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Investment opportunities in Europe and the UK

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Given the relatively low valuations, brightening economic prospects, and the prospect of falling interest rates in the second half of the year, attractive investment opportunities are emerging in various market segments both in the Eurozone and the UK.

The current reporting season for corporate results in the first quarter is still in full swing in Europe. It is encouraging that the number of positive earnings surprises has increased compared to previous quarters and is now significantly above average. Overall, we continue to rate Eurozone stocks as neutral. However, the region's relative valuation remains attractive, in our view. And with inflation continuing to fall, there are legitimate hopes for imminent interest rate cuts in the Eurozone. Yet, even as numerous leading economic indicators move upward, economic growth remains subdued, indicating a slow but steady recovery in profits.

We therefore prefer stocks that benefit from falling inflation, interest rate cuts, and gradually recovering industrial activity, and are attractively valued. Due to the robust labor market and declining inflation, we expect further improvement in consumer confidence. If the European Central Bank cuts interest rates soon, Eurozone small- and mid-caps are likely to benefit from the easing of credit conditions and accelerating economic growth, especially as their relative valuations have reached a 20-year low. The materials sector also offers attractive relative value potential, with the bottoming out in manufacturing and the end of inventory reduction providing upside potential.

The UK stock market is often overlooked by investors. However, the outlook for the industry worldwide is improving, the earnings momentum of British companies is increasing, and the domestic economic environment is likely to become more favorable as inflation continues to fall. We have therefore upgraded British stocks to most preferred and believe that now is the time to consider additional engagement here. The improving global industrial economy should enhance the environment for companies in the oil and industrial metals sectors, which have a significant weight in the UK market.

The broad-based global improvement in the economic environment is important because the FTSE 100 has a high level of international engagement (over three-quarters of revenues are generated abroad). We expect corporate profits to recover after a decline of 11% in 2023, with an increase projected for this year. Following the recent rise in oil and copper prices, we have raised our forecast for earnings growth in 2024 from 2% to 4%. We anticipate a further acceleration to 7% in 2025, driven by higher profits from commodity companies and banks. Moreover, the declining inflation should allow the Bank of England to start easing monetary policy later this year, likely from August. Lower interest rates should benefit stock valuations, which we believe are likely to recover from their currently low levels. Currently, the price-to-earnings ratio of the FTSE 100 based on expected earnings stands at 11x, compared to the long-term average of 12.8x.

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