Back in the game

Why European equities are off the lead and running free.

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Andre Kostolany, the legendary Hungarian investor, once remarked that "the relationship between stock market and economy is like a man walking his dog. The man walks slowly, the dog runs back and forth." It's an apt metaphor for Europe today, where economic gloom and equity market performance have been pulling in rather different directions.

Let's deal with the usual scepticism first: economic growth has been anaemic, tariffs remain a headwind and government debt continues to rise. Throw in persistent geopolitical tensions and it doesn't entirely look like a region on the cusp of a dramatic upswing.

That may be the man, but the dog has been far livelier: in 2025, five of the world's ten best-performing stock markets were European, with the Spanish IBEX 35 delivering a 60%-plus return.

This disconnect should not be surprising given that European equities are not a pure play on the regional economy. Around 60% of MSCI Europe revenues are earned overseas, twice that of the US and emerging markets. As a result, performance is shaped as much by the macro backdrop in the US and Asia as conditions closer to home.

European companies may not command the headline-grabbing glitz of the Magnificent Seven, but the region is home to a roster of world-class businesses trading at more attractive valuations than their American peers. For investors willing to follow the dog, Europe could offer a compelling opportunity.

The unsung global winners

A decade of entrenched US exceptionalism has opened a clear valuation gap, with US-listed companies often commanding higher multiples than their European-listed peers. Yet Europe also boasts global leaders at the centre of powerful structural trends.

AI has taken the world by storm and ASML is another European success story. As the sole global supplier of extreme ultraviolet lithography machines required to manufacture the most advanced semiconductor chips, it sits at the heart of soaring demand for data centres and high-performance computing.

Its blue-chip customers include NVIDIA, TSMC, Intel and Apple, and it recently agreed a multi-million-dollar deal with Samsung Electronics to expand chipmaking capacity in Korea. Yet ASML still trades at lower multiples than several US semiconductor equipment peers despite its market-leading position.

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SAP is also trading at a discount to many US software peers, despite its global leadership in enterprise software after a multi-year transition to cloud-based subscription revenue. High recurring revenues, improving margins and deeply embedded products provide a long growth runway, particularly as AI adoption accelerates.

Europe's leadership also extends beyond technology into financial market infrastructure. As one of the leading exchange operators, Deutsche Börse sits at the heart of Europe's capital markets ecosystem.

The company provides exposure to powerful structural trends including rising market activity, increasing demand for financial data and analytics and growing participation in capital markets. Mobilisation of Europe's substantial household savings into equities could also provide a further tailwind.

Despite its high-quality characteristics, strong cash generation and long-term growth prospects, Deutsche Börse continues to trade at an attractive valuation relative to its US-listed financial infrastructure peers.

Together, these businesses provide exposure to powerful global megatrends across AI infrastructure, digital transformation and capital markets, while offering a margin of safety relative to the valuations of their US counterparts.

The tide is turning

Global markets have offered rich pickings for European companies, but there's a notable improvement in the domestic picture too.

After a decade of austerity, Germany's easing of its fiscal debt brake marks a clear shift in direction, opening the way for increased investment in defence, transport and energy infrastructure. At the same time, defence budgets are rising across the region as NATO members ramp up spending and co-operation.

Energy security provides a further catalyst, with geopolitical uncertainty pushing European policy-makers to reduce reliance on external suppliers and accelerate investment in domestic renewables and grid capacity.

Moving from the public to private sector, European households sit on an unusually high level of savings, often in low-yielding deposits. The Draghi report has built political momentum to reallocate this capital into productive investment, which could have a substantial impact on equity markets.

These domestic catalysts support an improving earnings outlook for European equities, with growth forecast to move from neutral in 2025 to high single numbers in 2026.

The active advantage

While passive strategies own the market, warts and all, active funds such as **Fidelity European (FEV)** focus on finding the right companies and having the conviction to keep holding them. Managers Marcel Stötzel and Sam Morse draw on more than 50 years of combined experience, supported by around 140 global equity analysts, including a dedicated European team.

Their approach is deliberately selective, holding 40-50, predominantly large-cap companies with strong cash generation, disciplined capital allocation and clear structural growth drivers. Dividend growth is central to the strategy, driven by underlying earnings rather than headline yield, meaning that quality and compounding take priority over short-term income.

This discipline is reflected in the longevity of many holdings. FEV has owned SAP for over 25 years and ASML for over a decade, allowing the portfolio to capture the full compounding effect of durable business models.

Over the past 30 years, this long-term approach has delivered an annualised return of 12%, comfortably above the MSCI Europe Index at 8%. Or, to put it another way, £1,000 invested in FEV 30 years ago would have grown to almost £30,000, compared to £19,000 for the S&P 500.

The managers have positioned the portfolio to capitalise on the most compelling structural themes. TotalEnergies, a holding since the 1990s, illustrates how disciplined capital allocation has supported a pragmatic approach to the energy transition by increasing oil and gas production to fund its pivot into clean energy. Despite comparable share price performance and forecast earnings growth to ExxonMobil, TotalEnergies trades at roughly half the valuation of its US peer.

In digitalisation and AI, Legrand provides a differentiated "picks and shovels" angle to SAP and ASML. Data centres now account for around a quarter of the French electrical specialist's revenue, supported by targeted acquisitions and expansion into the Americas.

Alongside these long-term themes, the managers also take an active approach to capture shorter-term opportunities. Financials are one such example: European banks now have stronger capital bases, more resilient earnings and attractive valuations. FEV has recently added BNP Paribas and continues to hold Deutsche Börse, which could benefit if household savings are channelled into equity markets.

Airlines also offer a more contrarian opportunity: while higher fuel costs are a clear headwind, this can force weaker operators to retrench and enable stronger carriers to improve their pricing power and market share. As a result, FEV holds a position in leading European carrier Ryanair, thanks to the success of its low-cost model and healthy balance sheet.

Be more dog

For much of the last decade, a sluggish economy has weighed on investor sentiment towards Europe, despite its cohort of world-class companies. With valuations still materially below the US and domestic stimulus beginning to pay dividends, the man and the dog may finally be running together.

Unless specified otherwise, data as at 09/06/2026, and total share price returns in GBP.

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