
European rally set to continue and performance broaden out

European equities | November 2025



Paul Doyle
Head of Large Cap European Equities

- **The US Federal Reserve is hinting at rate cuts despite struggling to meet its inflation target. Growth is strong but questions surround labour and debt.**
- **Despite the spending frenzy around AI there is currently little payoff. The AI hype echoes the dot-com era with trillions needed for returns.**
- **China stocks are holding up but the economy is down – a property slump and weak consumption mean it is ever-more reliant on exports.**
- **In Europe the soft landing is holding: high savings, an expected fiscal boost and falling inflation set the stage for potential equity gains.**

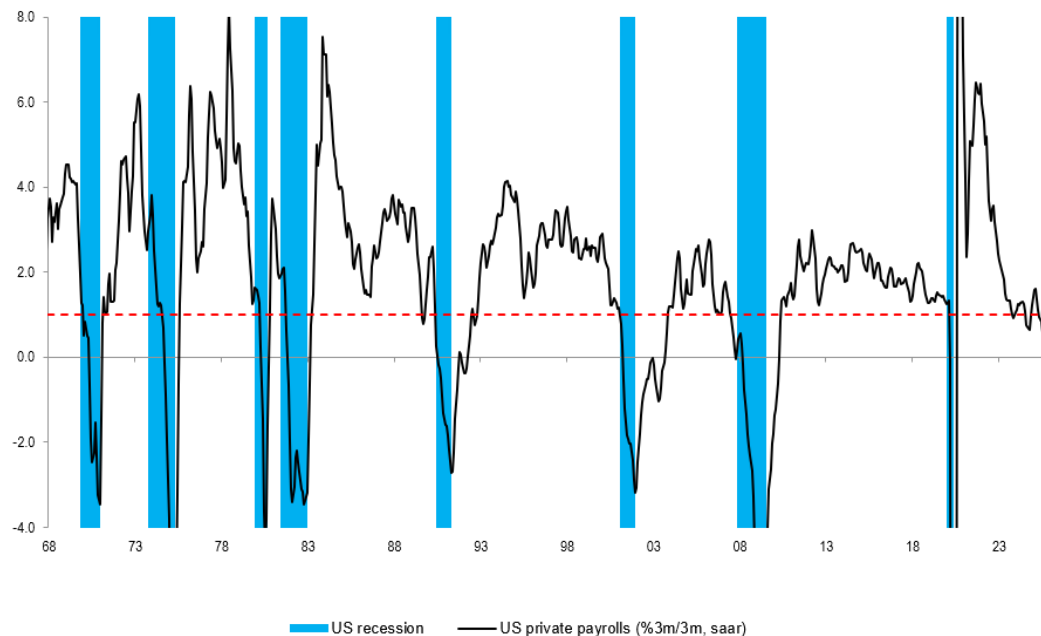
The US

For decades, the US Federal Reserve (Fed) has been wedded to its 2% inflation target. But with the economy growing 4% and inflation above 2%, this is breaking down. The Fed is guiding to falling interest rates even with inflation above 3%. Long-term inflation expectations remain at 2%, but if the Fed is effectively targeting 3%, then long-term expectations will get there, risking a vicious circle of rising expectations. Strong gold – unusually rising alongside equities – shows something is amiss. The current situation will underpin gold, crypto and equities until the circle takes hold and inflation rises. With 10-year Treasury yields at 4% (50 bps below 2024's year-end) all should be well. But if yields break higher, there will be trouble.

The US labour market continues to weaken: average non-farm payroll growth in the three months to end-August was under 30,000. -30,000 excluding healthcare. The three-month change in the aggregate of hours worked is negative, unusual outside a recession. Job openings are falling, suggesting labour demand is falling more than supply. The number not in the labour force but looking for a job increased by 875,000 since January.

We lack official data because of the US government shutdown, but when the moving average run rate of private payrolls falls below 1, a recession occurs. We are there now (Figure 1).

Figure 1: US private payrolls



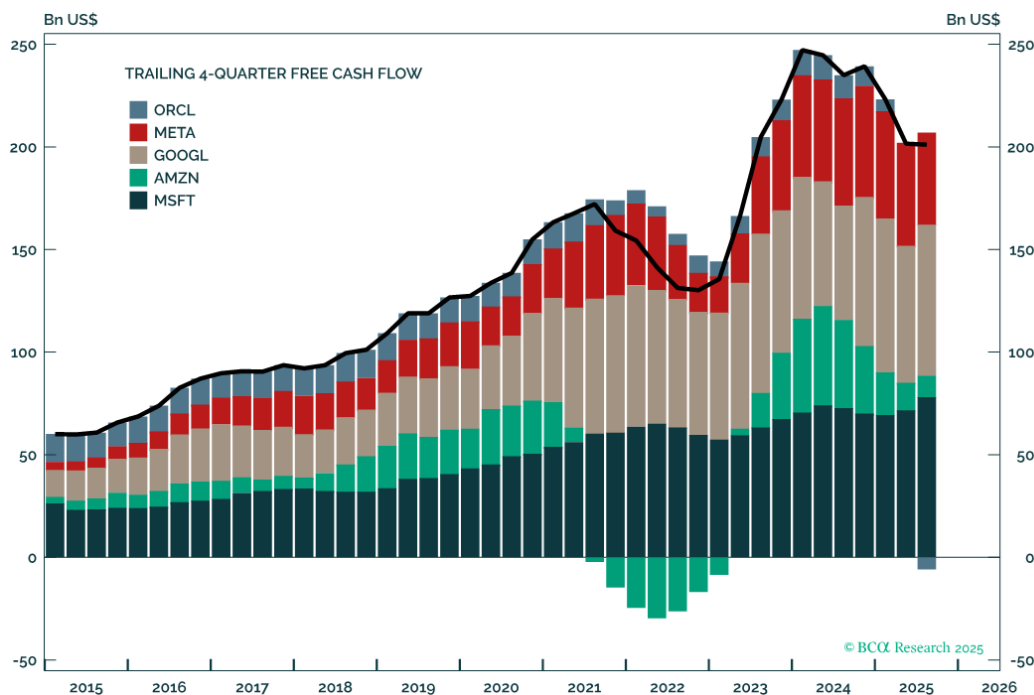
Source: Bloomberg Finance LP, as at September 2025. Saar: Seasonally adjusted annual rate.

Concerns have been raised about artificial intelligence (AI) leaders funding clients. Meta and Microsoft sold off following announcements of capital expenditure plans, but tech still leads. Despite the frenzy around AI, it is unclear how it will transform productivity and growth or how profitable it will be for companies committing investments. McKinsey says 80% of companies are using generative AI, but the same number are not making profits; MIT says 95% of companies see no benefit from AI investments.

Before the technology, media and telecoms (TMT) boom-and-bust of the early noughties, companies were claiming internet-derived productivity benefits. But it was only in 2005, as productivity growth normalised, that companies actually saw rising profits from the internet, driven by network effects. But AI does not benefit from network effects or scale: your relationship is with the model, not users, and brand differentiation is dubious with data centres, graphics processing units (GPUs) and electricity. The constraint now is the cost of “compute” power – a cyclical rather than structural phenomenon. Profits are high in cloud computing right now, but once invested the prices and profits will come down.

Free cashflow in the hyperscalers is falling because capital expenditure is rising faster than operating cashflow (Figure 2), similar to what happened to the telcos during the TMT boom and bust.

Figure 2: Free cashflow among hyperscalers is declining



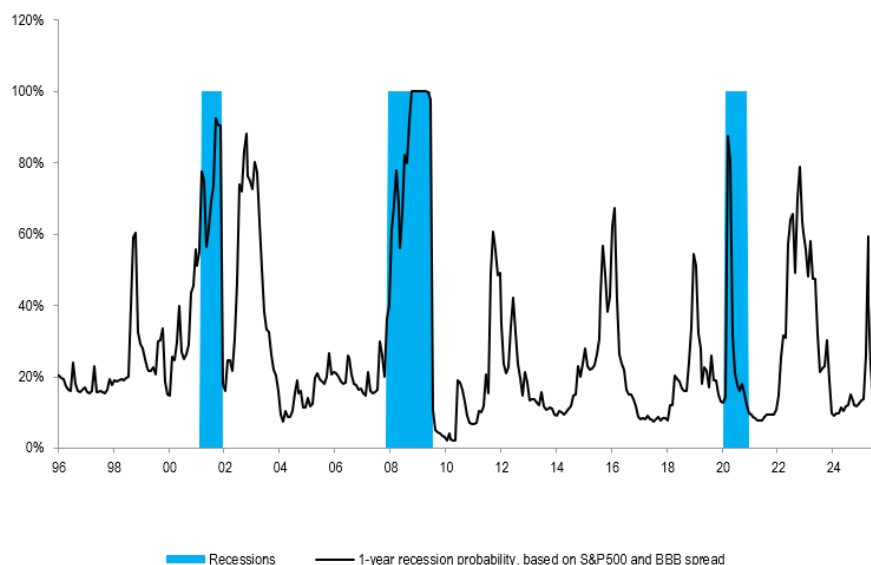
Source: BCA Research/Bloomberg Finance LP, as at September 2025.

It is not surprising that so many companies are jumping on the AI bandwagon: share prices are rewarded with double-digit jumps. AI stocks rise on every announcement, so no need to fear a crash. But beware announcements that are accompanied by falling share prices (as Meta saw in 2022).

Financial consultancy Bain say AI companies need to generate extra revenue of \$2 trillion by 2030 to see a return on the capex committed so far. For context, Microsoft's full-year revenues are less than \$300 billion, Meta's below \$200 billion.

Sentiment is benign: recession fear is only 20% (Figure 3), but we are not out of the woods until payrolls stabilise. If we see a downturn it is likely to be a shallow recession with a sharp market correction and capex will dry up. Bond yields would fall, as after the TMT bubble.

Figure 3: Recession probability indicator

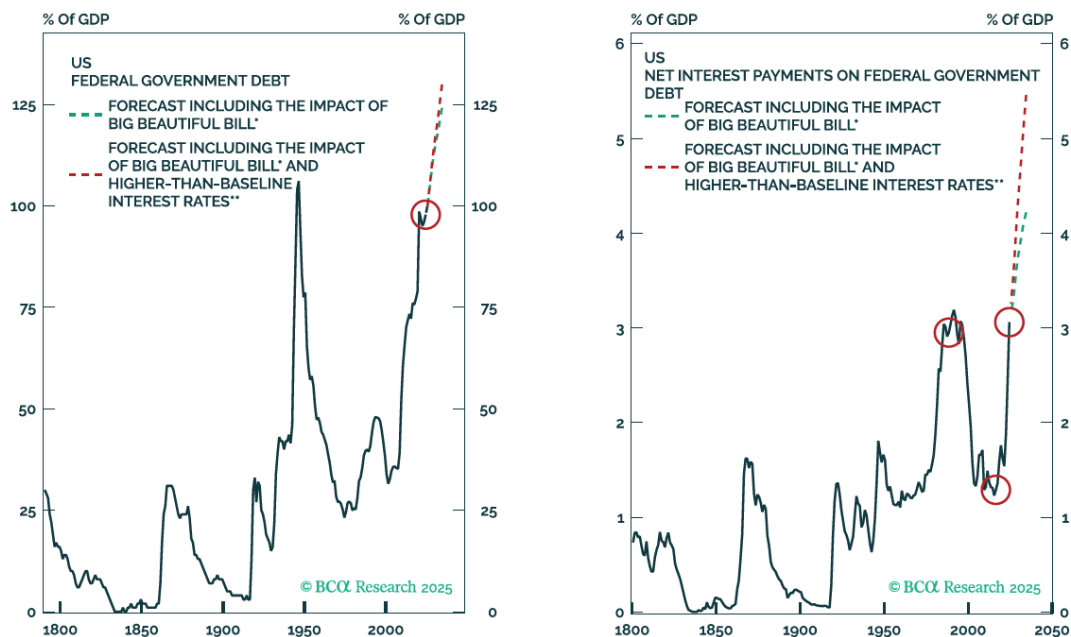


Source: JP Morgan, as at July 2025.

The dollar has unwound its spike from last year but is still not cheap. US foreign liabilities exceed foreign assets by 88% of GDP. This was not a problem when the yield on US liabilities was low, but at 4% this is now depressing the balance of payments and the dollar. Another difference between the TMT bubble and now, is that in 2001 the federal government surplus was 2.3% of GDP and government-debt-to-GDP was 55%; now the deficit is more than 6% and debt-to-GDP is 120% (Figure 4). If the deficit balloons the Fed would need to buy bonds.

Two disinflationary forces are reversing. First, the ratio of workers to consumers rose in the US and elsewhere from the late 1980s until 2020 as more women entered the labour force, had fewer babies, and Communist markets opened up. But as we age and consume more than we produce, savings fall and inflation rises. Second, globalisation collapsed the price of consumer goods, but pandemic supply-chain disruptions and Trump tariffs have upended globalisation. Services inflation makes it difficult for the Fed to get to inflation back to target. We expect a lower energy price and dollar, which would be good for emerging markets.

Figure 4: Unsustainable debt dynamics in the US



Source: US Congressional Budget Office / BCA Research, 2025. *Calculations based on estimates from 'Debt-service effects derived from HR1, The One Big Beautiful Act', CBO (June 2025). **Assumes the average interest rate on Federal debt is raised above the baseline by a differential that starts at 10 basis points in 2025 and increases by 10 basis points in each subsequent year until it reaches 1% in 2034.

China

There is a disconnect between Chinese equities and the economy: shares are rallying. This may mean the economy is showing green shoots which should help Europe. Like Europe, China enjoyed an export boom to the US ahead of tariffs, but that has reversed.

Property remains weak: housing transactions are stabilising but starts are down 72% from the peak. There is a glut of empty apartments and the working population may fall by 700 million by the end of the century. Despite a shrinking working-age population, youth unemployment remains high. But weak labour and property markets are affecting consumption, with durable goods spending and car sales falling. Fiscal support is only 2% of GDP, unlike previous reflations. With residential and non-residential investment in China weakening, only exports can drive growth. China's trade surplus is more than 1% of global GDP. However, with tariffs undermining exports to the US, China is dumping them elsewhere, prompting trade cases against Chinese goods. China needs to increase consumption as a share of its GDP.

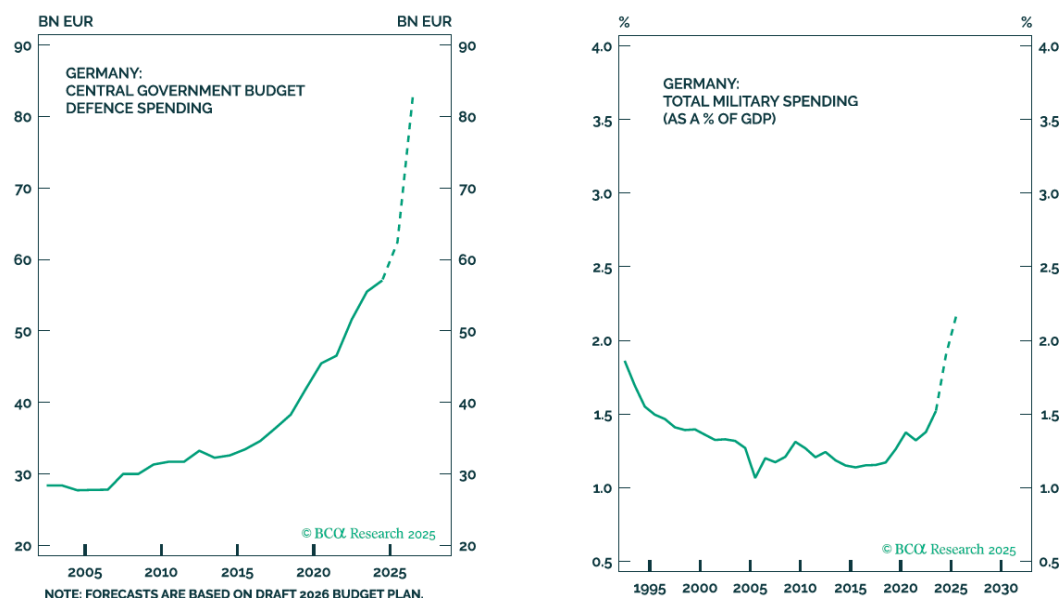
Europe

Unlike the US, Europeans still have excess pandemic savings: the personal savings rate is more than 15% and excess savings are €2.5 trillion higher than pre-pandemic. Having rocketed, Europe's trade surplus with the US tailed off in the face of 15% tariffs. Competition with China is not helping: China's exports to Europe rose 11% year-on-year in July while Europe's exports to China fell 8%. Germany is suffering most.

The relaxation of the debt brake means the German budget deficit will rise from 1.3% in 2023 to 2.8% next year. Germany is one of few capable of fiscal expansion (no chance of that in

France). The fiscal deficit can rise a long way before it scares bond markets. Federal spending will rise 6.1% this year and 3.5% in 2026, and federal investment will be 2.6% of GDP this year and 2.8% in 2026. Military spending will rise to \$200 billion by 2029 (3.5% of GDP), up from 1.3% before the Ukraine war (Figure 5). Including off-budget special funds, German government borrowing will surge from €50 billion in 2024 to €174 billion in 2026: doable because of low debt-to-GDP (65% gross or 50% net). German demographics look challenging with 70% more people aged 55-64 versus 15-24, so healthcare and pensions need funding. Immigration could help, but Europe has a terrible problem with integration: second-generation educational attainment remains below the average of native Europeans.

Figure 5: German outlays shoot up with plan to bolster defence and national security



Source: Ministry of Finance, Germany*/World Bank/BCA Research, 2025.

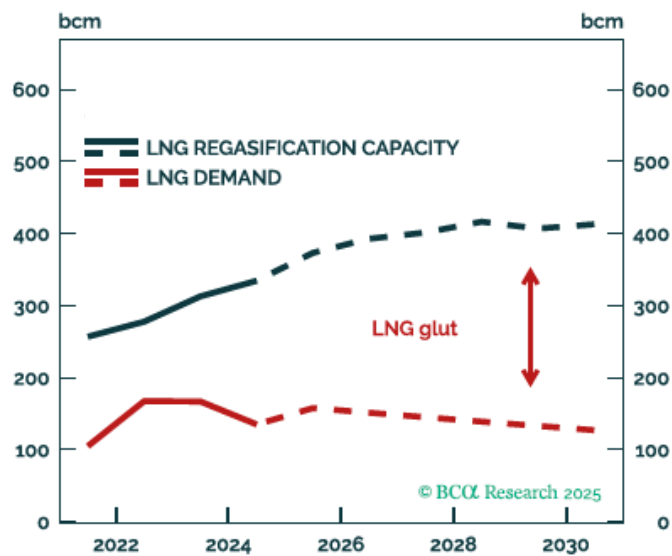
Despite chaotic headlines, France's downside from here should be limited, having underperformed especially against the periphery. If the Chinese economy turns, Europe will do better. Europe has gone sideways for months, though there have been strong moves from defence and banks (after a decade of repair, banks have healthy balance sheets and are lending more).

The bottom line

With markets still at or near all-time highs, here are some concluding thoughts.

Inflation will continue to fall in Europe despite stable growth. China is exporting deflation: a goldilocks situation for Europe that has enabled a soft landing. Capital expenditure is rising and demand will be helped by easing fiscal conditions and abundant household savings. Easing wage growth suggests downward pressure on services prices. Cheaper energy and a strong euro mean inflation is on a downward path. Earnings will improve in Europe in 2026 and despite all-time highs for the S&P500, positioning is not back to its high.

Figure 4: LNG regasification and capacity outlook



Source: BCA Research/The Institute for Energy Economics and Financial Analysis (IEEFA). Note: Europe includes EU27, UK, Norway and Turkey.

The rally in Europe has been driven by banks and defence and these may continue to perform, but we expect performance to broaden out as earnings growth rises next year. German fiscal largesse (€400 billion on defence and €600 billion on infrastructure over 10 years) will filter into the eurozone. Europe also expects a tailwind from a liquefied natural gas glut, pushing electricity prices and inflation lower, helped by moderate wage growth. It might give scope for a rate cut.

Unless specified, all data is Bloomberg, as at November 2025



Important Information

For use by professional clients and/or equivalent investor types in your jurisdiction (not to be used with or passed on to retail clients). For marketing purposes.

This document is intended for informational purposes only and should not be considered representative of any particular investment. This should not be considered an offer or solicitation to buy or sell any securities or other financial instruments, or to provide investment advice or services. Investing involves risk including the risk of loss of principal. Your capital is at risk. Market risk may affect a single issuer, sector of the economy, industry or the market as a whole. The value of investments is not guaranteed, and therefore an investor may not get back the amount invested. International investing involves certain risks and volatility due to potential political, economic or currency fluctuations and different financial and accounting standards. The securities included herein are for illustrative purposes only, subject to change and should not be construed as a recommendation to buy or sell. Securities discussed may or may not prove profitable. The views expressed are as of the date given, may change as market or other conditions change and may differ from views expressed by other Columbia Threadneedle Investments (Columbia Threadneedle) associates or affiliates. Actual investments or investment decisions made by Columbia Threadneedle and its affiliates, whether for its own account or on behalf of clients, may not necessarily reflect the views expressed. This information is not intended to provide investment advice and does not take into consideration individual investor circumstances. Investment decisions should always be made based on an investor's specific financial needs, objectives, goals, time horizon and risk tolerance. Asset classes described may not be suitable for all investors. Past performance does not guarantee future results, and no forecast should be considered a guarantee either. Information and opinions provided by third parties have been obtained from sources believed to be reliable, but accuracy and completeness cannot be guaranteed. This document and its contents have not been reviewed by any regulatory authority.

In Australia: Issued by Threadneedle Investments Singapore (Pte.) Limited ["TIS"], ARBN 600 027 414. TIS is exempt from the requirement to hold an Australian financial services licence under the Corporations Act 2001 (Cth) and relies on Class Order 03/1102 in respect of the financial services it provides to wholesale clients in Australia. This document should only be distributed in Australia to "wholesale clients" as defined in Section 761G of the Corporations Act. TIS is regulated in Singapore (Registration number: 201101559W) by the Monetary Authority of Singapore under the Securities and Futures Act (Chapter 289), which differ from Australian laws.

In Singapore: Issued by Threadneedle Investments Singapore (Pte.) Limited, 3 Killiney Road, #07-07, Winsland House 1, Singapore 239519, which is regulated in Singapore by the Monetary Authority of Singapore under the Securities and Futures Act (Chapter 289). Registration number: 201101559W. This advertisement has not been reviewed by the Monetary Authority of Singapore.

In Hong Kong: Issued by Threadneedle Portfolio Services Hong Kong Limited 天利投資管理香港有限公司. Unit 3004, Two Exchange Square, 8 Connaught Place, Hong Kong, which is licensed by the Securities and Futures Commission ("SFC") to conduct Type 1 regulated activities (CE:AQA779). Registered in Hong Kong under the Companies Ordinance (Chapter 622), No. 1173058.

In Japan: Issued by Columbia Threadneedle Investments Japan Co., Ltd. Financial Instruments Business Operator, The Director-General of Kanto Local Finance Bureau (FIBO) No.3281, and a member of Japan Investment Advisers Association and Type II Financial Instruments Firms Association.

In the UK: Issued by Threadneedle Asset Management Limited, No. 573204 and/or Columbia Threadneedle Management Limited, No. 517895, both registered in England and Wales and authorised and regulated in the UK by the Financial Conduct Authority.

In the EEA: Issued by Threadneedle Management Luxembourg S.A., registered with the Registre de Commerce et des Sociétés (Luxembourg), No. B 110242 and/or Columbia Threadneedle Netherlands B.V., regulated by the Dutch Authority for the Financial Markets (AFM), registered No. 08068841.

In Switzerland: Issued by Threadneedle Portfolio Services AG, Registered address: Claridenstrasse 41, 8002 Zurich, Switzerland.

In the Middle East: This document is distributed by Columbia Threadneedle Investments (ME) Limited, which is regulated by the Dubai Financial Services Authority (DFSA). The information in

this document is not intended as financial advice and is only intended for persons with appropriate investment knowledge who meet the regulatory criteria to be classified as a Professional Client or Market Counterparty and no other person should act upon it. This document and its contents and any other information or opinions subsequently supplied or given to you are strictly confidential and for the sole use of those attending the presentation. It may not be reproduced in any form or passed on to any third party without the express written permission of CTIME. By accepting delivery of this presentation, you agree that it is not to be copied or reproduced in whole or in part and that you will not disclose its contents to any other person.

This document may be made available to you by an affiliated company which is part of the Columbia Threadneedle Investments group of companies: Columbia Threadneedle Management Limited in the UK; Columbia Threadneedle Netherlands B.V., regulated by the Dutch Authority for the Financial Markets (AFM), registered No. 08068841.

Columbia Threadneedle Investments is the global brand name of the Columbia and Threadneedle group of companies. © 2025 Columbia Threadneedle. All rights reserved.

columbiathreadneedle.com

11.25 | CTEA8638552.1