

Europe finds its footing

European equities | February 2026



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- **US growth is increasingly dependent on a narrow, AI-driven capex boom, with labour and consumption soft.**
- **Valuations in the US are stretched and foreign inflows may falter, leaving the dollar vulnerable.**
- **Europe enters 2026 with better balance sheet health, savings and easing inflation, and Germany's fiscal policy is a boost.**
- **Global earnings are broadening, giving Europe and small caps a clear opportunity in 2026.**

The US

After three years of 20% gains, 2026 has again started on a strong note. This latest rally is one of the most concentrated ever. The global stock market is two-thirds American, of which 40% is just 10 stocks with one huge bet: generative artificial intelligence (AI). A quarter of the world stock market relies on this.

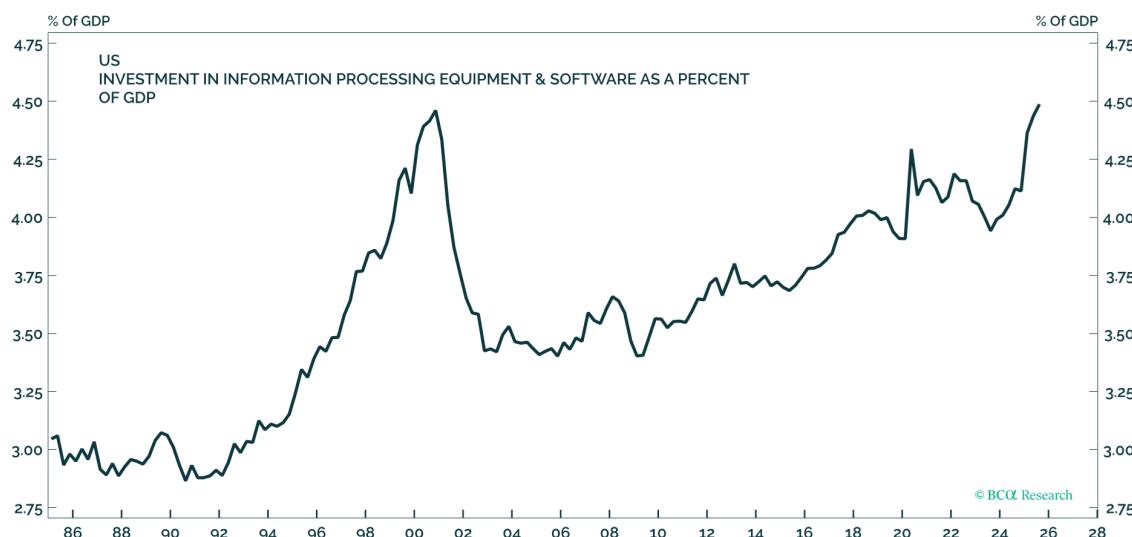
Five hyperscalers – Amazon, Google, Meta, Microsoft and Oracle – plan to add \$2 trillion of AI-related assets to their balance sheets by 2030. These assets will be depreciated at 20% per annum – an annual cost of \$400 billion – which is more than their 2025 profits. And this is not the whole picture: OpenAI needs \$1.4 trillion for data centres, not to mention plans from Anthropic, xAI, CoreWeave, Lambda and Crusoe.

Meta's chief AI scientist, Yann LeCun, has questioned large language models (LLMs): they are brilliant at recycling old knowledge but not capable of coming up with the new. AI adoption slowed at the end of 2025; we saw this in the late 1990s with dotcom.

Investment is needed for first-mover advantage where network effects, economies of scale or patent/legal protections are present. This is not the case with AI, where the user does not interact with other users but with AI itself. Unlike software programmes which you can replicate at little marginal cost, expanding the AI user base demands more data centres and energy. We hope the AI ecosystem delivers, as every extra dollar of equity wealth brings five cents of additional US consumer spending.

US households have more than \$65 trillion in the stock market, half held by the richest 1%. Doubts over the AI rollout will hit this richest cohort and marginal spending. Large language model (LLM) token prices are falling, as are graphics processing unit (GPU) rental rates, while AI adoption is plateauing. Technology capital expenditure (capex) is 7.2% of US GDP – more than the 7.1% seen in the pandemic remote working boom, and the 6.4% in the dotcom bubble (Figure 1). This is before the \$1 trillion to be spent this year and next by hyperscalers.

Figure 1: Investment is surpassing past peaks

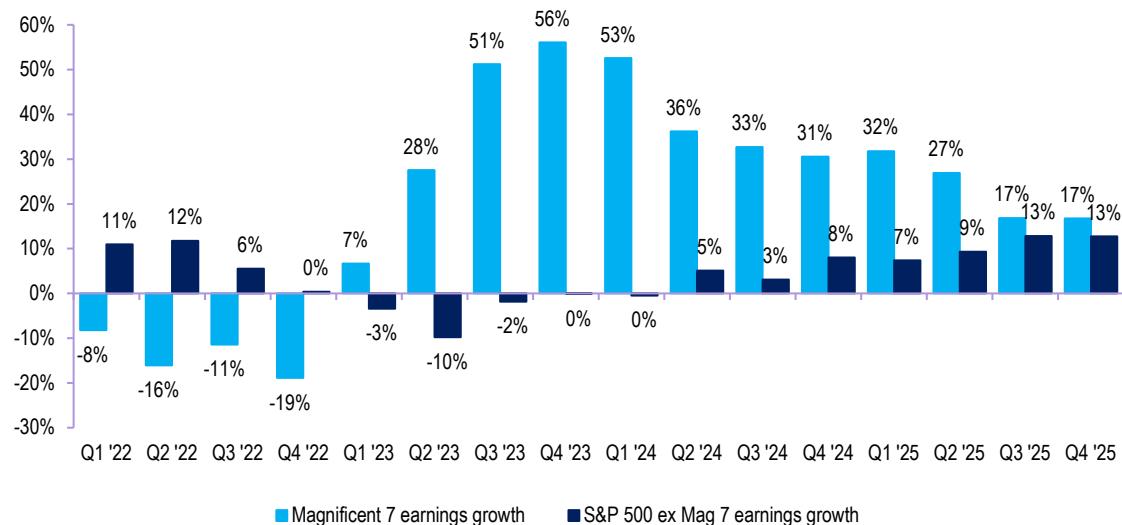


Source: Bureau of Economic Analysis (BEA) / BCA Research, January 2026

Total capex averaged 15% of the US economy over the past century, with an increasing portion devoted to technology. Tech capex booms have previously ended when the 10-year change in that capex as a share of total GDP exceeds the structural increase by 1-1.5 percentage points. The increase is currently running at 1 percentage point.

Two-thirds of US growth is now AI-capex-driven, with the labour market and consumer having a mixed year. Outside the Magnificent 7, earnings growth is modest (Figure 2), while the earnings and free cashflow of the Magnificent 7 themselves are diverging. US job openings have trended down since 2022, hidden in official unemployment figures by the 2.5 million retirements during Covid. In fact, the jobs/workers gap has closed. The price of 2.5 million fewer workers is above-target inflation. The Fed would rather have inflation at 3% than raise rates to bring it back to target, since a rise would undermine both the stock market and consumer spending.

Figure 2: Magnificent 7 and S&P 500 ex Mag 7 earnings growth



Source: JP Morgan, January 2026

Hiring continues to slow and unemployment edges higher. The labour market could tip the US into recession unless AI investment supports growth, productivity and earnings to boost labour. Soft data on consumer confidence is weaker than hard data in the labour market. Job searches easy or hard to get suggest that the Fed needs to support. US wage growth and inflation are moderating.

Weaker jobs growth means slower real income gains. Excluding money market funds held by the rich, bank deposits as a percentage of disposable income are lower than in 2019.

Delinquencies on consumer loans are running at recessionary levels, building permits are at a five-year low. Home sellers have exceeded buyers by the largest margin in a decade. New home inventories are the highest since 2009. Home prices have been falling in real terms for nine months. Consumers can consume from past, present or future income. Since excess savings from the pandemic are fully spent and earnings and hiring are slowing, credit needs to keep spending up until the labour market recovers. Yet real consumer credit is contracting, so it is the stock market wealth effect that keeps the consumer going.

The US runs fiscal and current account deficits that need continuous foreign capital inflows to finance (Figure 3). This was not an issue when the US was the only game in town. But with Europe and Japan more attractive, savings can go elsewhere. Financing the current account deficit depends on risk assets and hot money equity inflows rather than reserve accumulation. Foreign investors hold a fifth of the US stock market. Any reversal in the AI narrative means a lower US dollar and higher cost of capital, and the dollar increasingly relies on portfolio flows. The fiscal impulse that has driven the US higher than other economies will fade, as other economies inject stimulus. The first part of the US dollar's downturn was against the euro. The next will be against Asia where US trade deficits are largest. Correcting this needs a weaker dollar. Asian currencies already look cheap – none more so than the renminbi.

Figure 3: US twin deficit continues to deteriorate



Source: US Bureau of Economic Analysis / European Commission / UK Office for National Statistics / Bank of Japan, Japanese Cabinet Office / BCA Research. * Sum of fiscal deficit and current account deficit. ** Proxy for EMU pre-1991 = Germany, France, Italy and Spain. Note: all series shown as a four-quarter moving average.

Europe

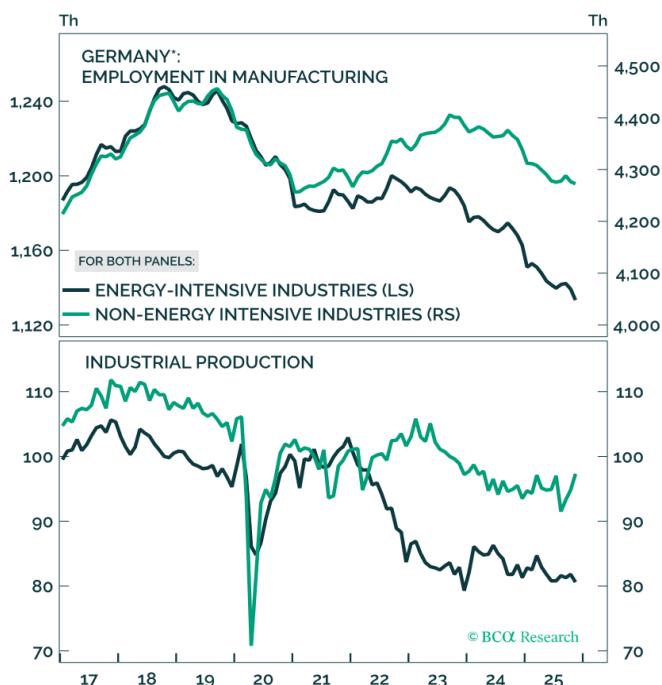
Europe will eventually thank Putin and Trump for recent actions, forcing Europe to reform, integrate, invest, grow, improve energy and military security, and reduce wasteful welfare.

But the US is not going to abandon Europe or NATO. Europe provides two-thirds of US foreign direct investment and a quarter of services exports. Europe growing and defending itself means the US can concentrate on the China threat. Europe will also need to do this because China is a threat to Europe's economy. Europe's exports to China have been falling for a decade and are now only 7.5% of its total exports: the EU is running a €350 billion trade deficit in goods with China. Now China is a competitor where Europe – and Germany in particular – once thrived.

Europe entered 2026 in good shape. Unemployment is at a multi-decade low, consumers – unlike in the US – have savings to spend, and bank balance sheets are strong. Although inflation is already at the ECB's 2% target, deflation from China could ease it further. Wage growth of less than 2% should ease service sector inflation, so inflation could undershoot the target by 50 bps. That makes at least one more rate cut likely, if not two, although this is not consensus.

Germany is returning to growth after two dull years (Figure 4) and – unlike Italy, Spain, Belgium and France where debt-to-GDP is more than 100% – could expand its budget deficit by more than 2% of GDP. Labour is stabilising, residential activity improving and consumer confidence on the up. Real GDP growth could reach 1.5% this year. Germany is really beginning to spend – it envisages €500 billion of net new borrowing between 2025 and 2029. Meanwhile, the Next Generation EU plan is helping activity in periphery countries within Europe, while Sweden, a barometer of global activity because of its exports, is expanding. This is seen in the new orders to inventory ratio.

Figure 4: Low energy prices will support German rebound



Source: BCA Research/German federal Statistical Office, January 2026

There is scope for lower gas prices in 2026. Europe increased liquefied natural gas (LNG) regasification capacity by 25% in the past three years and plans to add another 25%, just as LNG production is ramping. Based on current projects, LNG export capacity will jump 40% by the end of the decade, driven by the US and Qatar. Global import capacity will increase a further 20% while LNG supply growth will be the largest on record.

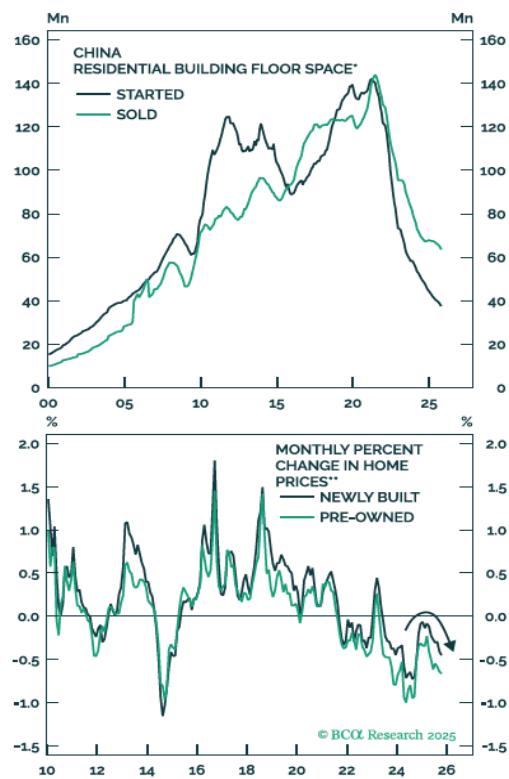
An oversupplied market suggests lower natural gas prices, positive for Europe since gas sets the marginal price of electricity. This has previously hit Germany hard, but it will now benefit, freeing up cash for investment and returns to shareholders while improving productivity and profitability. The heaviest energy users – chemicals, industrials and utilities – will benefit the most.

China

China's growth slowed in 2025 due to anti-involution measures designed to curb overproduction of electric vehicles, solar components and other products suffering from deflation. Fixed asset investment was down 11% year-on-year by Q4. Exports held up as China redirected away from the US and towards the rest of the world, although volumes slowed towards year-end.

China's housing market went from bad to worse (Figure 5): starts in 2025 were down 74% from their highs and home sales down 56%. Prices are falling in all markets in China, not helped by a shrinking population. The government tried to stimulate – fiscal spending was greater in 2025 than 2024, although it slowed towards the end of 2025.

Figure 5: China's housing bust



Source: BCA Research/National Bureau of Statistics, 2025. * Commodity building floor space, show in million square metres and as a 12-month rolling average. ** For 70 medium and large cities.

has moved into double digits. Europe is positioned for a rebound after two flat years, with a credible path to double-digit earnings growth. That favours small caps, cyclicals and energy intensive sectors, where valuations remain too low.

Defence remains in a multi-year uptrend, but the bigger opportunity will come from Europe finally delivering earnings rather than just rerating. If profits follow through, capital will follow with them. Maybe the rest of the world is finally catching up with the US.

With the housing market in the doldrums and five years of higher investment in manufacturing (more than half of all fixed asset investment), exports are unlikely to drive the economy in 2026 as they did in 2025. This means the Chinese authorities are likely to increase stimulus to drive consumption.

Looking ahead

The S&P 500 started 2026 trading above 22x earnings and with a price-to-sales ratio more than 50% higher than at the peak of the dotcom era. Monetary policy will support, but sticky long-term yields and persistent fiscal deficits limit how far rates can fall without a recession. A soft labour market and a 10% slide in the dollar show that the US is no longer the sole engine of global equity returns.

The next leg of the cycle needs global earnings to broaden. Early signs are encouraging – as with Sweden, Taiwanese exports are growing (40% year-on-year), and global earnings growth

Unless specified, all data is Bloomberg, as of February 2026



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