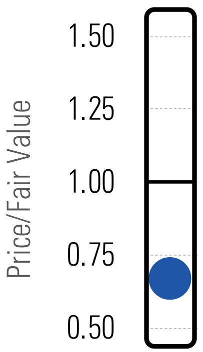
Equipment spending has averaged 28% of total budgets over the past four years, reaching 30% in 2024. We see this as insufficient to address decades of underinvestment. In the midterm, we expect Europe to prioritize inventory replenishment, with equipment spending rising to 50% of budgets in 2025-26 and 40% from 2027-30, before declining to 25% by 2034 as personnel and research and development investments grow.

This shift is expected to generate a cumulative USD 1.8 trillion opportunity in defense equipment by 2030 and approximately USD 3 trillion over the next decade, with European contractors positioned as the primary beneficiaries.

Source: Energy Information Administration. Data as of Nov. 21, 2024. 2025-34=forecast.

Industrials | Top Picks

Bureau Veritas **BVI**



Market Cap
EUR 13 Bil

Moat
Wide

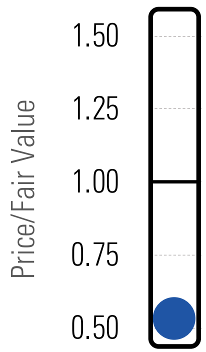
Rating
★★★★★

Yield
3.7%

P/FV
0.67

P/E
17.8x

Melrose Industries **MRO**



Market Cap
GBP 7 Bil

Moat
Wide

Rating
★★★★★

Yield
1.8%

P/FV
0.53

P/E
12.4x

Rheinmetall **ETR: RHM**

Market Cap
EUR 61 Bil

Moat
Wide

Rating
★★★★★

Yield
0.9%

P/FV
0.57

P/E
42.7x

Source: Morningstar. Data as of April 4, 2025.

Utilities

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European Utilities Continue to Underperform

High Interest Rates Weigh on the Sector
European utilities have been the strongest performing sector year to date. With recent rallies driven by a flight to safety.

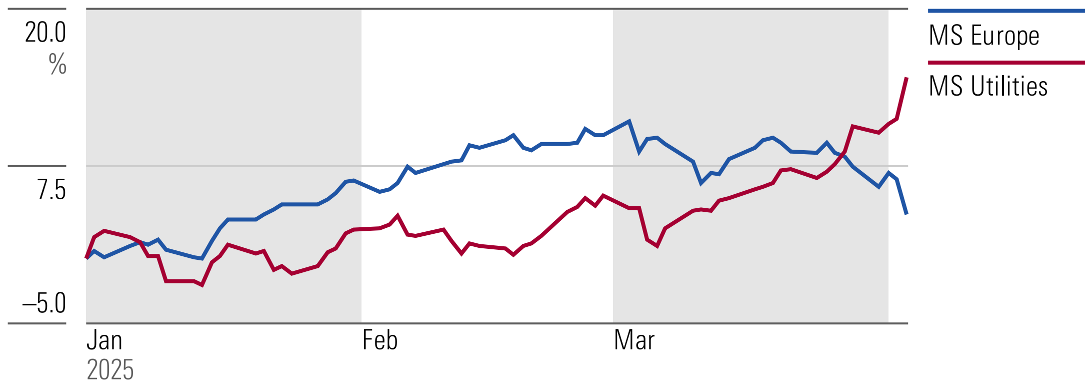
Geopolitical Developments Fuel Volatility in Commodity Prices
Power and gas prices have tumbled since the start of talks between the US and Russia. Power prices fell by 6% year to date. Due to geopolitical uncertainty, high volatility could persist. Low gas storage levels involve upside risk.

Renewables Capacity Additions Were Flat in Q4
They accelerated sequentially as companies rushed to meet their annual targets. We expect capacity additions to shrink in 2025 as most companies trimmed their ambitions amid investor skepticism toward the sector. Pure players face balance-sheet constraints while diversified utilities are reallocating their investments to networks.

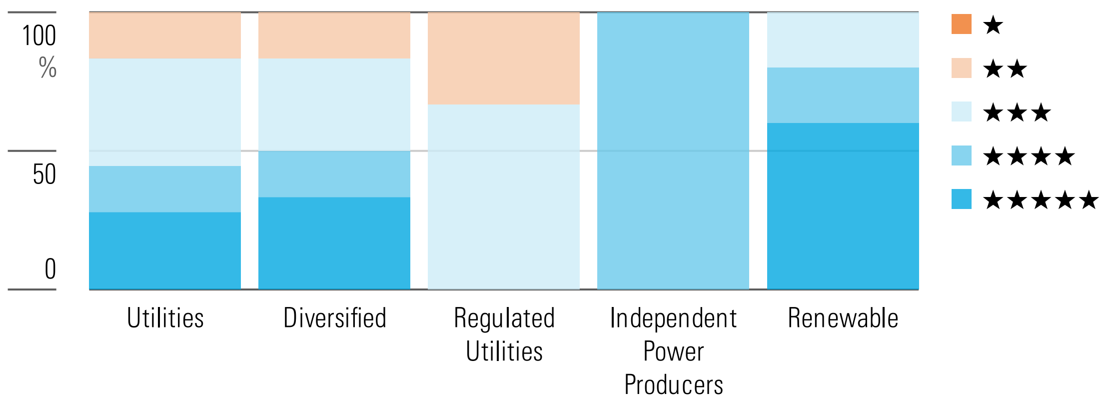
Regulation Is Improving in Spain
The extension of the energy levy to 2025 was rejected. An extension of the nuclear fleet is on the cards.

Sector Is Slightly Undervalued
The median price/fair value estimate ratio is 0.94. The median dividend yield of 4.7% aligns with the historical median.

Utilities vs. the Morningstar European Index



Utilities Star Rating Distribution by Industry



Source: Morningstar. Data as of April 4, 2025.

Wholesale Power Prices Declined Slightly in the First Quarter of 2025

The European utilities' yield premium to European government bond yields has shrunk by nearly 70 basis points in the first quarter as the sector increased while government bonds sold off. At 1%, it is below the 2.1% historical average. On an absolute basis, the median trailing dividend yield of 4.7% aligns with the historical median.

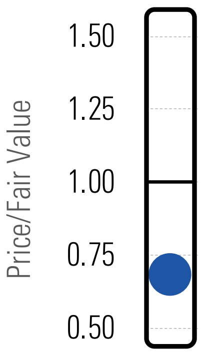
German Power Prices Declined Slightly in Q1

European Utilities' Yield Premium Receded So Far in 2025

Source: Morningstar commodities. Data as of March 20, 2025.
Note: MWh=megawatt-hours.

Utilities | Top Picks

SSE



SSE

Market Cap
GBP 23 Bil

Moat
None

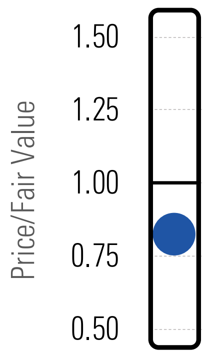
Rating
★★★★★

Yield
4.3%

P/FV
0.68

P/E
9.8x

Veolia



VIE

Market Cap
EUR 25 Bil

Moat
Narrow

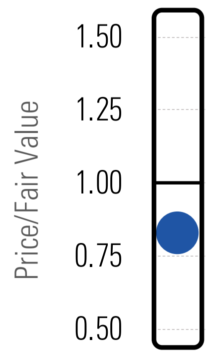
Rating
★★★★

Yield
5.0%

P/FV
0.82

P/E
13.9x

E.On.



EOAN

Market Cap
EUR 40 Bil

Moat
Narrow

Rating
★★★★

Yield
4.1%

P/FV
0.83

P/E
12.6x

Source: Morningstar. Data as of April 4, 2025.

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