



Europe Equity Market Outlook: 2025 Q4

Risks remain, but Europe is well positioned.

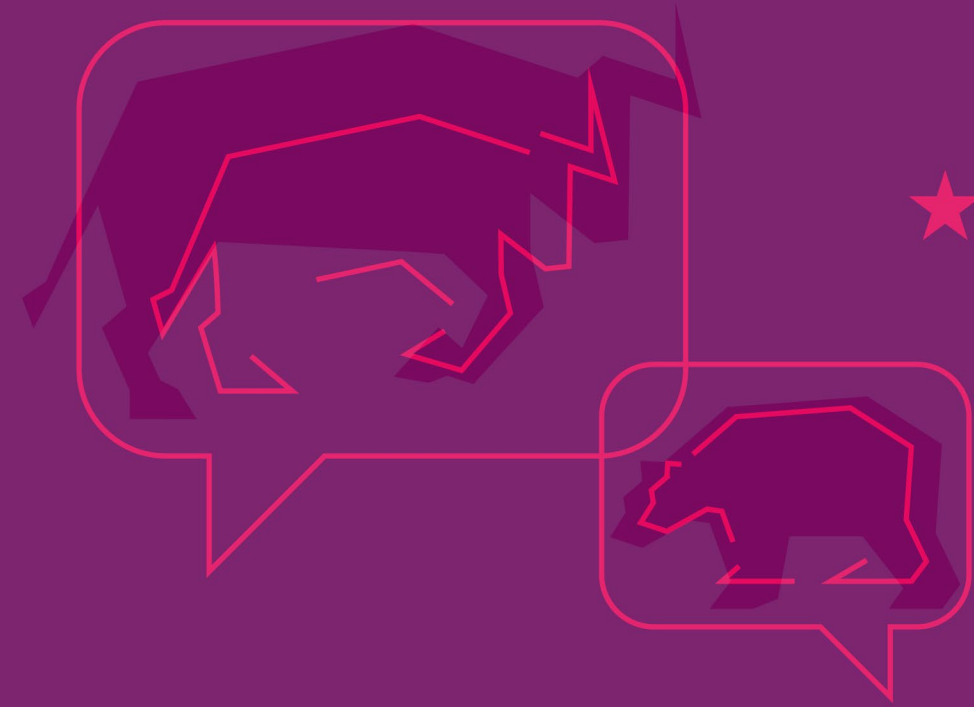


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Important Disclosure

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Market Overview

Rising valuations coincide with an improving macroeconomic backdrop.

An Improving Economic Picture Should Support Equity Markets

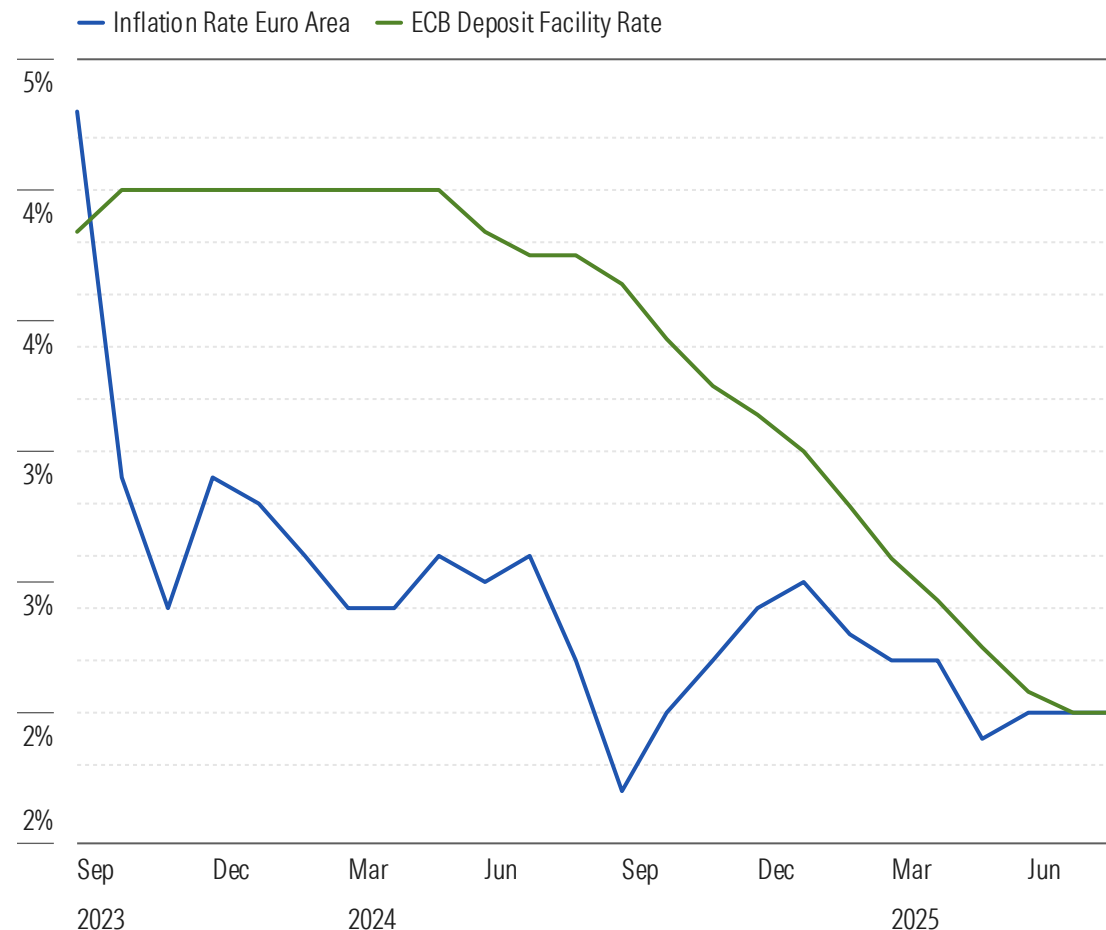
European equity markets have been through the ringer in 2025, experiencing massive levels of volatility along the way. As we stand today, however, performance has been solid, and barring any further geopolitical shocks, the region is set to close out 2025 in relatively strong fashion.

Fundamentally, the macroeconomic picture is improving. Expectations for GDP growth show an incremental increase in 2025 and a further step-up in 2026. Economists are now talking about the downside risk to inflation, a situation that could lead to further interest rate cuts, which in turn could boost equity markets.

With trade deals in place between the US, the UK, and Europe, we have at least some clarity on trade conditions going into the fourth quarter and further into 2026. Tariffs of 10%-15% are not ideal, but workarounds will be found, and European firms are already diversifying their customer bases across other regions.

The fanfare that came at the beginning of the year with a new German government and the establishment of a national infrastructure fund has not yet materialized into a discernible uplift in spending in the region; however, between this and the commitment to increased defense spending by European NATO members, we believe the outlook is positive for 2026.

Inflation and Interest Rates in the Euro Area Over the Past Two Years

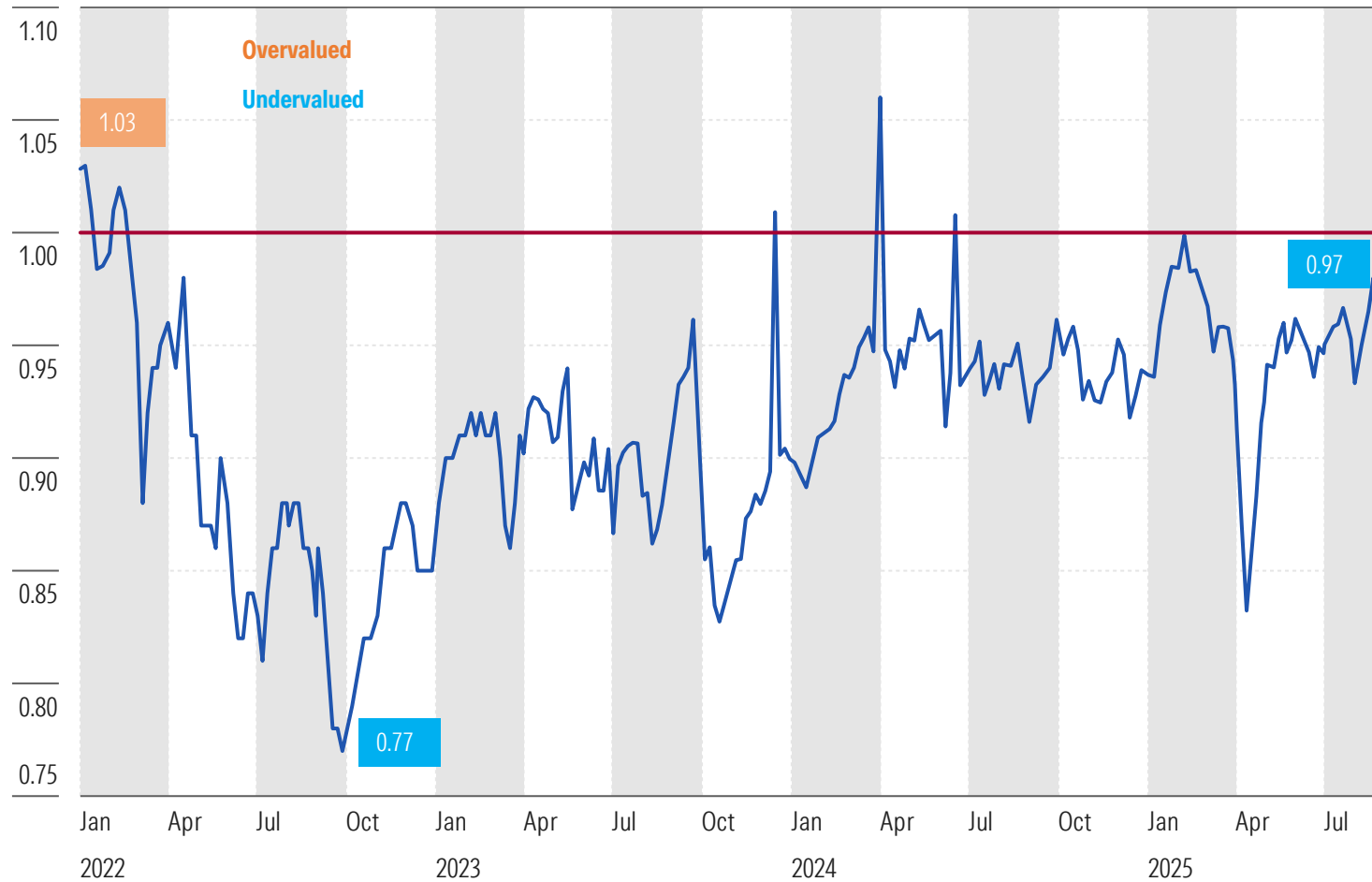


Source: European Central Bank, 2025. Morningstar. Data as of Sept. 18, 2025.

See Important Disclosures at the end of this report.

European Equities Offer Modest Upside

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



The selloff that occurred after the US announced sweeping tariffs in April seems like a long time ago when we look at valuations today, with the market having fully recovered those losses.

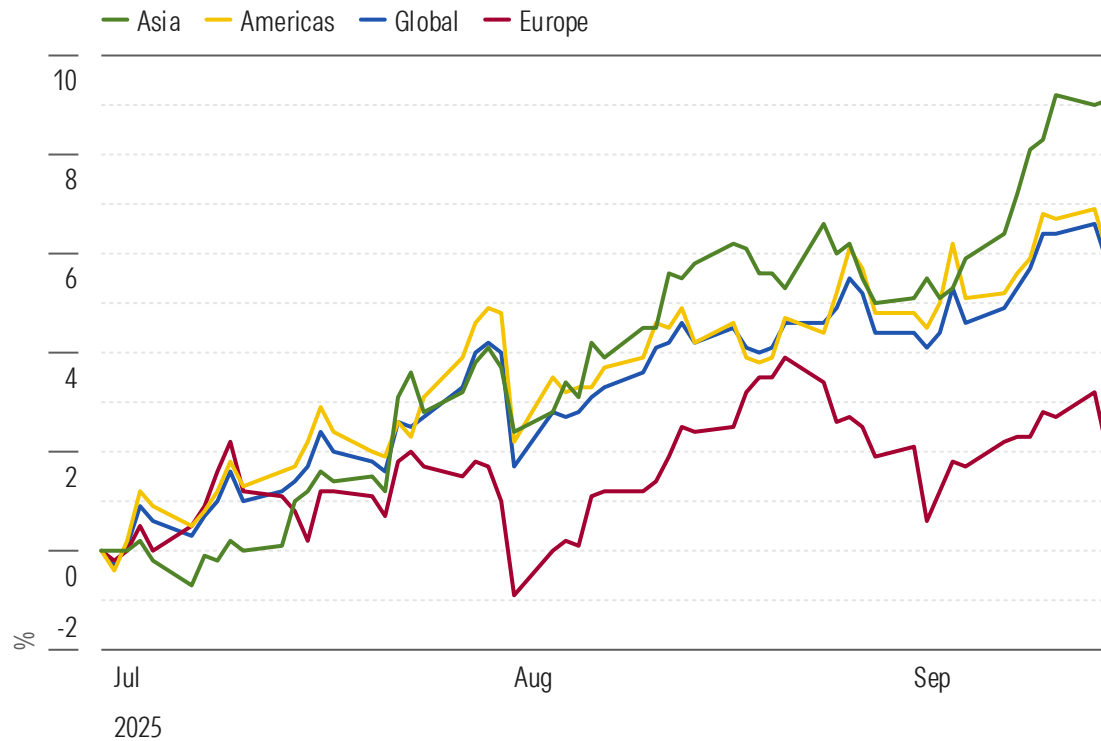
European markets now trade at just a 3% discount to our fair value estimate, a smaller discount than the market has traded at for much of the last two years.

That said, given the improved clarity on trade and the improving economic backdrop in Europe, the risk/reward equation does not appear to be bad.

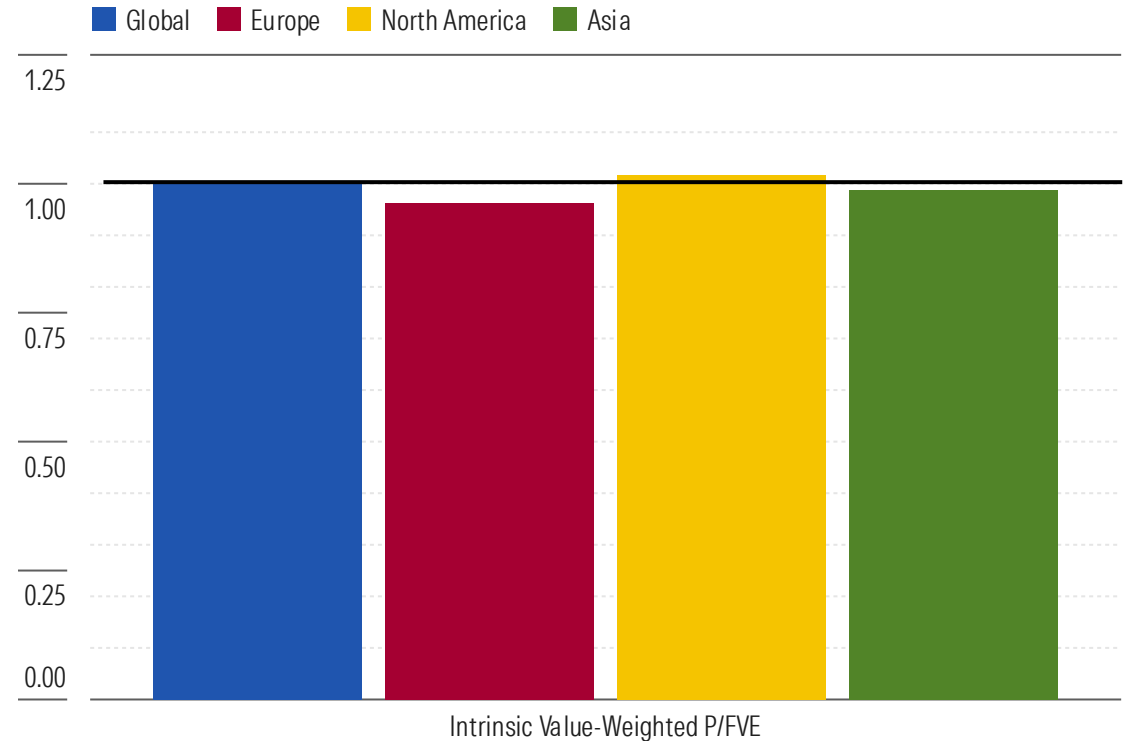
European Equities the Laggard in Q3

Having started off the year so strongly, most other major markets have since largely caught up with Europe. On a valuation basis, however, Europe is marginally the most attractive market, particularly compared with the US, which now trades above its fair value estimate.

Regional Price Movements Over the Third Quarter

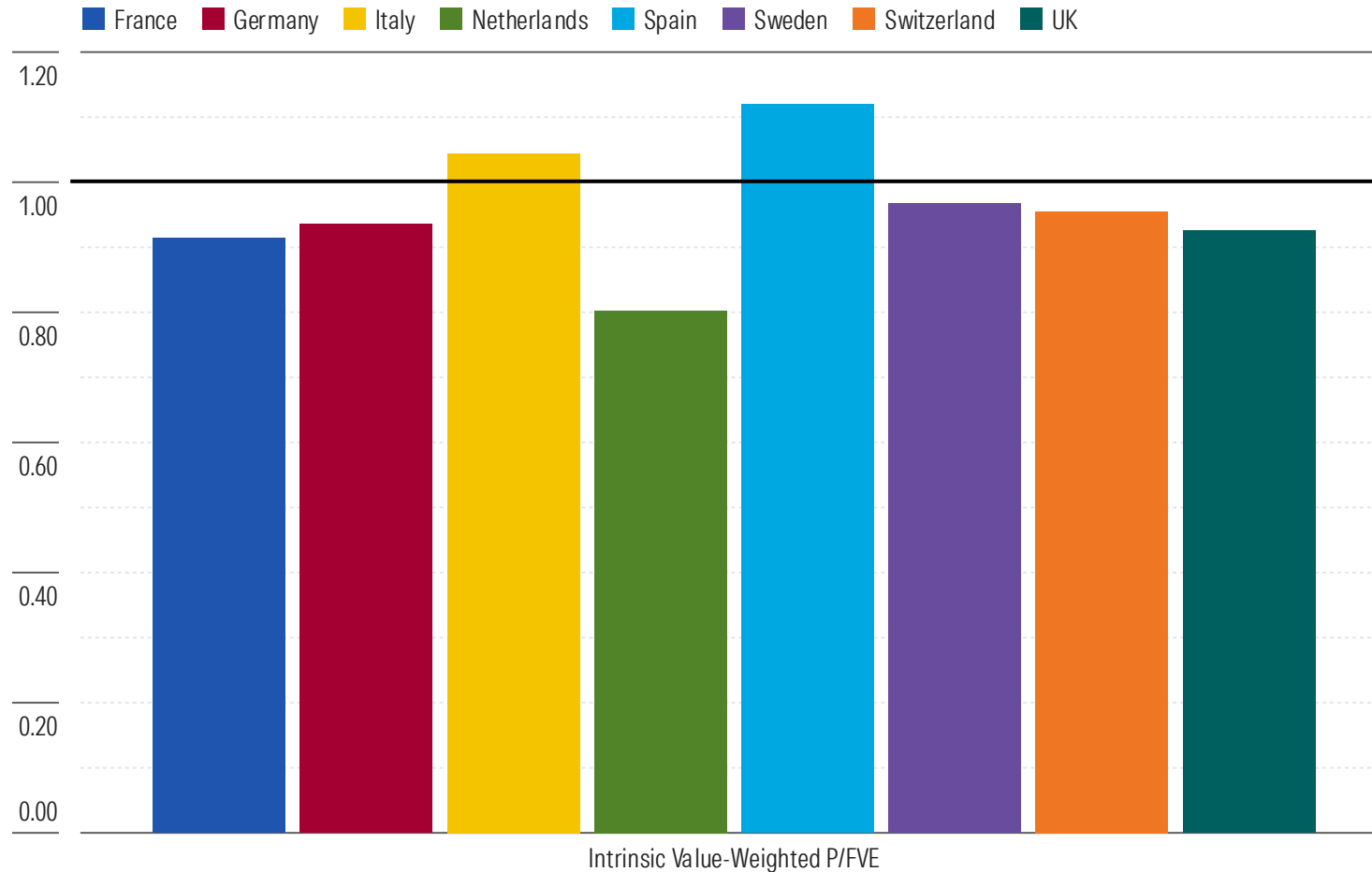


Intrinsic Value-Weighted Price/Fair Value Estimate for the Regions



Valuations Differ Materially Across European Markets

Intrinsic Value-Weighted Price/Fair Value Estimate by Country



Current market valuations across Europe vary materially. This is despite the broad market conditions affecting most nations, including low and falling interest rates.

Most markets trade at a discount to our fair value estimate. The two that trade above their fair value estimates, Spain and Italy, happen to be performing ahead of the pack economically.

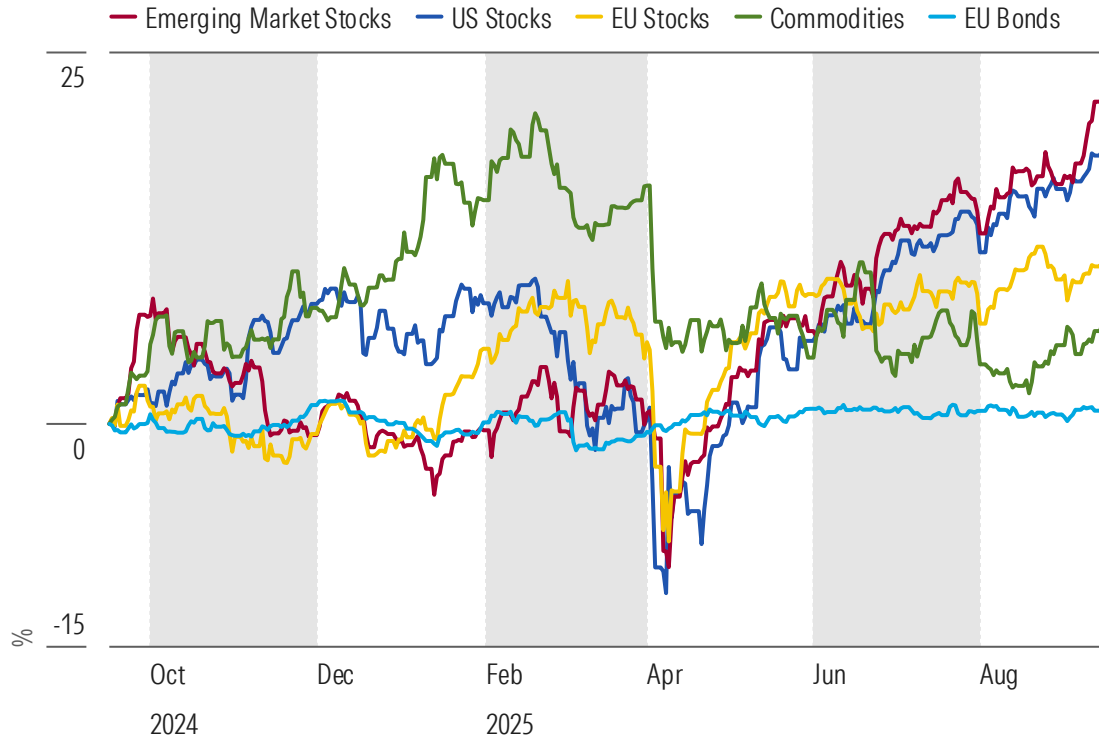
The two cheapest decent-size markets in Europe are the Netherlands and Denmark. This is largely a result of the composition of these equity markets, with both having an oversize exposure to an underperforming European giant, ASML in the case of the Netherlands and Novo Nordisk in Denmark.

European Equities' Relative Outperformance Has Waned, While Bond Yields Remain Elevated

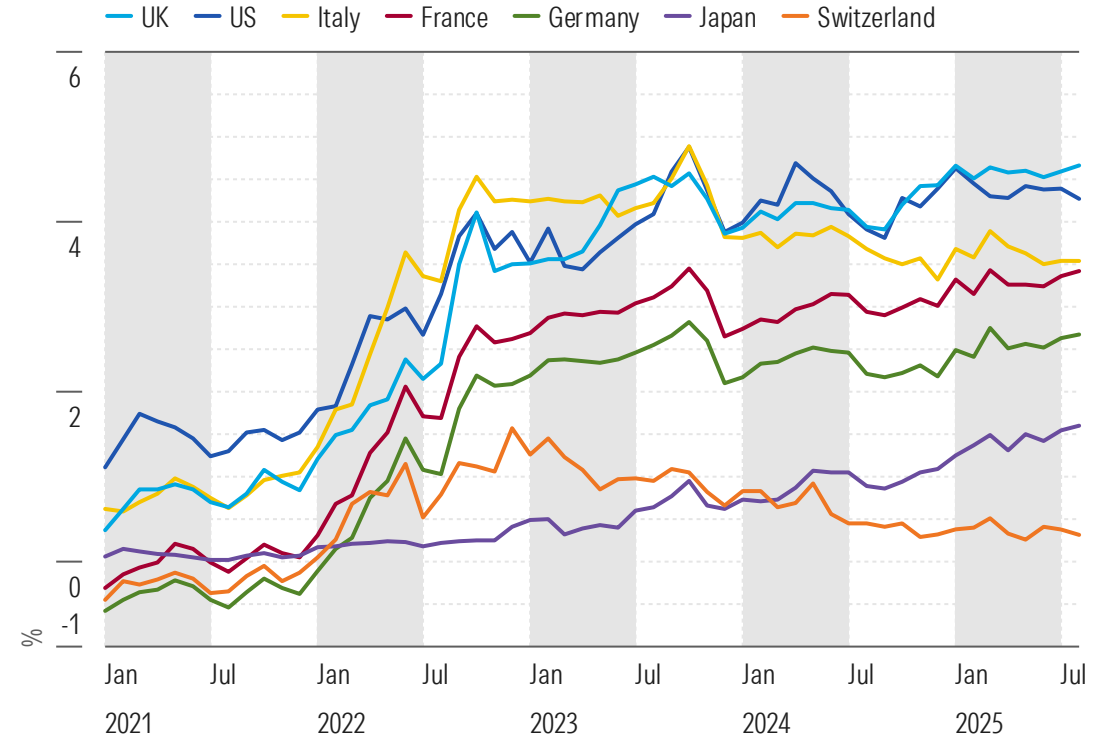
European equities have outperformed other asset classes like bonds and commodities, but their 12-month performance has lagged regions like the US and emerging markets.

Despite falling interest rates in Europe, bond yields remain elevated. Italian 10-year bonds, for example, offer a premium of more than 1.5% over the ECB deposit rate.

Trailing 12-Month Performance of Major Asset Classes



Global Sovereign Benchmark 10-Year Yields



Small Cap and Mid-Cap Offer the Most Upside

The general market offers modest upside in Europe, 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

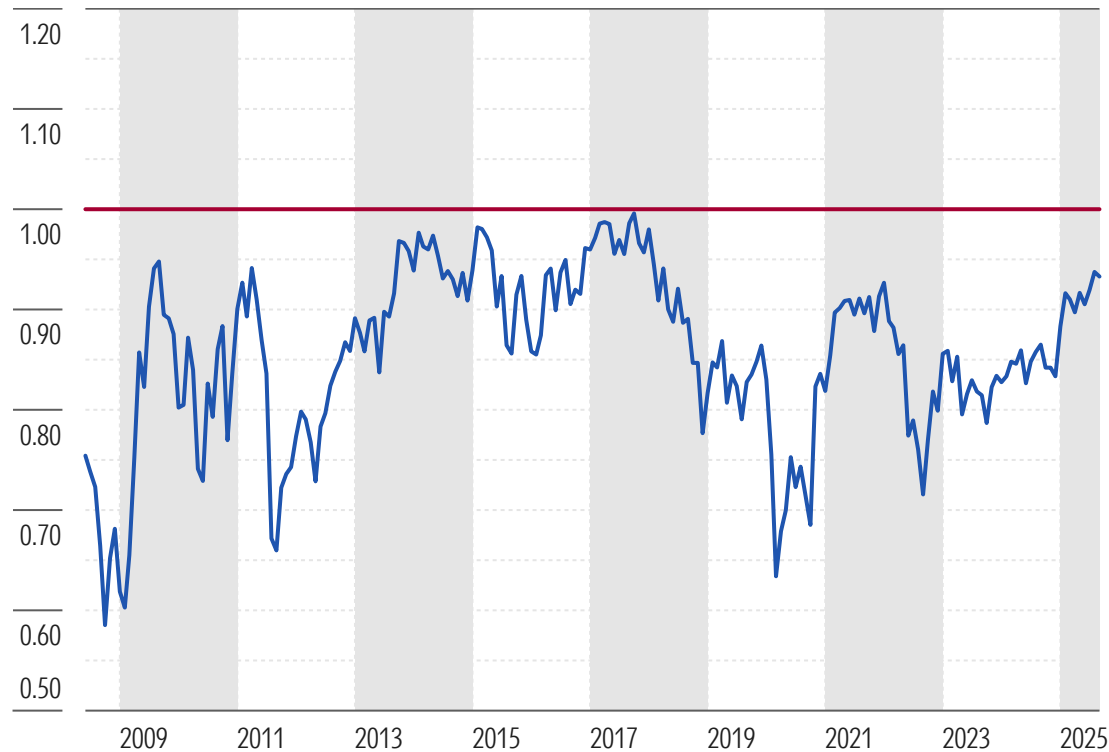
US Intrinsic Value-Weighted Price/Fair Value Estimate



Small-Cap Stocks Trading Cheaply, Even Relative to Historical Levels

Value stocks in Europe trade at a reasonable 6% discount to our fair value estimate. Small caps, however, are trading at an even steeper discount to our fair value estimate. Relative to historical levels, this is an extremely attractive proposition.

Value Stocks Price/Intrinsic Fair Value Estimate



Small-Cap Stocks Price/Intrinsic Fair Value Estimate



Source: Morningstar Research Services LLC. Data as of September 2025. Price/fair value is calculated using the intrinsic valuations as determined by the Morningstar Equity Research team and weighted in proportion to their portfolio weight within the relevant Morningstar equity index.

See Important Disclosures at the end of this report.

Sector Valuation Overview

Prices and valuations have shifted materially over the third quarter.

Sector Performance Varied Heavily in Q3

With markets still adapting to tariffs, lower interest rates, and a continued weak consumer demand environment, sector performance was extremely mixed in the third quarter.

Sectors like financials and industrials continued to perform well during the period. The former is still benefiting from better operating conditions than investors had expected for this year, while many industrials firms continue to benefit from structural growth themes like the growth in data centers, boosting the overall sector. There were a few losers, with a backlash against renewables, and rising bond yields, causing a drop in utilities.

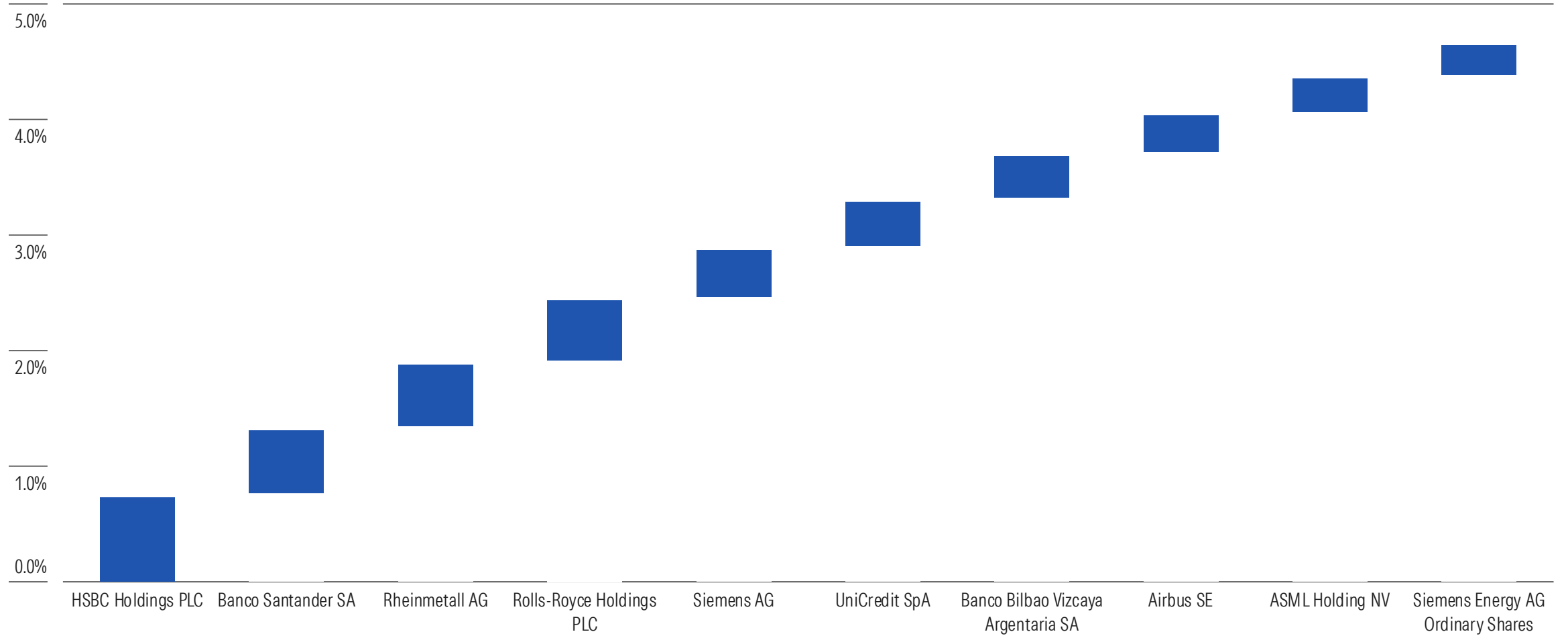
Over the last 12 months, sector performance has been even more marked. Financial-services firms have delivered an almost 40% return, more than 3 times the market level. Industrials and communications have also been strong performers, returning 24% and 19%, respectively. Conversely, healthcare has been the big loser, with prices falling by almost 17% over the period.

Sector Price Movements

Sector	TTM% Change	Trailing Quarter % Change
Aggregated European Market	12.5%	2.8%
Cyclical		
Basic Materials	(1.1%)	0.6%
Consumer Cyclical	(5.0%)	1.9%
Financial Services	38.9%	7.3%
Sensitive		
Communication Services	18.7%	0.9%
Energy	(0.5%)	4.9%
Industrials	24.2%	3.8%
Technology	2.7%	(0.2%)
Defensive		
Consumer Defensive	(2.9%)	(0.5%)
Healthcare	(16.7%)	2.4%
Utilities	13.1%	(3.5%)

The Top 10 Performers Generated Around a Third of the Market Return

Contribution to European Market Return by Stock Over the Last Year












Valuations Have Risen, but Most Sectors Still Undervalued

The valuation picture has shifted somewhat in the third quarter. Some sectors, like energy, utilities, and tech, have seen their valuations decline somewhat, creating opportunities.

Only two sectors, financials and telecoms, are overvalued currently, while six remain undervalued. Both consumer defensive and cyclicals offer attractive upside, albeit in a continued difficult operating environment. Technology is now the cheapest sector in Europe, trading at a 14% discount to our fair value estimate.

Tariff-related overhangs remain on the above sectors and could have an important role to play in the coming periods. That said, this cuts both ways, and any further clarity or improvement in trade relations could move share prices positively.

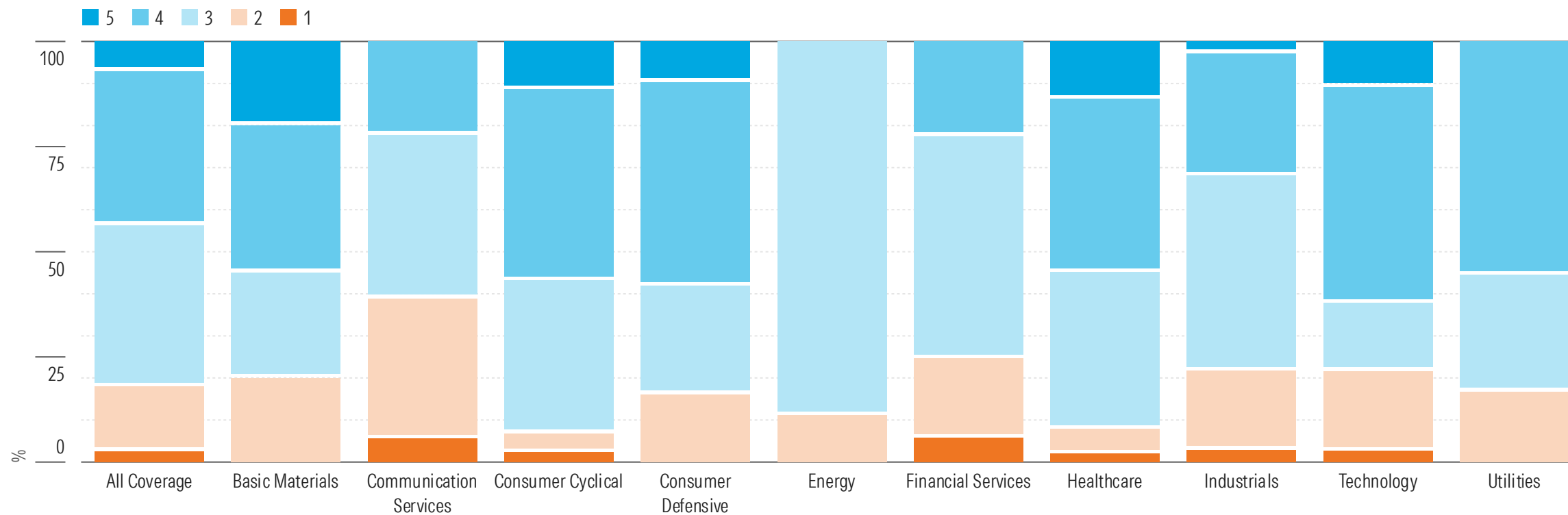
Morningstar European Coverage: Average Price/Fair Value Estimate by Sector

Cyclical Sectors	Average Price/Fair Value	Sensitive Sectors	Average Price/Fair Value	Defensive Sectors	Average Price/Fair Value
 Consumer Cyclical	0.91	 Comm. Services	1.08	 Consumer Defensive	0.90
 Financial Services	1.11	 Energy	0.96	 Healthcare	0.88
 Tech	0.86	 Industrials	1.00	 Utilities	0.99

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

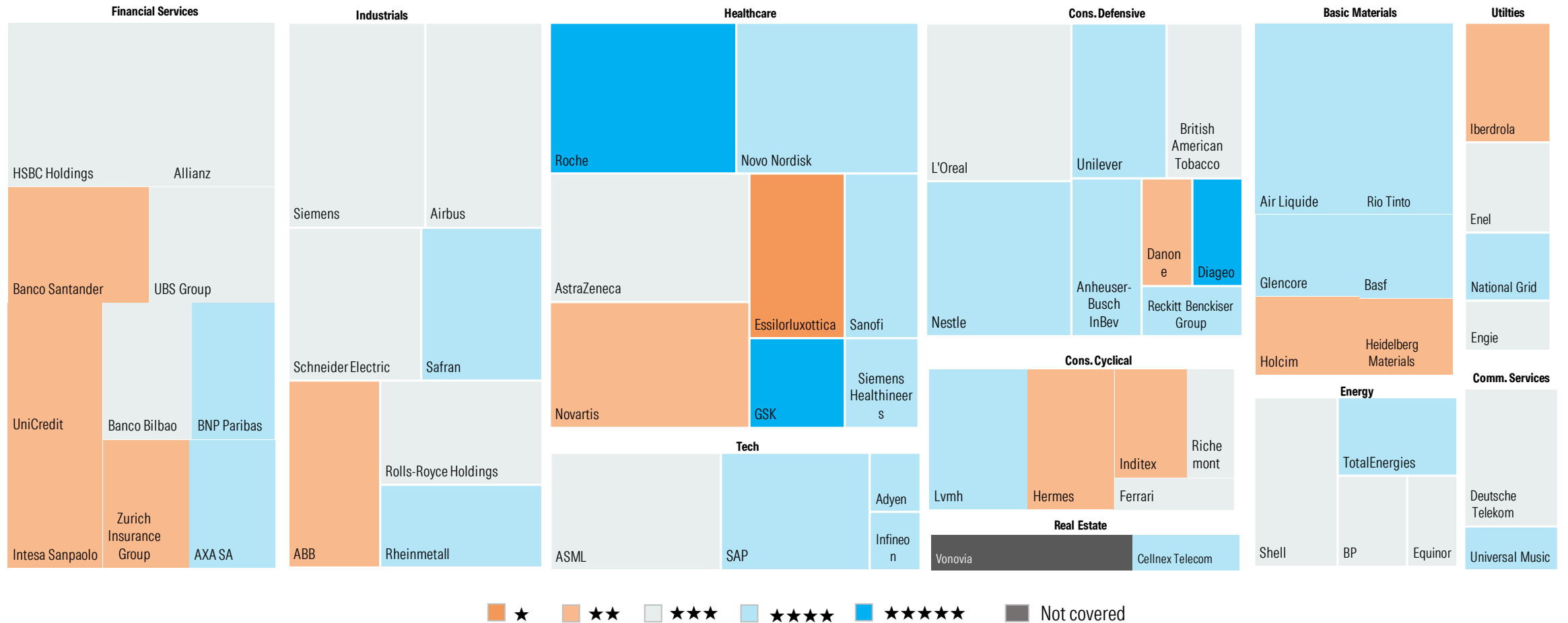
Almost half the stocks under our coverage are trading at either 4 or 5 stars, with only around 20% in overvalued territory. Four-star stocks are present in all but one sector, highlighting the dispersion of opportunities.

Star Rating Distribution by Sector



Large 4- and 5-Star Stocks Are Visible in Sectors Like Healthcare and Consumer

Europe Index Sorted by Star Rating, Market Cap, and Industry



Source: Morningstar Research Services LLC. Data as of September 2025.

See Important Disclosures at the end of this report.



Communication Services

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Consolidation Continues for European Telecoms; Sector Fairly Valued

Consolidation Remains Elevated

The push for consolidation in Europe continues, with reports of potential new deals emerging every month. In Spain, Telefónica is reportedly seeking to acquire Vodafone Spain, with Digi positioned as the likely beneficiary of any mobile tower disposals Telefónica might be required to undertake. Telefónica is also mulling acquiring 1&1 in Germany if its plan in Spain doesn't work out as expected. We think the latter is a more realistic option, given 1&1's lower market share, which would likely invite less regulatory scrutiny. In France, speculation is mounting about a potential breakup of SFR, with assets possibly divided among Orange, Iliad, and Bouygues.

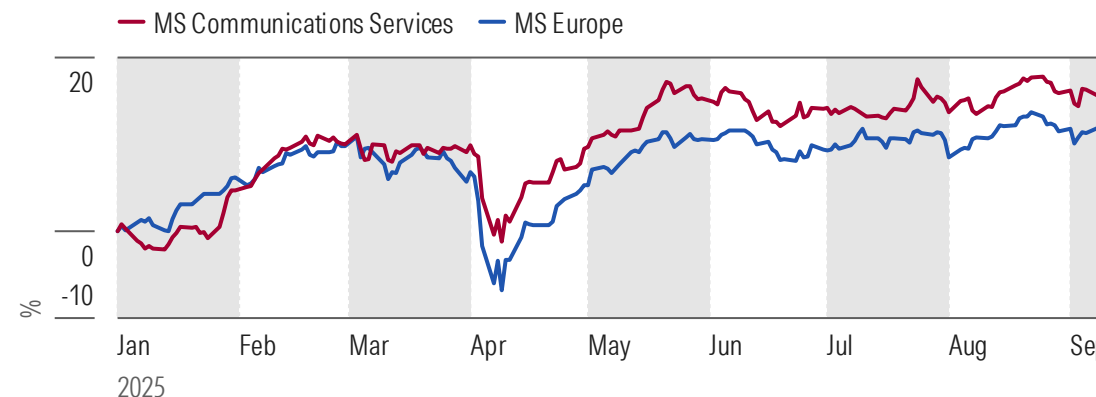
Yield Down to 4.8%, in Line With Historical Average

The average dividend yield of European telecoms has declined to 4.8% as of Sept. 16, down from 5% three months ago and 5.7% a year ago, bringing it in line with historical norms and appearing more maintainable in the long term.

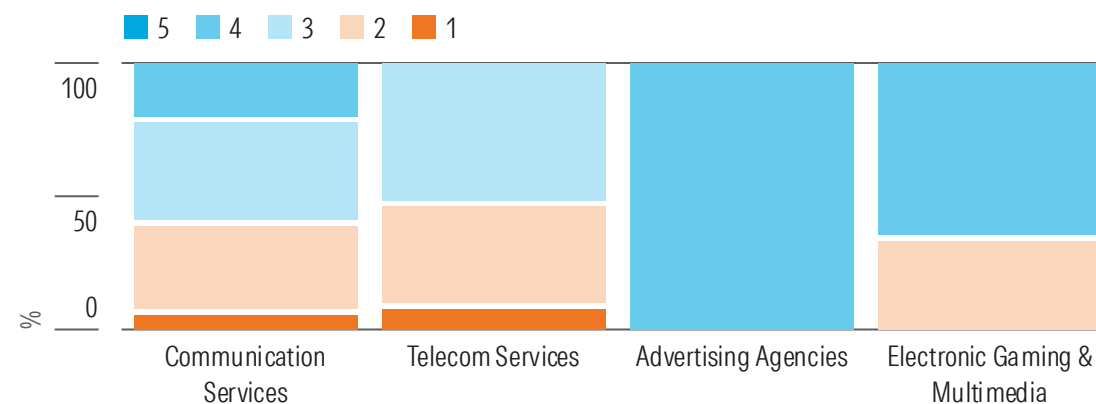
The Sector Screens as Fairly to Overvalued; We Recommend Waiting for Better Opportunities

After strong year-to-date returns, most of our European telecoms sit in 3-star territory or below. Deutsche Telekom has fallen over 5% since the start of the quarter, now trading in line with our fair value estimate. Our other preferred names, Tele2 and KPN, remain overvalued. We recommend investors wait for more compelling entry points, as the sector currently screens as fairly to overvalued.

Communication Services vs. Morningstar Europe Index



Communication Services Star Rating Distribution by Industry

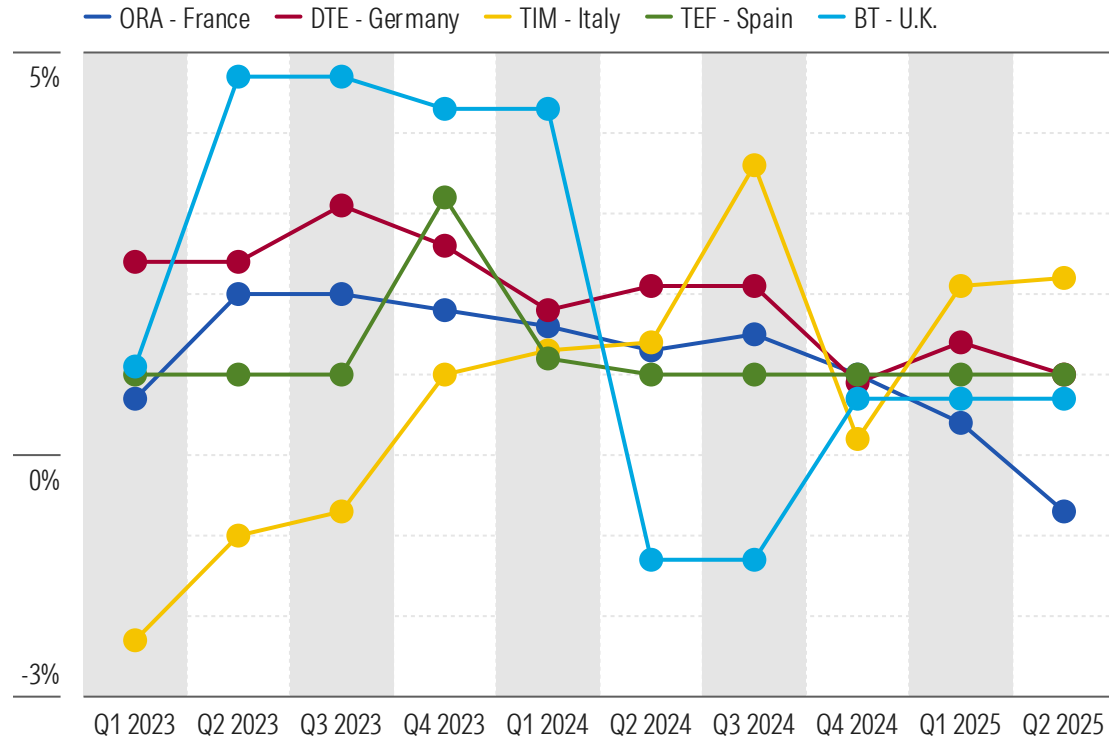


Service Revenue Growth Holds Steady Compared With Last Year

All large incumbents managed to increase service revenue in the second quarter of 2025. Orange was the only exception, though solid execution on the cost front helped shield its margins. Despite ongoing but moderating market share losses, we expect TIM to further increase its EBITDA margins in the coming quarters, as planned price increases will take effect while the firm takes advantage of its lower cost structure. DT's service revenue growth in Germany slowed, with mobile market share gains offset by a flat broadband customer base.

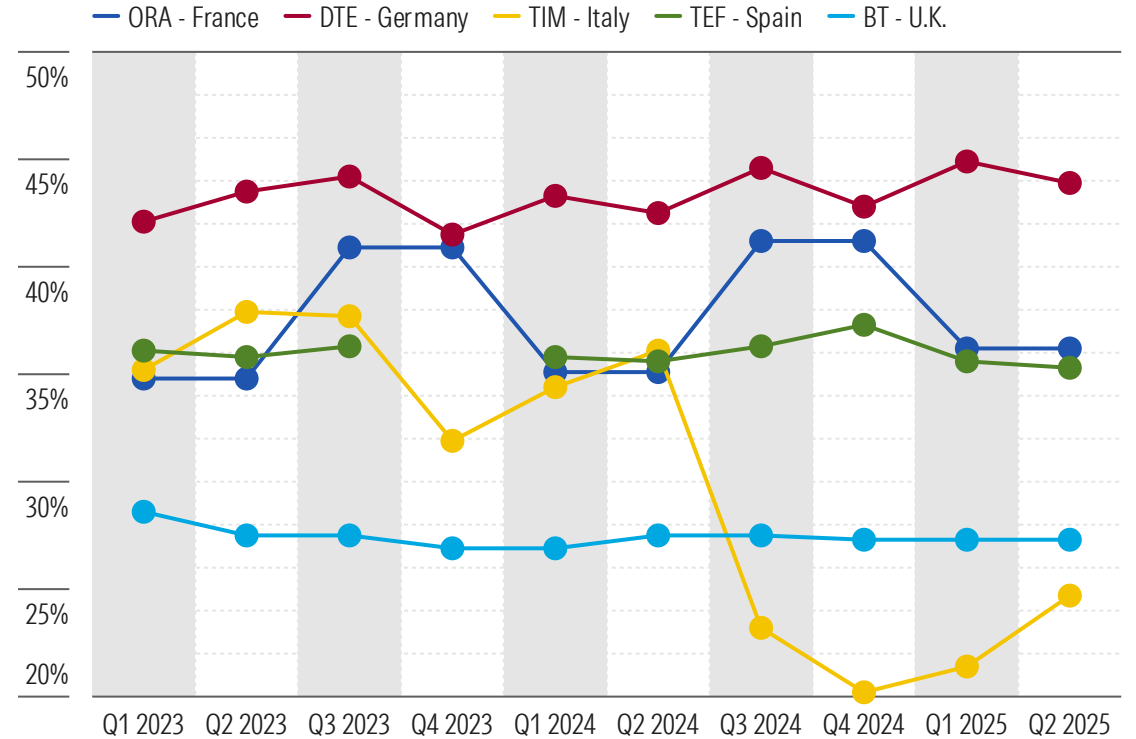
Average Service Revenue Growth Was 0.8% Versus 0.9% a Year Ago

Higher comparable figures and lower price increases the main drivers.



Telecom Italia's EBITDA Margin Expected to Further Improve Going Forward

ORA and DTE were the only firms to grow margins YOY through cost control execution.

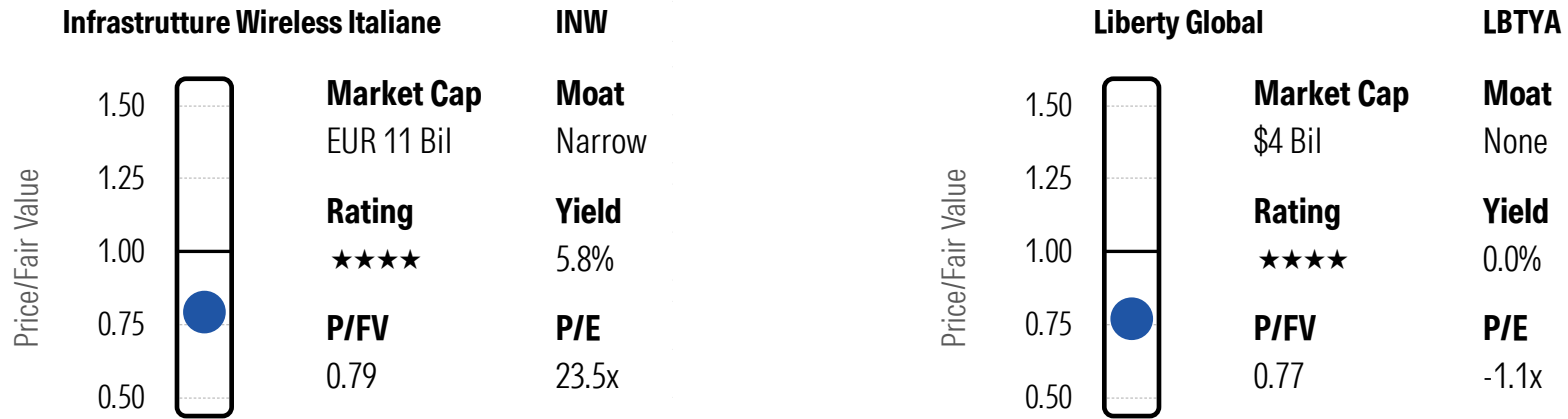


Sources: Company filings. For firms that only report EBITDA margin biannually (Orange, BT Group since the start of 2024), we assume that Q1 and Q2 margin is equal to H1 and Q3 and Q4 is equal to H2. BT Consumer's and Telecom Italia's EBITDA margin is lower, given they are consumer businesses without networks.

See Important Disclosures at the end of this report.



Communication Services | Top Picks





Technology

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Technology Looks Broadly Attractive, but We Favor Software in This Market

European Technology Has Underperformed the Broad Market Index

The sector has underperformed year to date, and this gap has increased over the last quarter. Recent underperformance has been primarily driven by IT services and software, as market concerns about the negative impact of artificial intelligence on these companies have intensified. IT services is bearing most of the brunt, with a continued weak market environment as clients delay decision-making while contemplating their AI strategies. In contrast, hardware companies have rebounded sharply as tariff fears have subsided. Semiconductors traded relatively flat in the last quarter.

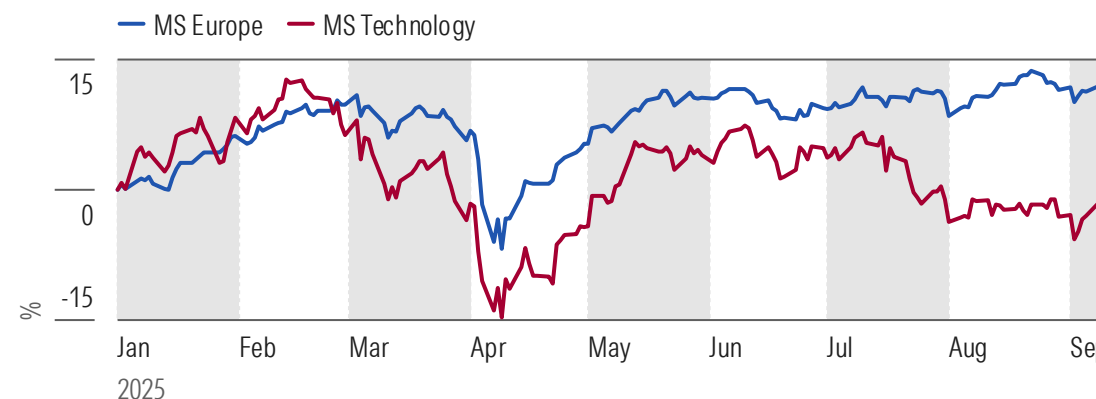
Potential AI Disruption Has Rocked Investor Sentiment

AI disruption risk is the theme of the quarter. Investors are questioning the value of software, services, and information in a future where AI could replace some use cases. Accordingly, any signs of softness in performance have resulted in the associated stocks being punished severely. However, we think the negative market reactions have been most severe for stocks that had been trading at elevated valuations. The selloff looks overdone to us, with several stocks now trading at 4- and 5-star levels.

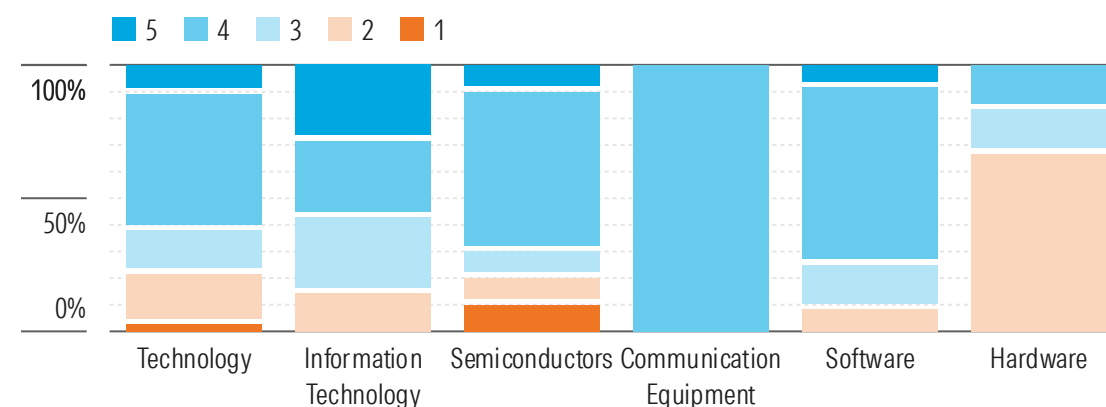
We Favor Software in This Market

While IT-services companies are generally trading at the steepest discounts to our fair value estimates, we favor software companies in this market, given their high recurring revenue, strong moats, and attractive valuations. Our top picks are Nice and Wolters Kluwer.

Technology vs. Morningstar Europe Index



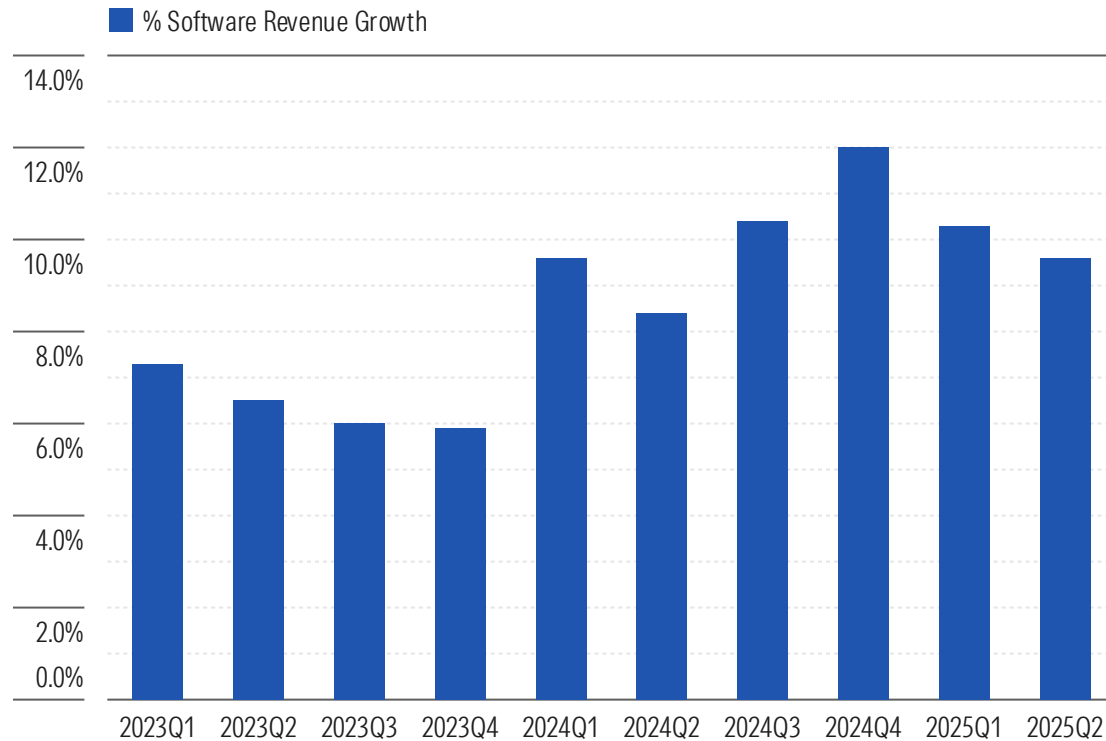
Technology Star Rating Distribution by Industry



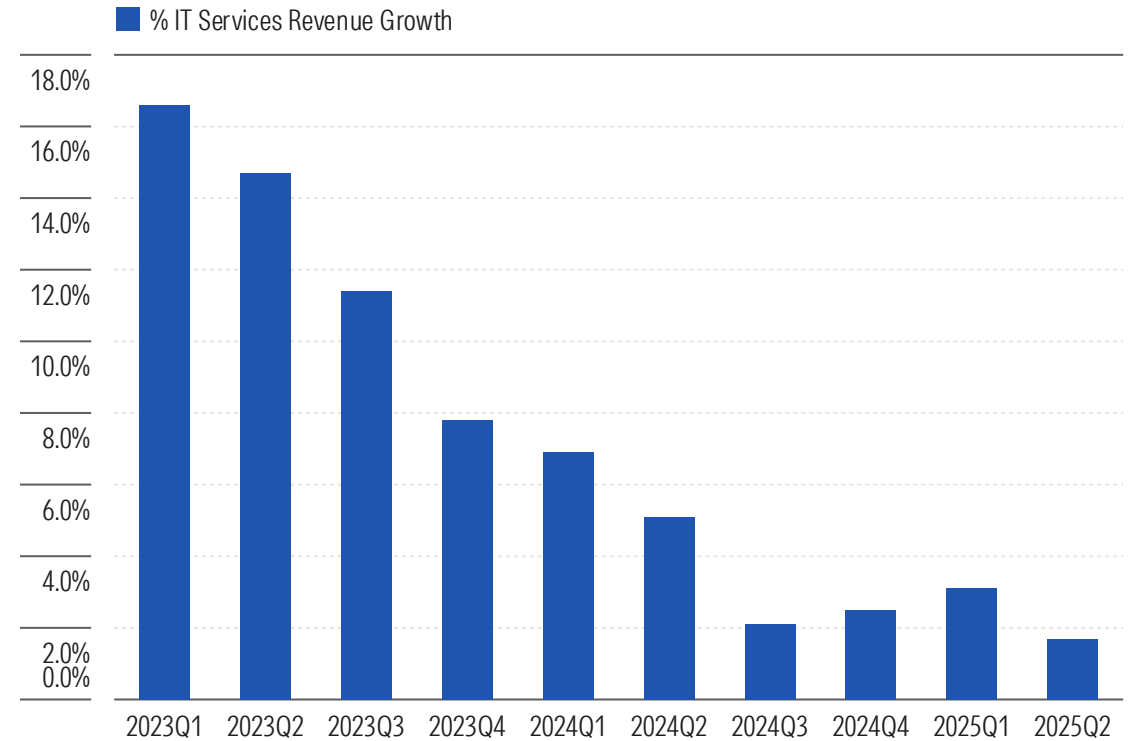
Revenue Growth Has Faded in Software and IT Services; Outlook Better for Software

Software companies continued to report healthy revenue growth in the second quarter, but the pace has softened. We think AI disruption risk has caused some slower decision-making in customers, but we expect growth to recover in the near term. IT services, on the other hand, experienced a sharp deterioration in 2024, and growth continues to languish, given difficult market conditions. Visibility is poor in IT services because of the short-cycle nature of project-based work. We expect weak conditions to carry over into 2026.

Software Revenue Growth Has Declined but Is Still at a Healthy Level

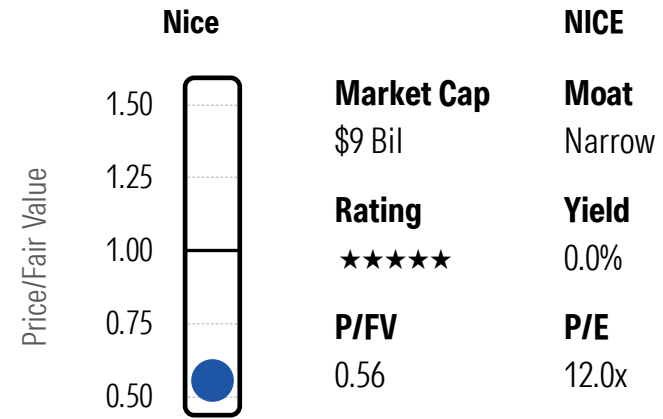
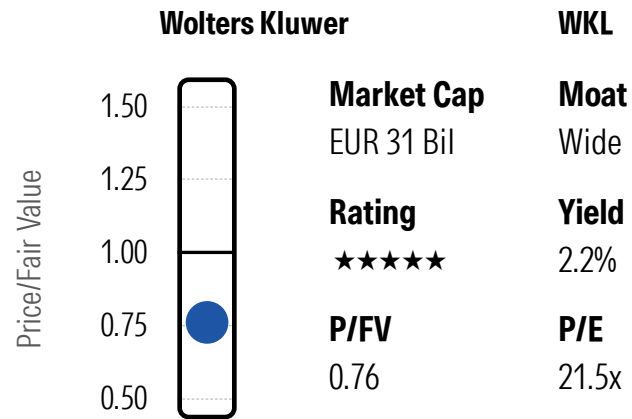


IT Services Revenue Growth Has Declined Sharply and Remains Depressed





Technology | Top Picks





Consumer Cyclical

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Autos and Homebuilders Offer the Best Value; Luxury Looks Attractive After a Selloff

As Hopes for Quick Cyclical Rebound Fade, Luxury Looks Attractive Again

After a tariff-related selloff and broadly weakening sales posted in the first half, investor hopes for a fast rebound of luxury demand from the 2024 downturn have declined. The sector looks undervalued to us, and we believe it to be moaty and structurally growing. Our top picks are turnaround stories like narrow-moat Kering, with investor patience required. More risk-averse investors might favor wide-moat LVMH or Richemont as strong market leaders, now trading in 4-star territory.

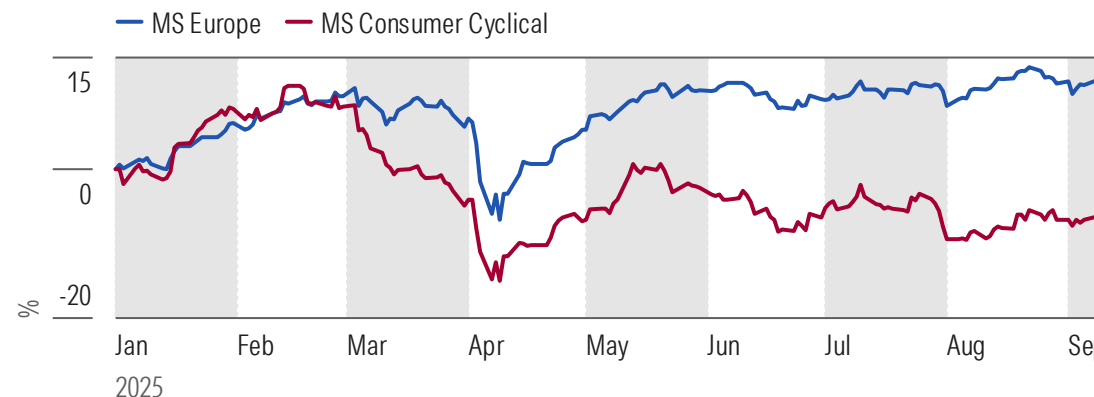
UK Homebuilders Still Offer Upside After Our Fresh Take

We lowered our fair value estimates for all homebuilders in the second quarter after moderating our near- and medium-term expectations for house price growth and margin recovery, but they continue to screen attractively. Shares had performed reasonably well year to date, before the sector sold off once more as rate cut expectations were pared back and government bond yields rose.

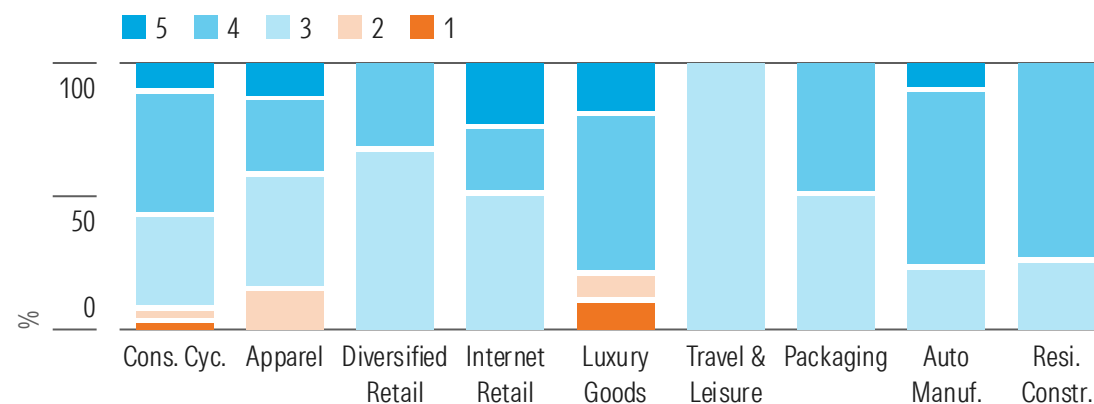
Peak Pessimism Reached in the European Auto Industry

We think encroaching Chinese competition, US import tariffs, slowing EV adoption, and the shrinking share for foreign automakers in the Chinese market are all baked into expectations. We think the European automakers that rightsize their costs accordingly, in some cases taking bold decisions, show flexibility in their supply chain, and maintain capital allocation discipline are best positioned. BMW is our top pick in the sector as a result. Peak capex has passed, and the rollout of its new product range Neue Klasse should signal an imminent improvement in earnings, asset turn, and free cash flow.

Consumer Cyclical vs. Morningstar Europe Index



Consumer Cyclical Star Rating Distribution by Industry



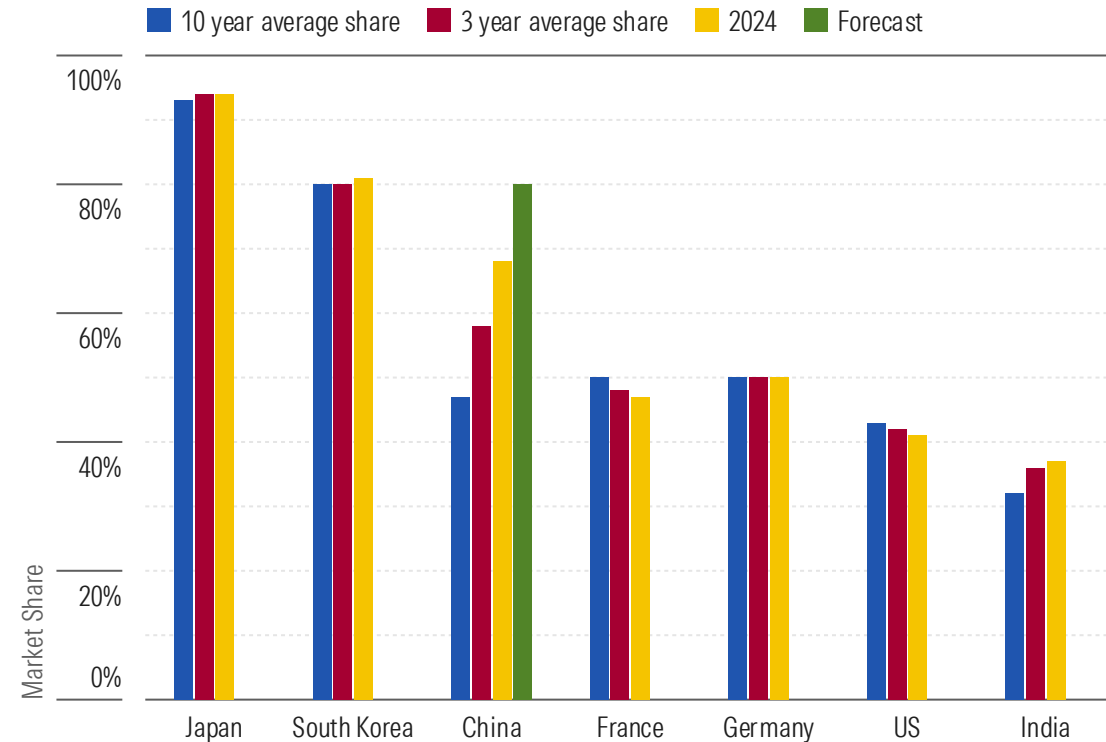
European Carmakers' Improving EV Availability Is Helping Defend Their Market Share in Europe

Chinese brands hold around a 70% share of the Chinese auto market. While we think there is room for this to increase, given the high loyalty rates for domestic brands in Asian countries, we see this core growth lever for the Chinese automakers dissipating.

The increasing proliferation of both affordable and premium European electric vehicles that match the technology of industry leaders, such as Tesla and the Chinese brands, has helped European carmakers claw back some market share lost in Europe.

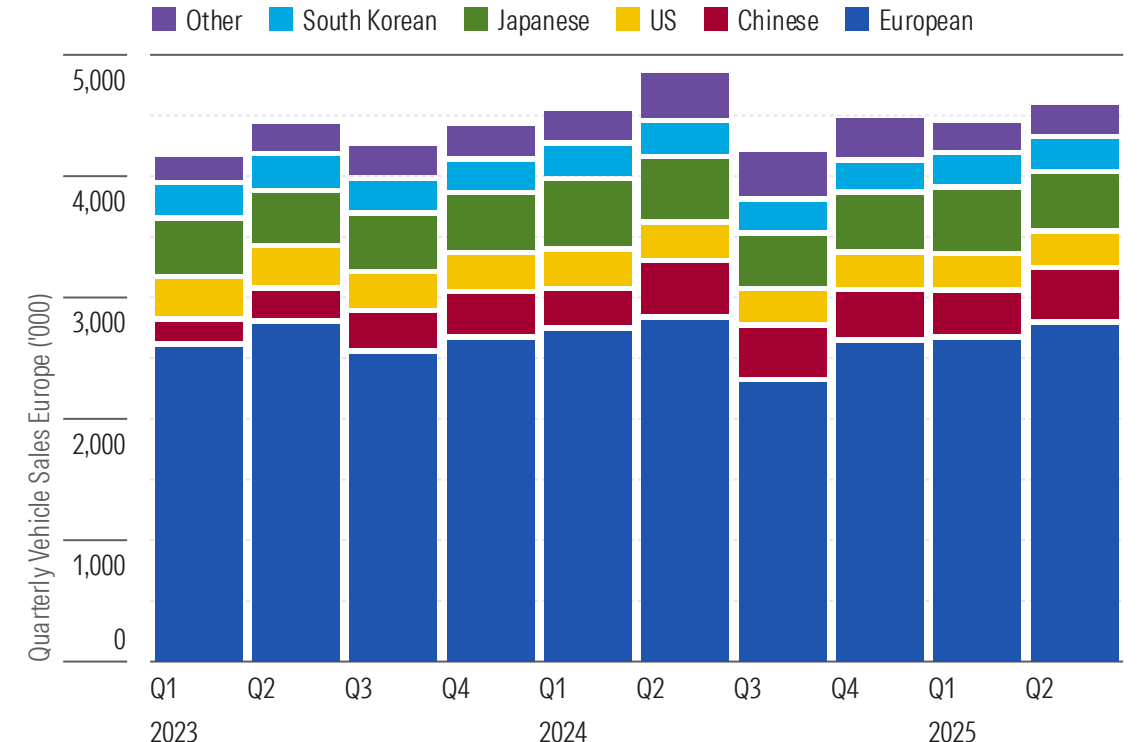
Chinese Auto Brands in China are Reaching Saturation, Driving Growth Globally

We think Chinese auto imports into Europe will continue to accelerate.



European Carmakers Incrementally Taking Share Back at the Cost of US Brands

Volkswagen and BMW are the winners.

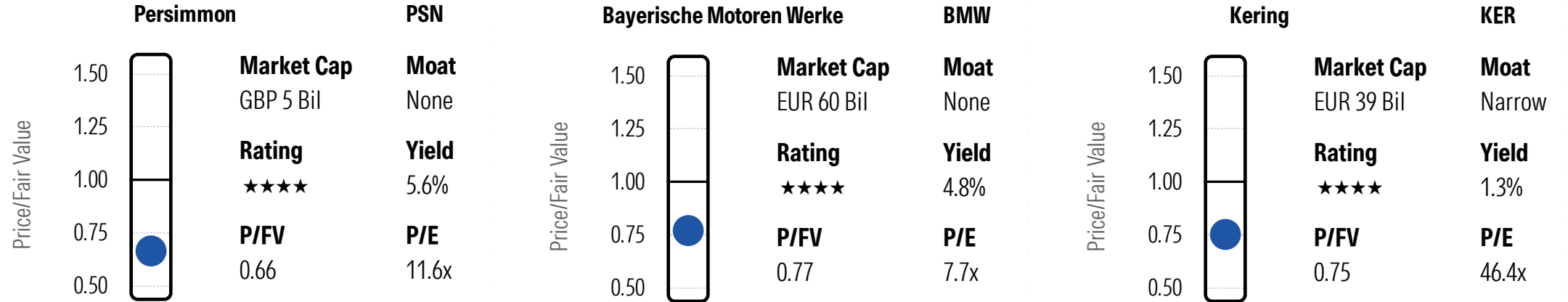


Source: Wards Intelligence.

See Important Disclosures at the end of this report.



Consumer Cyclical | Top Picks





Consumer Defensive

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Companies Pin Volume Growth Acceleration Hopes on Product Innovation and Marketing Push

Consumer Defensive Lagged the Market in the Third Quarter

The Morningstar Consumer Defensive Index has underperformed the broader Morningstar Europe Index in recent months, driven by concerns around deteriorating consumer sentiment as volume growth remains anemic across the sector.

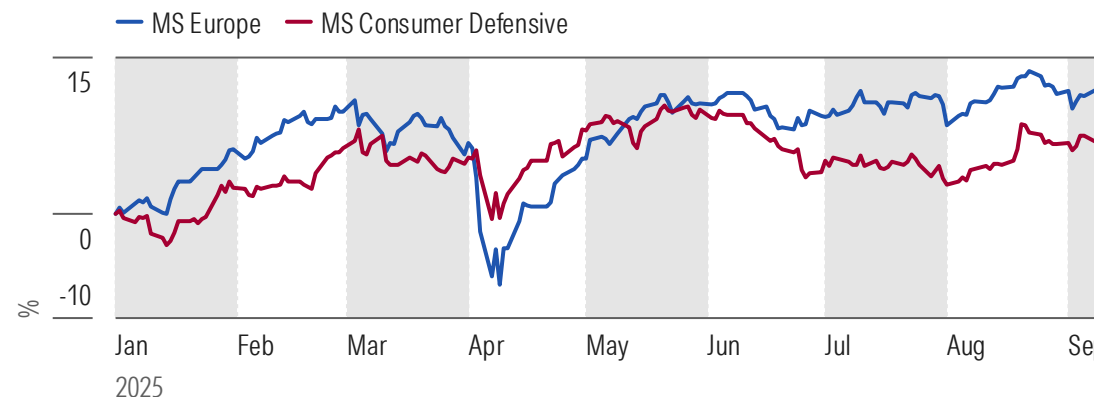
CPG Firms Are Counting on Innovation Pipelines to Reignite Volume Growth

Reported volume growth for consumer packaged-goods firms has been generally disappointing so far this year, with many Tier 1 companies slightly behind estimates. An acceleration is expected toward the end of the year, supported by the rollout of innovation plans and stepped-up brand and marketing investment. With continued pressure from increasingly attractive private labels and more cautious consumer sentiment, companies focusing on product differentiation through quality and perceived value will be best positioned to succeed.

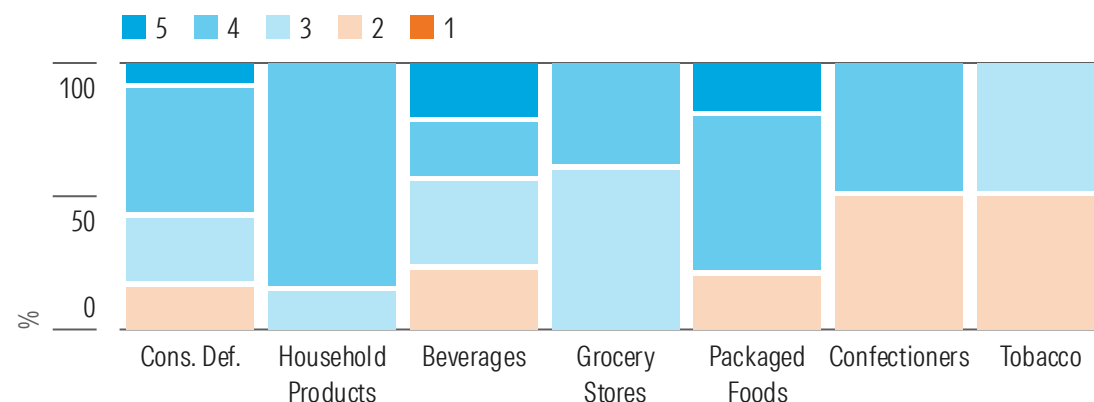
Opportunities Can Still Be Found Across Industries

Opportunities exist across many categories, especially beverages. Investor confidence in alcohol companies has been low, with concern over whether the industry's headwinds are cyclical or structural. Still, we are confident in long-term drivers, including premiumization and emerging-market penetration. We expect a recovery in the alcoholic beverage industry to be weighted toward the second half of 2026. However, the biggest risk is whether the demand environment in the United States and China improves, as they are the largest markets for premium spirits.

Consumer Defensive vs. Morningstar Europe Index



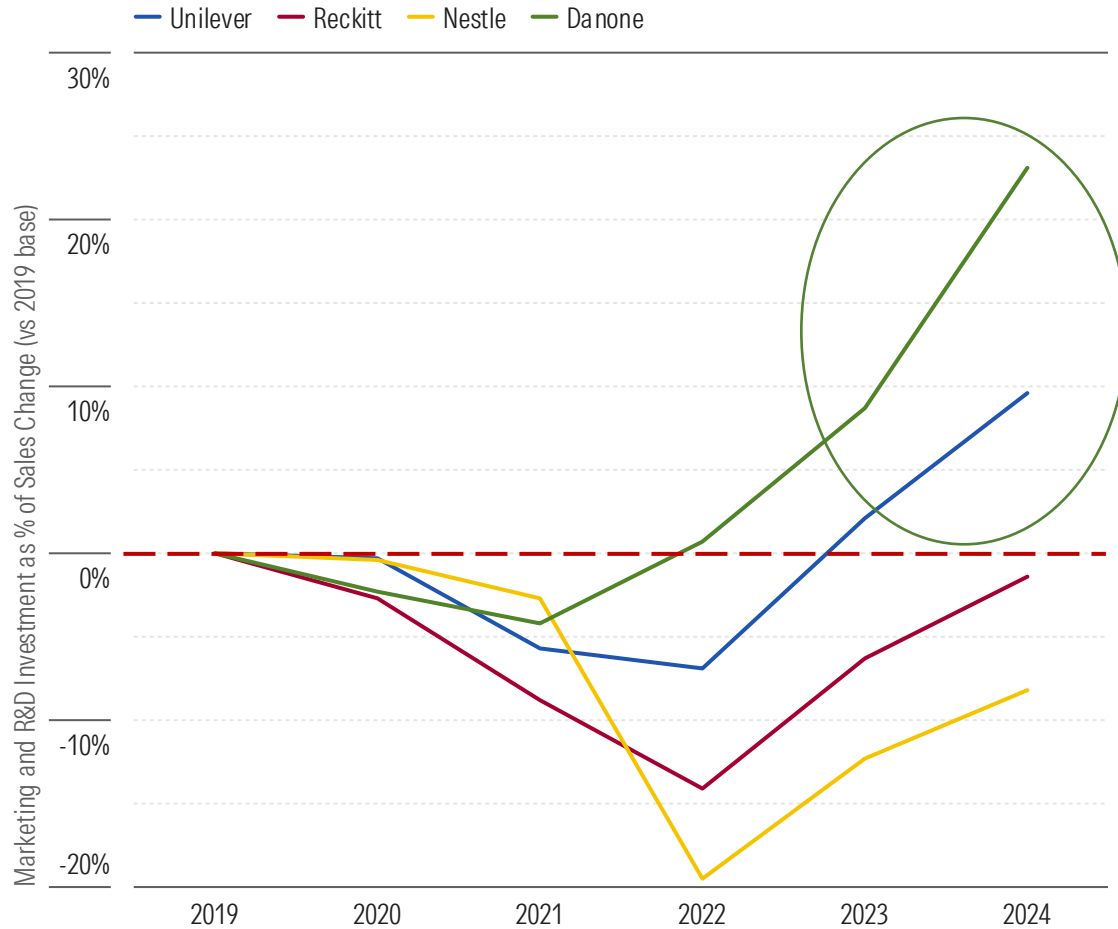
Consumer Defensive Star Rating Distribution by Industry



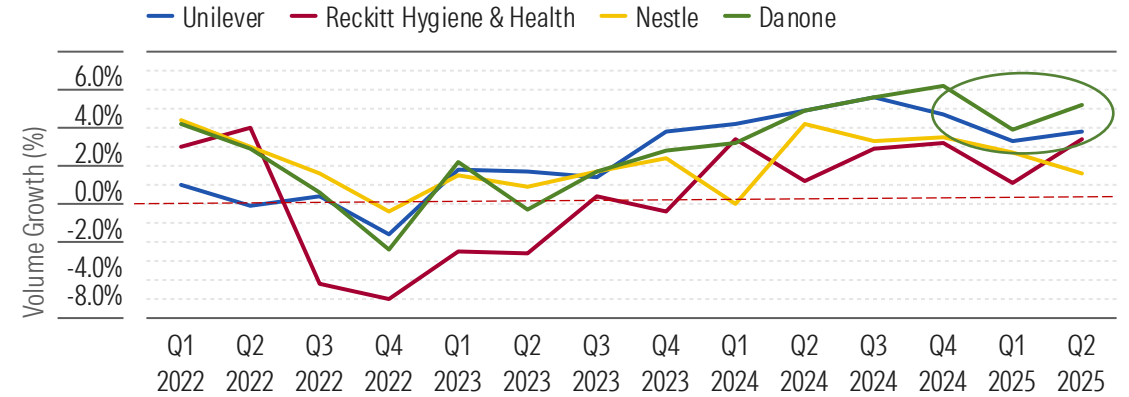
CPG Companies That Stepped Up Brand and Innovation Are Performing Better

Danone and Unilever Are Further in Their Turnaround Journeys

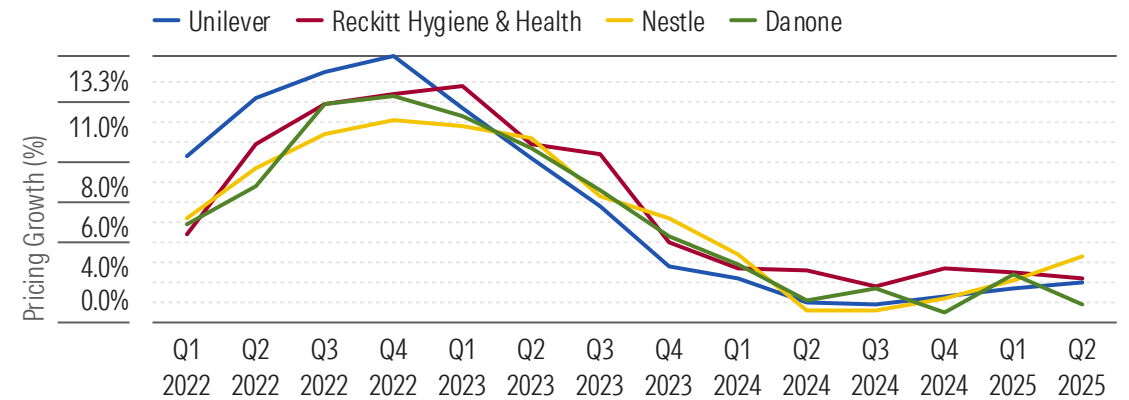
For these companies, the marketing and R&D investment is ahead of 2019 levels.



Translating Into Most Resilient Volume Growth in a Tough Consumer Environment

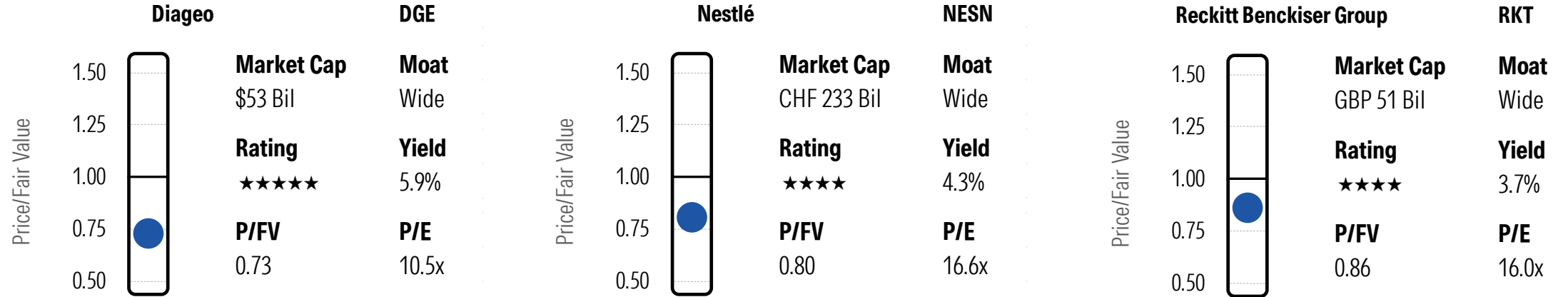


Pricing Growth Moderated but Remains Around 2% on Average Over the Last Year





Consumer Defensive | Top Picks



 **Energy**

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Oversupply Will Pressure Oil Prices, Creating More Buying Opportunities

Latest Crude Increases Will Weigh on Oil Prices

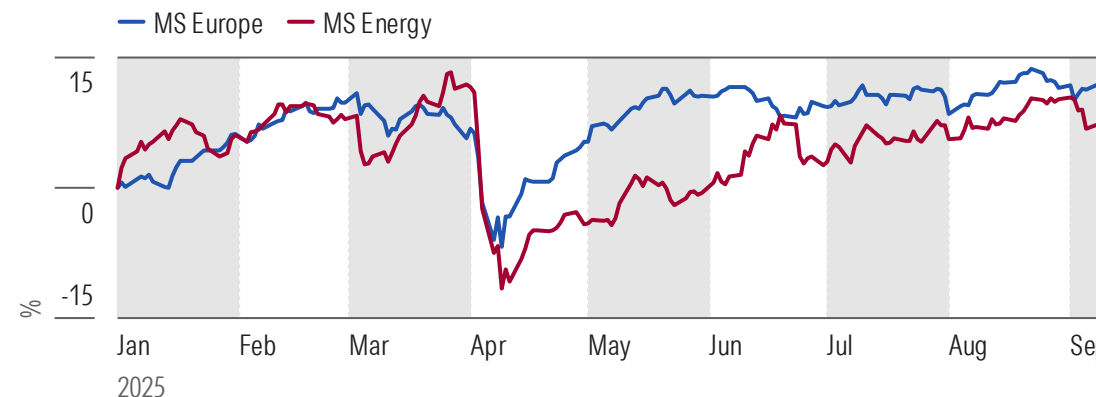
OPEC+ aims to raise production by 547,000 barrels per day in September, with a further 137,000 barrels per day scheduled in October. Still, barrels reaching the market will likely fall short of pledged volumes.

- The increases are the latest in a series of accelerated output hikes. The hikes unwind prior production cuts that began in late 2023, a year ahead of schedule.
- Excess supply has yet to be reflected in inventory data or crude futures, largely due to strategic stockpiling in China and summer seasonal trends.
- While more sanctions could more meaningfully affect Indian purchases of Russian oil, Brent prices mostly held steady during the quarter between the mid- and high-\$60/bbl range. Traders largely shrugged off the latest supply increases.

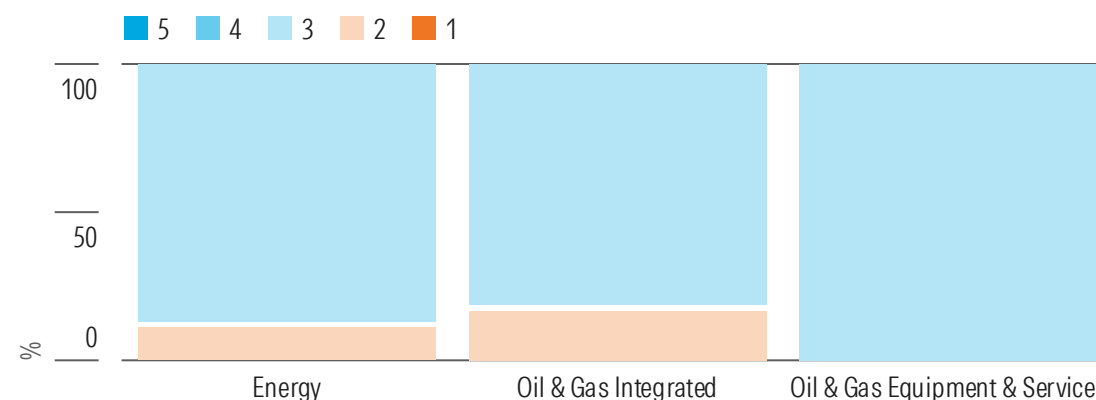
Valuations Suggest Limited Opportunity in the Short Term

If OPEC+ delivers on its new targets, the market could swing into oversupply next year, accelerating global inventories and subsequently crushing crude prices. While we expect share prices to correct sharply in this scenario, we see valuations being less affected, as our recently updated midcycle price assumption of \$65/bbl remains conservative relative to the US Energy Information Administration's outlook, offering attractive long-term buying opportunities for investors.

Energy vs. the Morningstar Europe Index



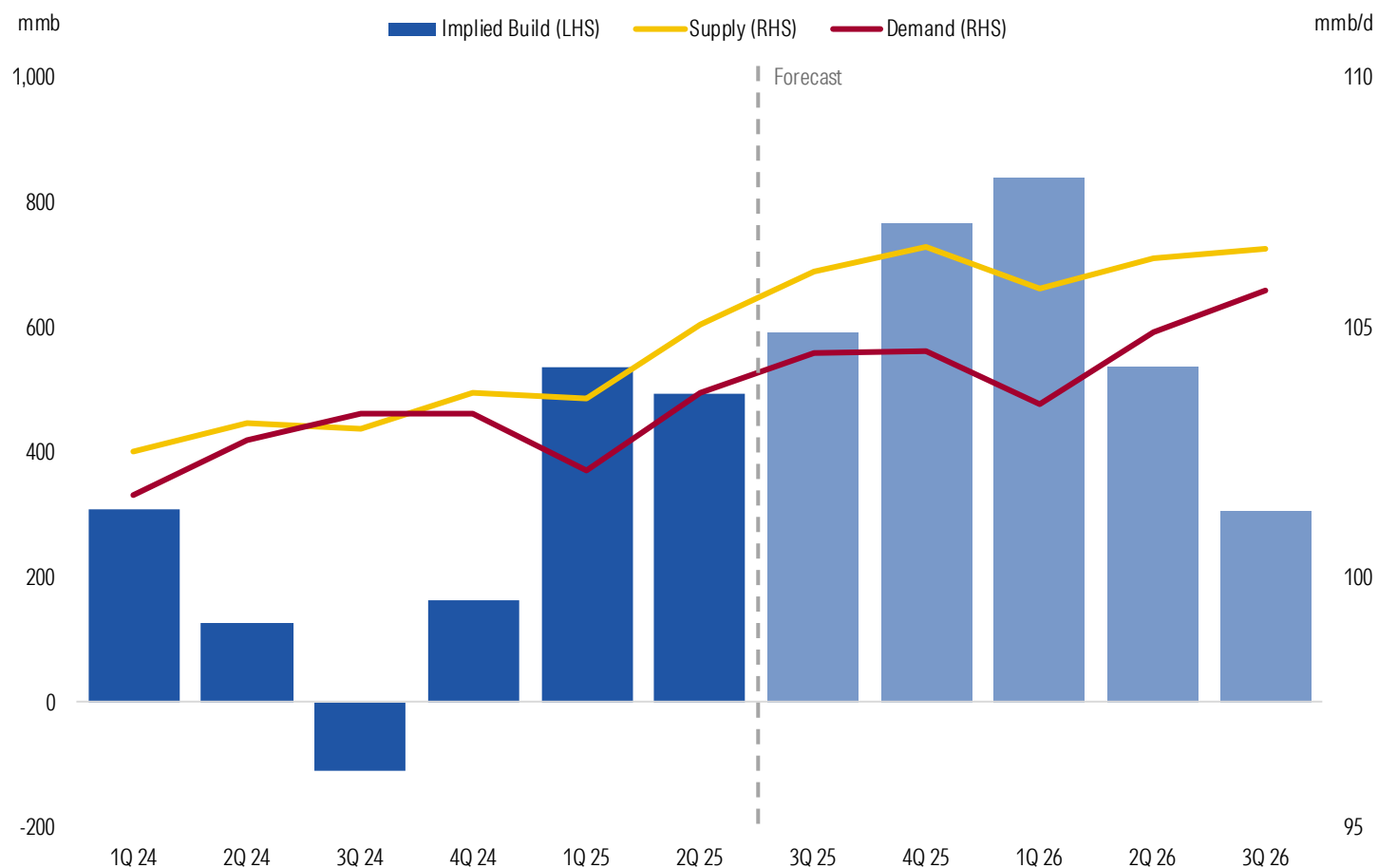
Energy Star Rating Distribution by Industry



EIA Believes Supply/Demand Imbalance Will Lead to Falling Oil Prices

Inventory Builds Are Accelerating; EIA Sees Oil Prices Dropping Quickly

This will create near-term pain for shareholders, but some long-term opportunities.



Accelerating Inventories Could Pressure Crude Prices

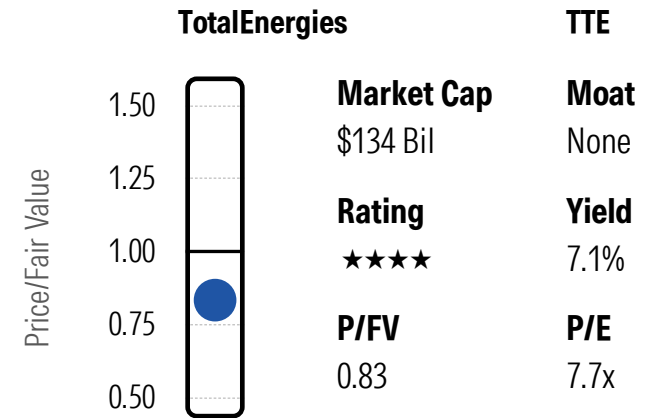
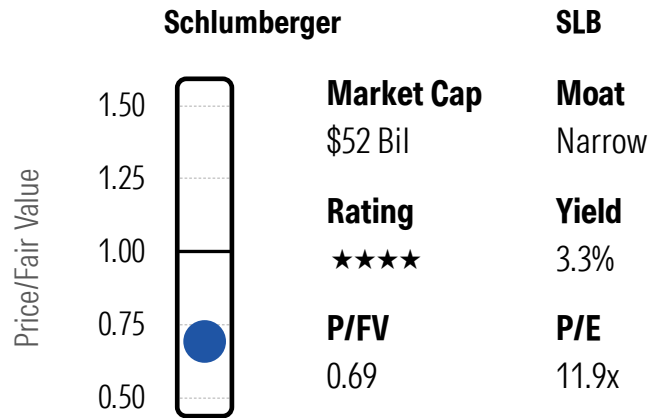
The EIA projects that global inventories will rise by over 1.6 million barrels per day through 2025 from 2024 levels.

- It expects global production to increase by more than 2.9 million barrels per day by year-end, while demand is seen growing by only 1.3 million barrels per day.
- EIA expects the imbalance between supply and demand to push the West Texas Intermediate benchmark down to \$51/bbl by the end of 2025.

If EIA Is Accurate, Stock Prices Could Fall Rapidly

If the projections are accurate, valuations would also fall, but not as much.

- EIA's price outlook remains well below the levels assumed by Nymex futures in our models.
- Producers would see lower revenue and could respond with workforce reductions to cut costs.
- Shale producers would also likely scale back capital spending significantly, pressuring suppliers across the value chain.





Financial Services

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Opportunities Have Dwindled, but Sector Remains Attractive in Parts

Interest Rate Cuts Mean We Prefer Better-Disciplined Businesses

As key rates continue to fall, we prefer banks and insurers with superior underwriting.

Picking Quality in Payments Is a Winning Strategy

Quality has become cheap again in the payment space, but investors shouldn't confuse a low price with quality. We think Adyen is attractive at current levels. Tariff impacts have marginally affected top-line growth in the near term, but its long-term outlook remains solid. Other European payment firms face idiosyncratic issues, structurally lower growth in the point-of-sale segment, and weakening competitive positions in e-commerce.

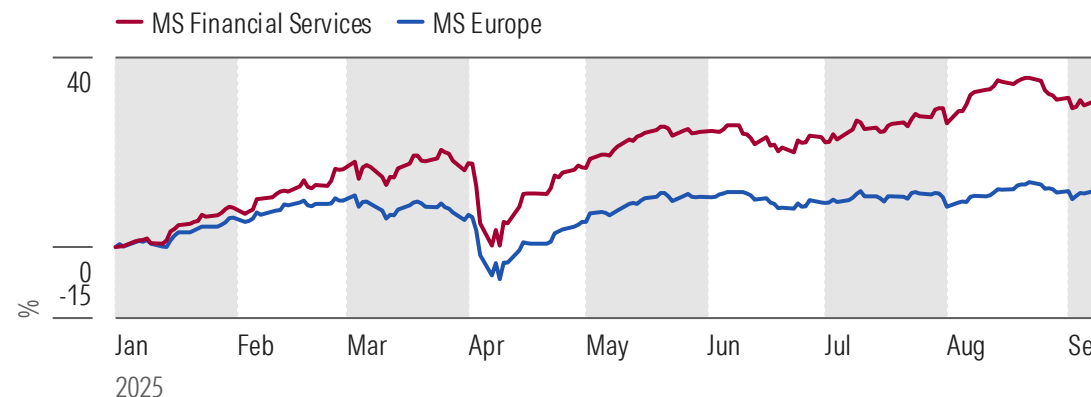
Opportunities in Banks Have Closed

Banks continue to post strong quarters as their loan books roll onto higher swap rates and credit costs remain benign. With monetary policy changes approaching an equilibrium for now, we expect European banks with deposit-heavy funding to continue to outearn their cost of capital.

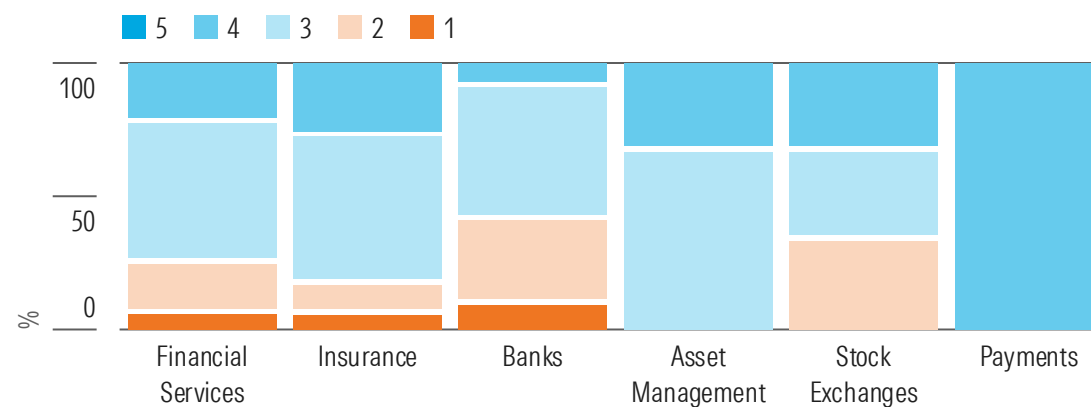
Reinsurer Underwriting Is Likely to Gradually Deteriorate

With the softening of the underwriting cycle now in swing, reinsurer revenue growth is likely to come off its peak. And as pricing continues to slide, while underwriting may improve in the near term, in the medium term, it is likely to deteriorate. For life insurers with traditional savings products, the outlook from lower rates is lower sales. Companies like Prudential are well positioned because of their reliance on health and protection, so their earnings are less sensitive to equity markets and interest rates.

Financial Services vs. the Morningstar Europe Index



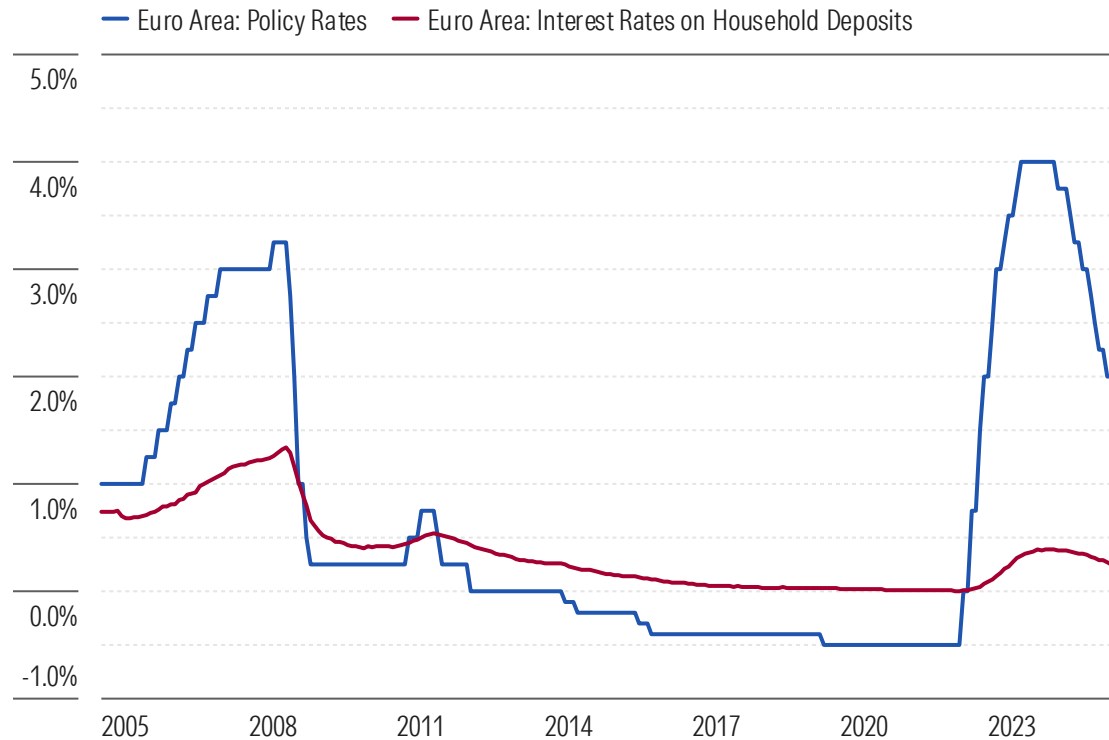
Financial Services Star Rating Distribution by Industry



We Expect Banks and Insurers to Remain Profitable

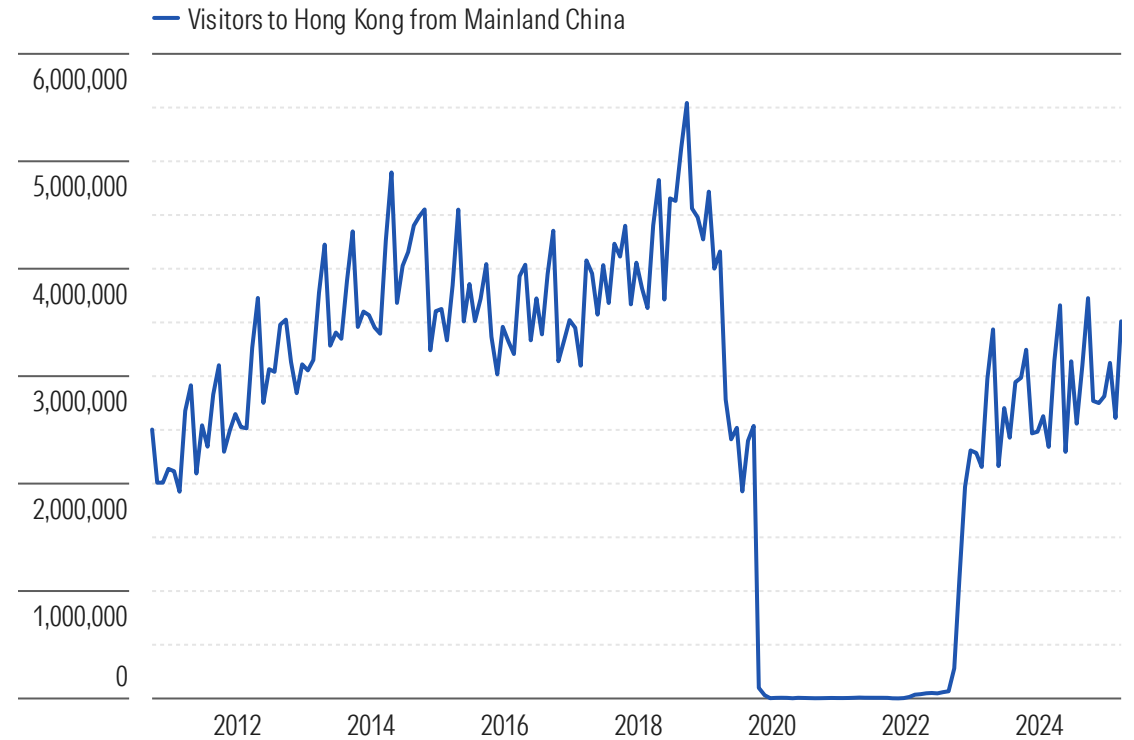
With tariff wars and increased fiscal spending likely to increase inflationary pressure across Europe, we expect interest rate cuts to slow. European banks will benefit from higher than previously assumed rates as well as potentially stronger economic growth.

Deposit-Taking Finally Profitable Again for European Banks



Prudential continues to show solid results in key metrics. New business profit in Hong Kong has grown by double digits as mainland China visitors return. Operating free surplus growth continues, driving a double-digit rise in the interim dividend.

Number of Mainland China Visitors to Hong Kong Continues to Rise

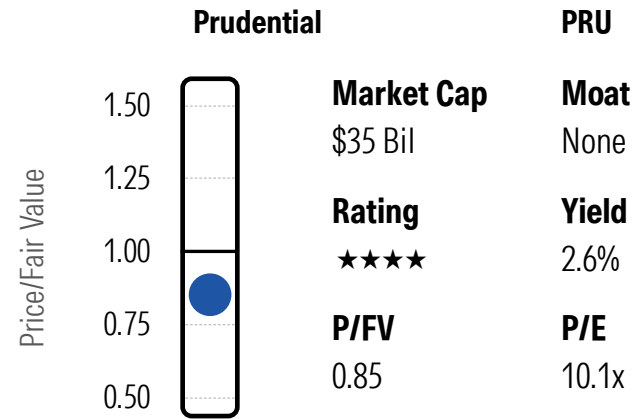
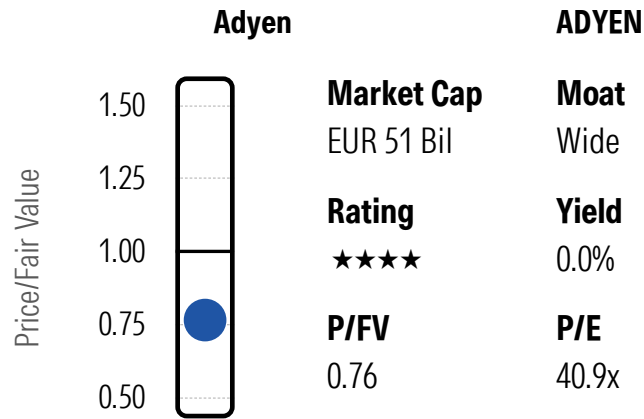


Source: European Central Bank, Haver, Hong Kong Census and Statistics Department. Data as of Aug. 1, 2025.

See Important Disclosures at the end of this report.



Financial Services | Top Picks



Healthcare

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US Policy Overhang Leaves Sector Undervalued

Healthcare Lagged the Broader Market Year to Date

The Morningstar Healthcare Index has meaningfully underperformed the Morningstar Europe Index this year. While performance was largely in line through February, the sector saw a sharper drawdown beginning in March, driven by rising uncertainty around potential US policy effects on growth rates for biopharma, healthcare plans, and medical technologies firms. Broader concerns around vaccine funding cuts and regulatory headwinds for US-centric firms further weighed on sentiment. We see potential for healthcare to close the performance gap in the coming months, driven by its defensive profile and improving clarity on policy risks.

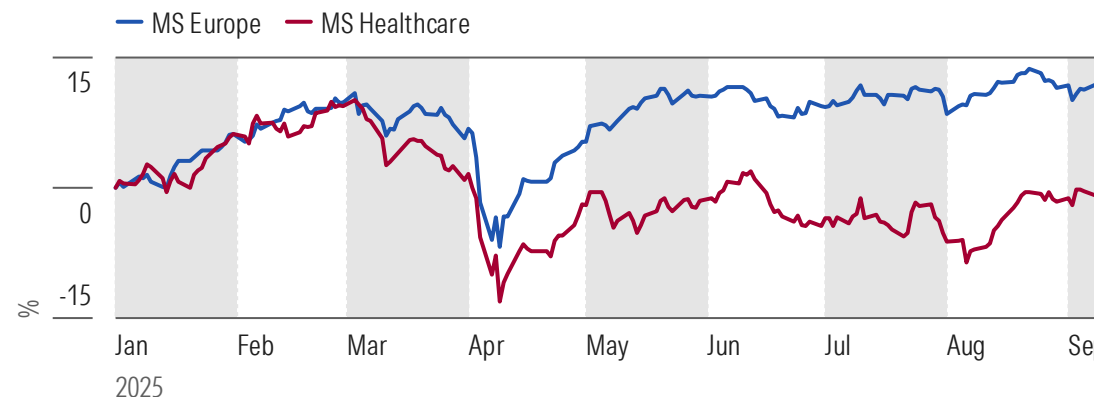
Valuations Still Look Broadly Attractive

The sector looks relatively undervalued overall, with the median price roughly 15% below our fair value estimates. We see several undervalued opportunities across biopharma (GSK, Genmab), medical diagnostics and research (Eurofins, Qiagen), and care facilities (Fresenius SE).

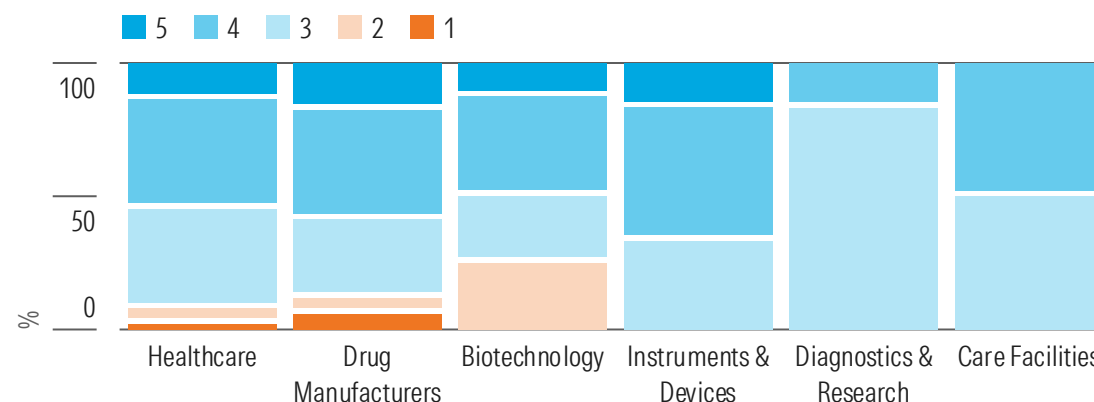
Regulatory Headwinds Add Volatility, but They Are Manageable

Volatility has remained elevated following the election of Donald Trump as US president and Robert F. Kennedy Jr.'s appointment as secretary of Health and Human Services. We have not made major valuation changes across healthcare industries, but we see high uncertainty around many stocks, particularly in biopharma and healthcare plans. In the obesity market, Novo Nordisk trades at a discount to its fair value estimate. We still see strong competitive advantages despite Eli Lilly's growing market share.

Healthcare vs. the Morningstar Europe Index



Healthcare Star Rating Distribution by Industry

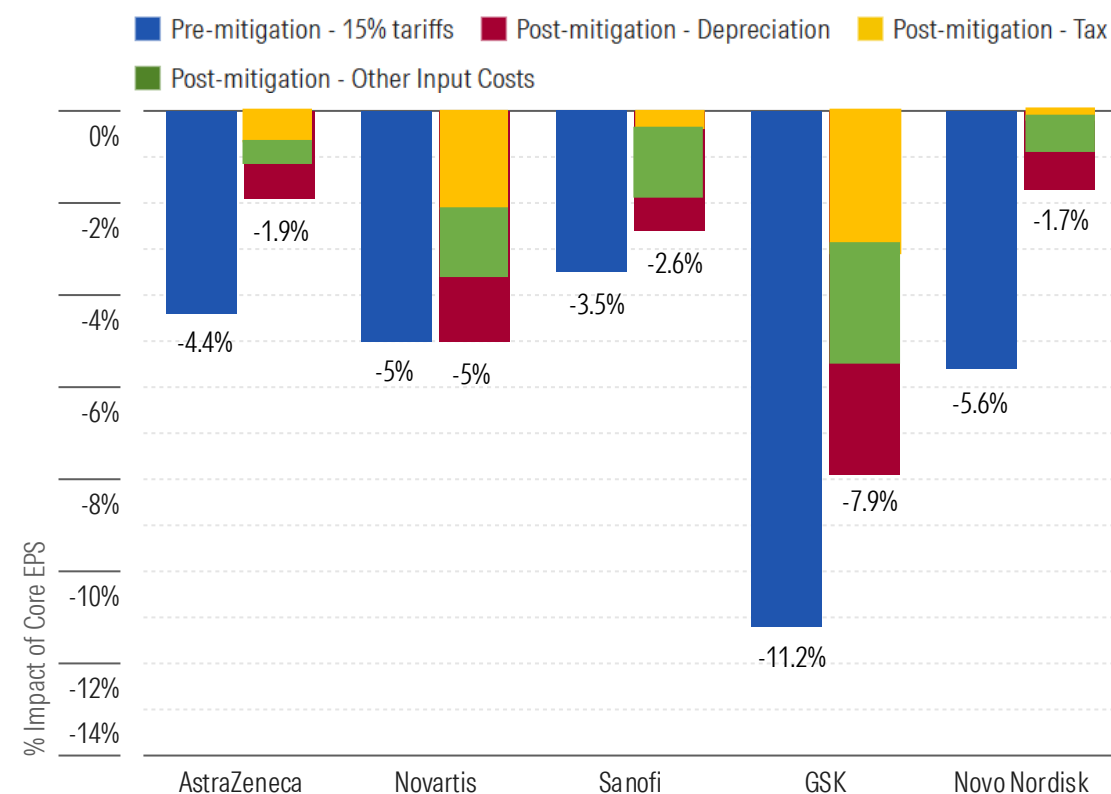


Policy Risks Intensify for European Pharma Amid Proposed Tariff Pressures and US Vaccine Policy Changes

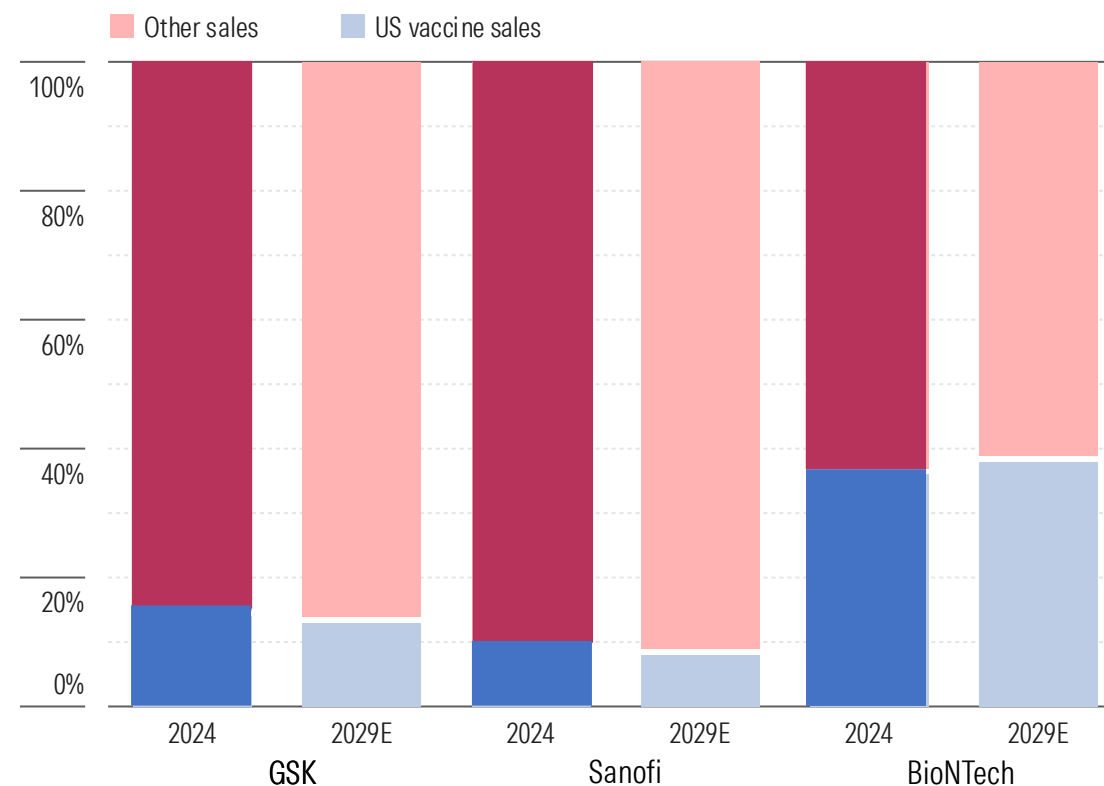
We estimate that 15% tariffs would have an average unmitigated impact of 6% to core earnings per share for European biopharma companies. We expect long-term effects to be mitigated, but still a headwind as firms build and ramp up new facilities in the US.

US vaccine sales account for only a small percentage of revenue for larger European biopharma, but cuts to HHS funding for mRNA vaccine research contracts, narrower covid vaccine approval, and changing federal recommendations heighten policy risk.

EPS Sensitivity to Proposed US Pharma Tariffs



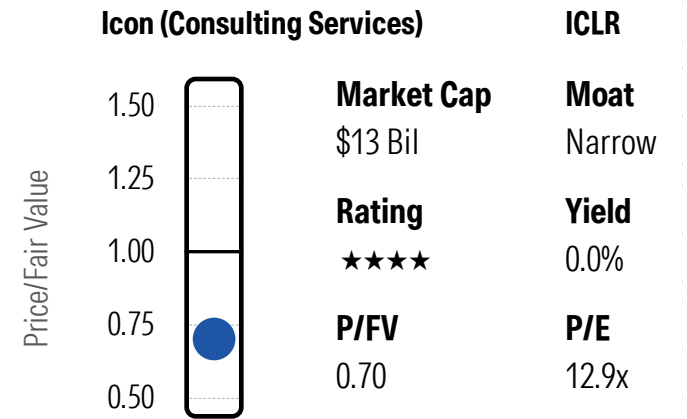
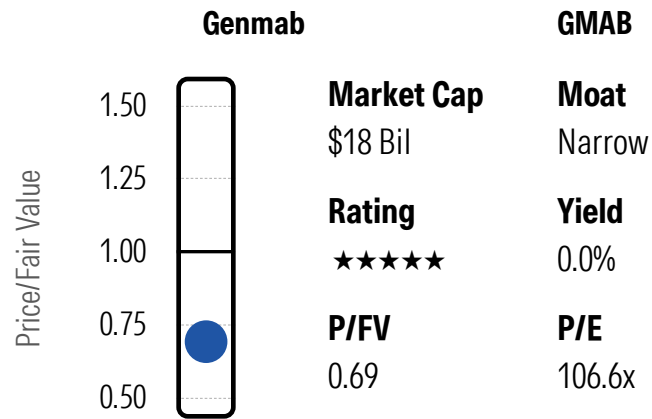
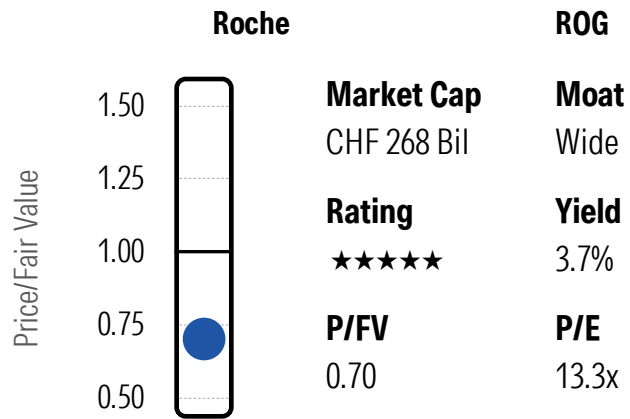
US Vaccine Sales Outlook of Europe Based Companies



Source: Morningstar analysis of company reports as of September 2025 and Morningstar estimates.

See Important Disclosures at the end of this report.

 Healthcare | Top Picks





Industrials

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Business Services and Defense Stocks Continue to Be Attractive

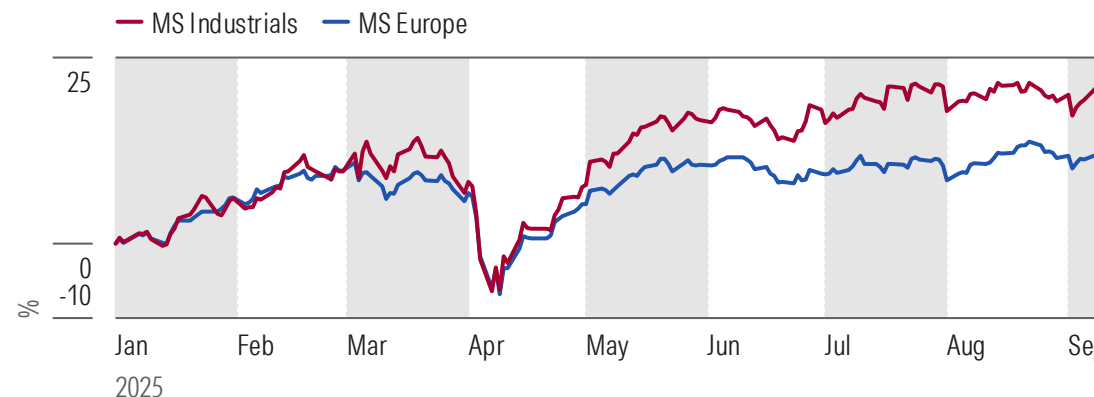
European Industrials Outperform Again in the Third Quarter

The performance of European industrials stocks exceeded the broader European equity market during another volatile quarter. After a year filled with fears of a recession due to US tariffs, the US and the EU locked in a trade deal that set duties at 15% for most goods imported from Europe, a positive in the eyes of investors. This boosted demand for the products of industrial businesses exposed to secular growth themes. These themes include supplying electrical equipment to data centers to support their AI capabilities and to electric utilities to modernize outdated electrical infrastructure. For these firms, local-for-local manufacturing limits their exposure to potential tariffs.

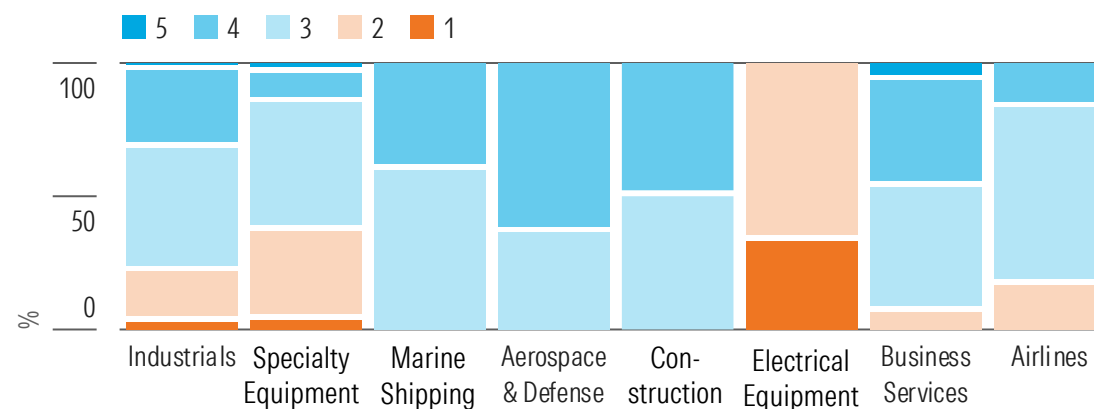
Business Services and Aerospace Stocks Remain Attractive

We identify compelling investment opportunities in the business-services sector, especially in testing, inspection, and certification firms, which benefit from global tailwinds in sustainability testing, product safety, and supply chain management. We also see opportunities in European aerospace and defense stocks. Defense stocks are benefiting from a global increase in government defense spending. Civil aerospace companies are supported by resilient travel demand and airlines operating older fleets that require more maintenance to meet this demand. Delivery delays both limit fleet expansion and force carriers to intensify aircraft utilization.

Industrials vs. the Morningstar Europe Index



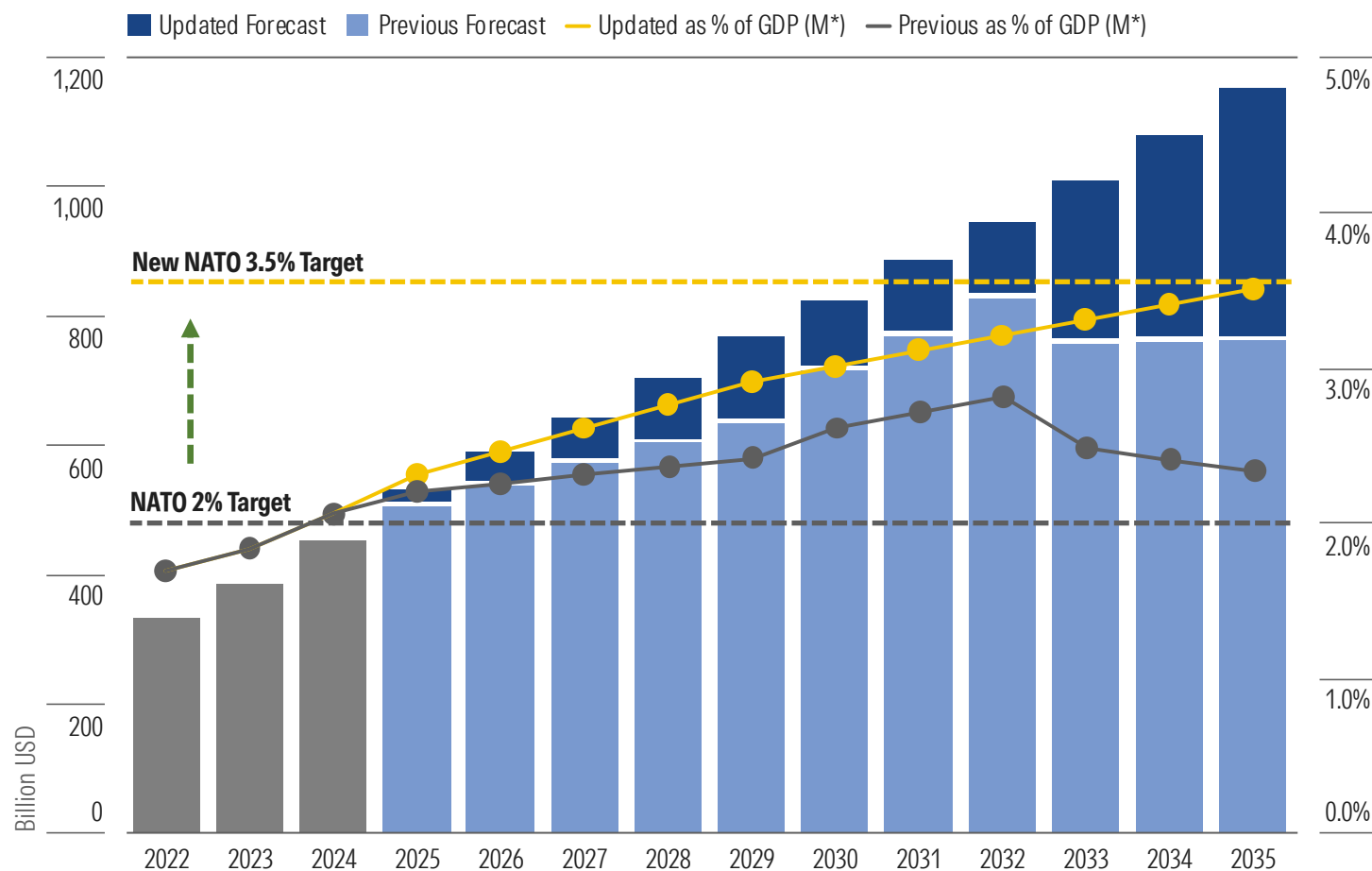
Industrials Star Rating Distribution by Industry



What Changed: Higher NATO Targets, Rising Equipment Share, Structural Uplift in Long-Term Defense Spending

Europe's Core Defense Budget Target, as Share of GDP, Increased to 3.5% From 2%


We expect share of equipment spending to increase to an average of 42% from the recent 28%.

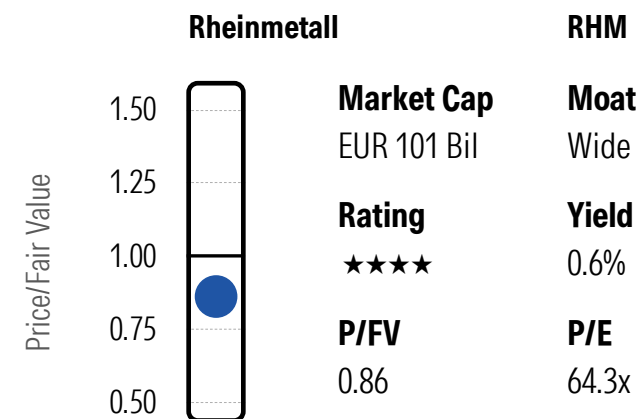
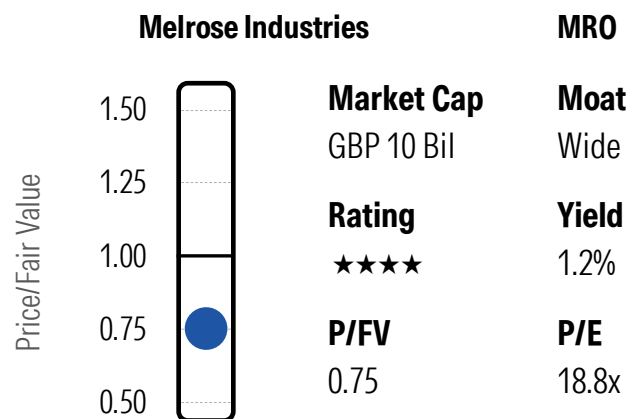
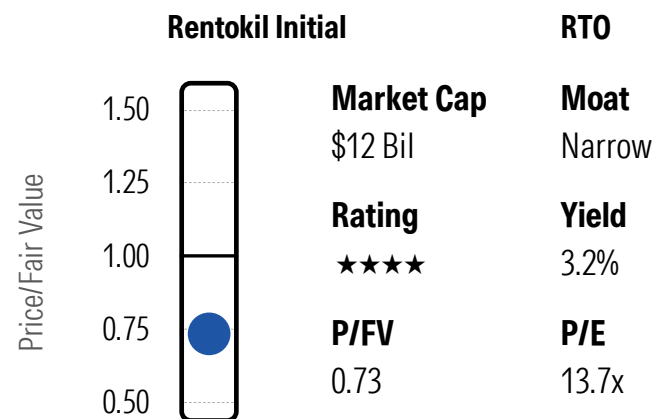


In our previous publication, we argued that NATO's 2% of GDP defense spending target was insufficient to reverse decades of underinvestment. While we already assumed that Europe would need to overshoot this threshold, and reach 2.4% by 2029 and 2.8% by 2032—driven by strategic urgency and Europe's push for autonomy from the US—our view remained bound by political willingness.

Since then, NATO has raised its defense spending target to 3.5% of GDP in core defense, removing earlier constraints. The increase was driven by intensifying geopolitical tensions, along with US pressure from the Trump administration. We now expect core defense spending to reach 3% by 2030 and 3.5% by 2035.

We raised our midterm equipment spending forecast for Europe to 42% from 32% previously to reflect European urgency in rebuilding scale and capacity amid strained inventories and decreased reliance on US support. We expect long-term spending to remain structurally above our prior 2% of GDP baseline, driven by the need to rebuild inventories and strengthen overall readiness.

 Industrials | Top Picks





Utilities

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Sector Hit by Government Bond Selloff in Q3

Rising Interest Rates Hit the Sector in Q3

While outperforming the market year to date, the sector has wobbled since June. The culprit is rising interest rates, chiefly because of concerns over budget deficits in France and the UK. Second-quarter earnings were also less robust than in previous quarters.

Power Prices Increased in Q3

Forward power prices increased by 4% on the back of a 12% increase in carbon prices. Meanwhile, gas prices were flat. All in all, clean spark spreads were flattish.

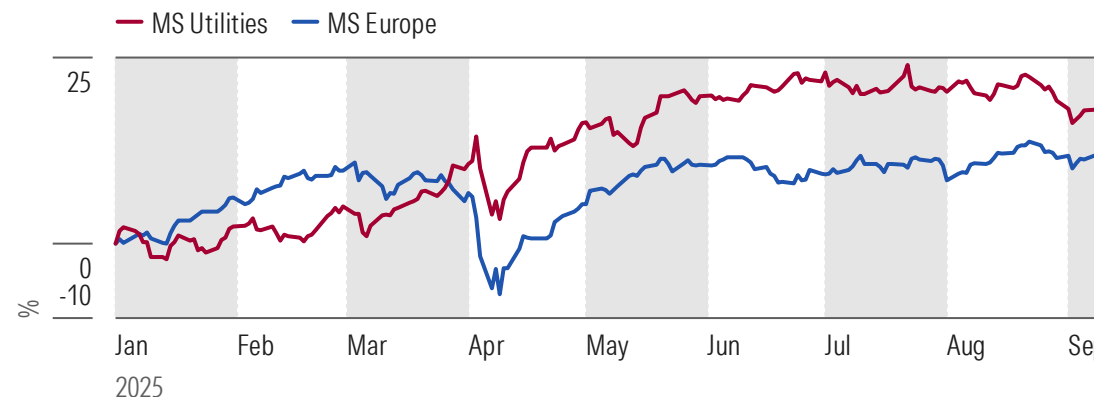
Political Support for Renewables Is Eroding in the US and Europe

The US tax-and-spending bill that passed in July included the phaseout of renewables tax credits in 2026 with a four-year safe harbor. The US administration renewed attacks against offshore wind, with a stop-work order against Orsted's Revolution Wind project. Orsted carried a massive rights issue in September. The German government is considering trimming renewables subsidies and offshore wind targets as the trade-off between economic competitiveness and energy transition deepens. Against this backdrop, companies increased network investments by 15% while reducing those in renewables investments by 28% in the second quarter. Meanwhile, renewables capacity additions dropped by 60%.

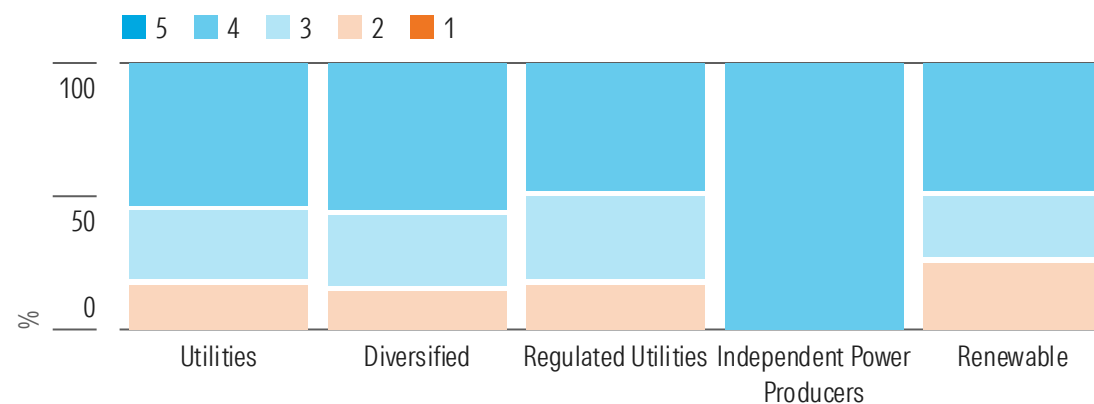
Sector Is Undervalued

We view the sector as undervalued, with a median price/fair value ratio of 0.93. The median dividend yield of 4.6% is in line with the historical median.

Utilities vs. the Morningstar Europe Index



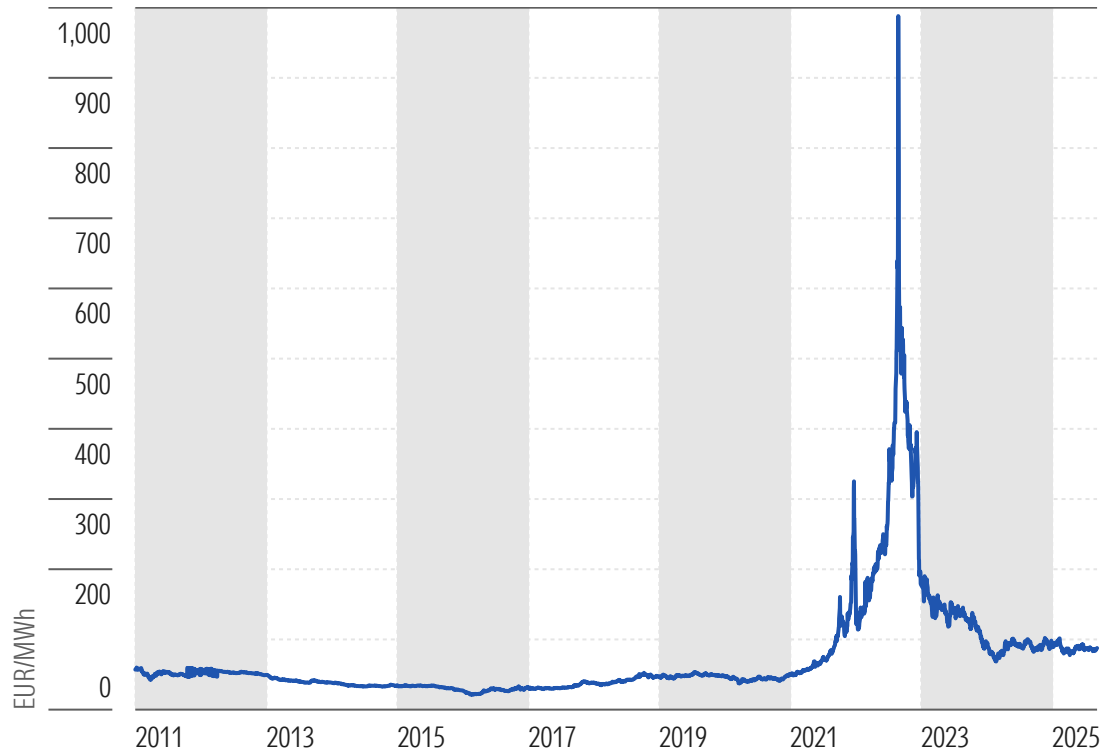
Utilities Star Rating Distribution by Industry



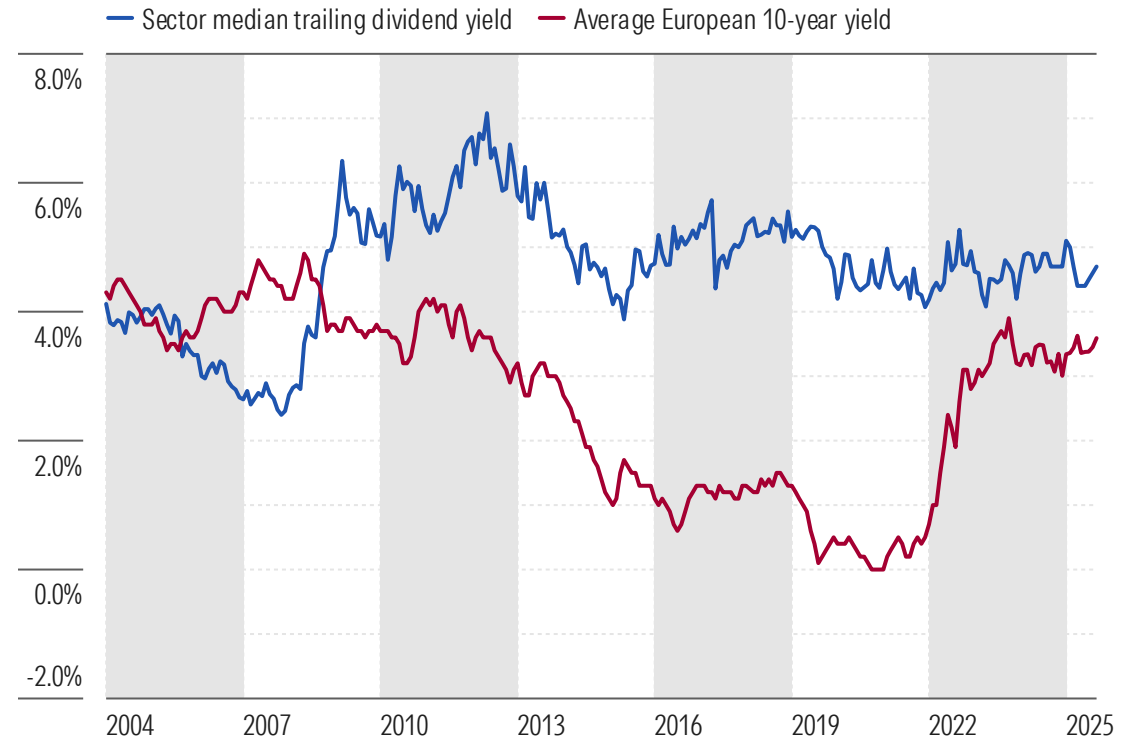
Wholesale Power Prices and Yield Premium Increased in the Third Quarter of 2025

Utilities' dividend yield premium to European government bond yields has increased by 30 basis points in the third quarter as the sector decline exceeded the government bonds' yield increase. At 1.3%, it is still below the 2.1% historical average. On an absolute basis, the trailing median dividend yield of 4.7% is in line with the historical median. Forward power prices increased by 4% on the back of a 12% increase in carbon prices.

German Power Prices Increased by Nearly 10% in Q3



European Utilities' Yield Premium Edged Up in Q3

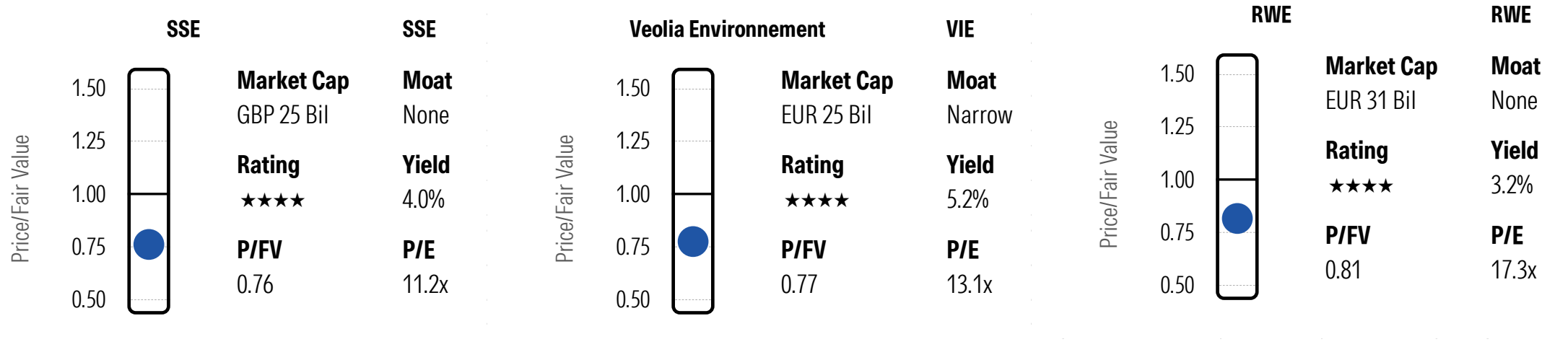


Source: Morningstar commodities. Data as of Sept. 9, 2025.
Note: MWh=megawatt-hours.

See Important Disclosures at the end of this report.



Utilities | Top Picks



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WEBINAR

Morningstar's Q4 EMEA Market Outlook:
Smooth sailing into 2026 or more turbulence to come?

Thursday, 9 Oct 2025 | 3 p.m. BST/4 p.m. CEST



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