EUROPEAN EQUITIES OUTLOOK Q3 2024

Goldilocks scenarios, election results, and new realities

The first half of the year closes on a positive note, with both the MSCI Global and MSCI Europe indices experiencing double-digit gains. The underlying trends feel familiar and mirror previous patterns: these gains are backed by strong performances among blue-chip companies and, in the US, a notable surge in technology stocks.

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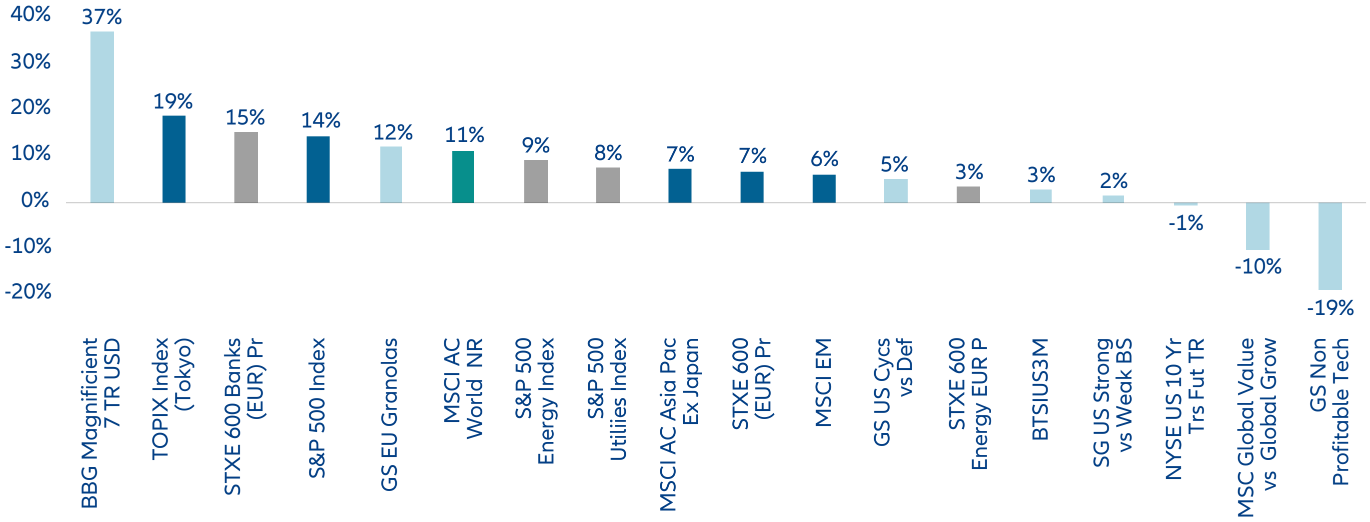
Interest rate discussions are starting to sound familiar, too. While the European Central Bank (ECB) has indicated that no further rapid changes are expected (following the 25bps cut in June), the Federal Reserve (Fed) remains cautious, with our House View indicating a likely rate cut in September.

The decline in inflation has been primarily driven by lower energy and raw material costs, and the easing of bottlenecks in supply chains. However, food prices, unit labour costs and inefficiencies stemming from the slowing globalization of goods production continue to negatively impact inflation. Wage costs are a lagging factor in a high-inflation phase and are therefore likely to remain a drag for some time to come. An ageing population, a shortage of skilled workers, and a lack of immigration are putting a strain on labour markets and driving up wage costs. Overall, the dovish stance of central banks is understandable given these conditions.

Exhibit 1: Total Return year-to-date /January – June in % across different assets



Sources: AllianzGI/Bloomberg, as of 30 June 2024

Equity markets are currently exhibiting momentum influenced by both broad geopolitical and local political events. Politically driven equity markets tend to react over the short term. However, the recent accumulation of such events has had a sustained impact. There have been no significant changes in relations with Russia and China; Ukraine and the South China Sea remain global flashpoints, posing substantial risks to the global economy; and while Ukraine is the most immediate concern for Europe, a stand-off over the South China Sea holds the potential for even greater disruption.

On a more regional level, the recent European Parliament elections proceeded without major surprises. A further shift to the right had been expected, and this was reflected in the results, but there was no major change in the balance of power. This status quo was confirmed when, on 27 June 2024, EU member states nominated European Commission President Ursula von der Leyen for a second term.

On a local level, however, some of the results were more surprising. The relative success of the National Rally (RN) in France led to President Emmanuel Macron calling a snap legislative election – a move that took markets by surprise. These snap elections, held on 30. June and 7. July, resulted in a close to three-way split between the main party groupings, heralding a time of further volatility in French politics.

The consequences of the European election results in Germany were less substantial, and the German government's reaction was less dramatic. However, the results highlighted its weak support domestically.

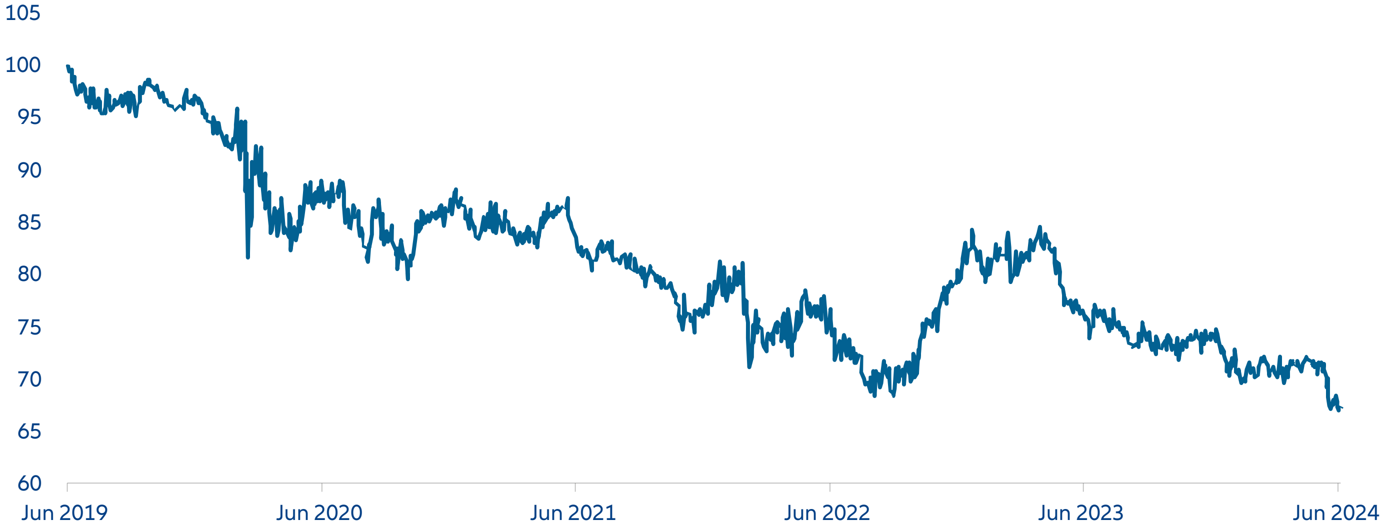
In the UK, the general election held on 4th July 2024 resulted in a victory for Labour, a widely anticipated result that did not perturb markets.

The most significant political event in the coming months will likely be the U.S. presidential election in November, which is expected to lead to substantial changes – and to thus introduce both opportunities and uncertainties in the market. Increased volatility should therefore be expected.

Due to these political uncertainties, and in particular of the unexpected French elections, European equities have been particularly weak, continuing to underperform relative to their US peers.

Exhibit 2: European equities versus US equities; Reaction to France!

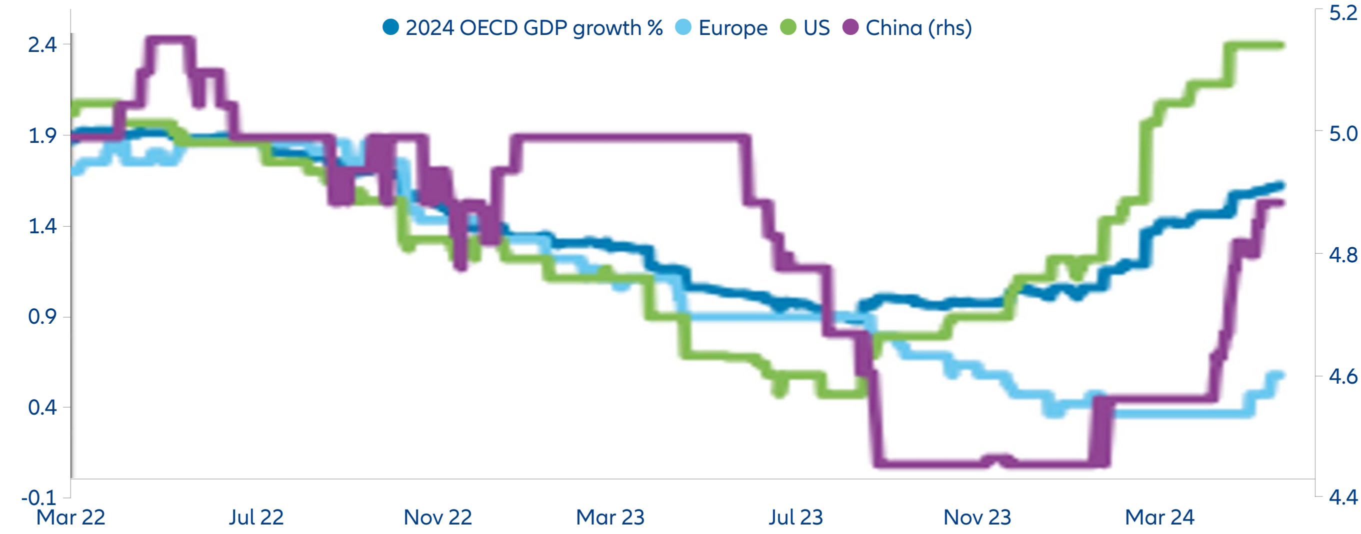
MSCI Europe/S&P 500 (in USD)



Source: Bloomberg/AllianzGI, as of 30 June 2024

The global economy has remained resilient, and the first two quarters of 2024 show stable economic development. The US remains the driving force, but other regions are also performing well. To keep the Goldilocks scenario and interest rate cut fantasies alive, some weaker economic data is needed to provide central banks with the justification to lower rates. As mentioned, inflation is declining, creating room for potential rate cuts. A key positive factor remains the stability of the labour market across nearly all regions, supporting high consumption and economic stability. However, increasing tensions between China, the U.S., and Europe could pose challenges, as seen recently in the electric vehicle sector. Indeed, increasing protectionism will be detrimental and counterproductive.

Exhibit 3: Upgrades to GDP Growth figure in different regions



Sources: Barclays Research, June 2024

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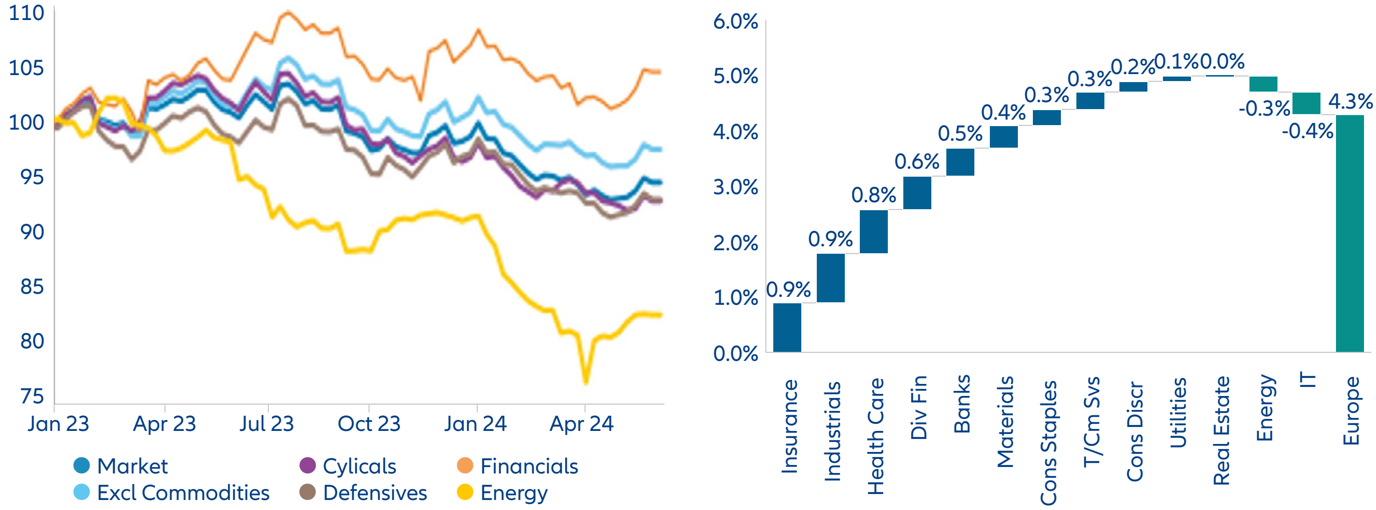
Corporate earnings continue to be a stabilising factor. Most companies expect their results to improve soon, leading analysts to raise their earnings estimates. The chart on the left shows a clear stabilization in earnings per share (EPS), outside of the energy sector, which is declining. The chart on the right breaks down the earnings stabilization for 2024 by sectors.

Exhibit 4: Earnings per share (EPS) 2024 estimated for MSCI Europe



Sources: Barclays Research, June 2024

The financial sector remains the most important component of Europe's profit growth, with insurance companies and banks leading the increases in EPS. Banks continue to benefit from the positive interest margin and insurers from price increases necessitated by the sharp rise in in claims costs. Conversely, the energy sector struggles due to low oil prices, while the IT sector also faces challenges.

What can we expect for the second half of 2024?

We are currently in an economic recovery phase, which could be stimulated by interest rate cuts. Yet, although the conditions for rate cuts are already in place, they remain somewhat fragile. Inflation is declining, albeit more slowly than anticipated. Corporate results and stock market valuations, especially in Europe, suggest a promising second half of the year. However, potential obstacles loom. Elections currently pose the biggest threat to European stock markets. Historically, elections cause volatility, but rarely lead to major distortions, and become irrelevant to markets over time. Nevertheless, the cumulative effect of these events should be taken into account.

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