Europe's Edge in 2026: Moats, Momentum and Mispricing

Xtrackers by DWS × STOXX

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Foreword

Europe is both a unified, powerful consumer market and a patchwork of languages, cultures, and regulations that makes it hard for many investors to view it as one equity universe. But it is also home to many globally recognised companies with distinct competitive strengths across countries and sectors.

In its 2025 flagship report **Gateway to Europe**, the DWS CIO Office argued that the region is entering a fundamentally different phase. After years of anaemic growth and fiscal restraint, evidence throughout 2025 has steadily mounted that a structural pivot is indeed underway.

These developments are beginning to also reshape how investors think about Europe. Capturing these dynamics effectively will require new approaches. This paper aims to guide investors through the transition from broad, benchmark-driven allocations to more targeted strategies. We frame the opportunity through three lenses: where Europe leads, where it grows, and where it may surprise.

Olivier Souliac
Head of Indexing at Xtrackers

European equity markets have lagged behind US and global indices in recent years amid a subdued economic backdrop and slow corporate momentum. Low valuations have been the region's perennial appeal, yet these can only translate into financial performance when unlocked by clear and credible catalysts.

This report offers an in-depth exploration of Europe's idiosyncratic strengths through a distinctive analysis of corporate positioning and long-term potential. It argues that despite widespread skepticism, the region remains home to a broad universe of industry leaders and "growers" – companies with durable competitive advantages relative to global peers.

For index-based investors, these dynamics present significant opportunities. Advances in index design now allow for a rules-based, systematic capture of more granular exposures.

Our partnership with DWS reflects a shared conviction that such nuanced approaches to portfolio construction can enhance outcomes. We hope readers find the insights that follow as informative and thought-provoking as we have.

Arun Singhal
Global Head of Product Management & Client Success at STOXX

Executive Summary

- Equity investor sentiment towards Europe has remained cautious, partly because traditional broad allocation options do not fully capture the evolving and policy-driven opportunities.
- A systematic screening indicates Europe's fundamentals are stronger than its reputation suggests and thereby provides a starting point for innovative portfolio construction.
- Europe offers a resilient bench of global leaders with defensible moats, for example in healthcare and luxury, alongside renewed momentum across sectors and countries.
- Valuation remains Europe's trump card. While not uniformly cheap, the potential for rerating may offer an additional return driver for 2026.

Europe's place in the investment world

To understand where Europe is heading, it helps to consider where it has been. For much of the past decade, the region occupied an awkward middle ground: it neither delivered the return profile of U.S. equities nor offered the diversification benefits associated with emerging markets. As a result, even domestic investors allowed their home bias to erode, leaving Europe under-allocated, under-valued, and largely overlooked in global portfolios.

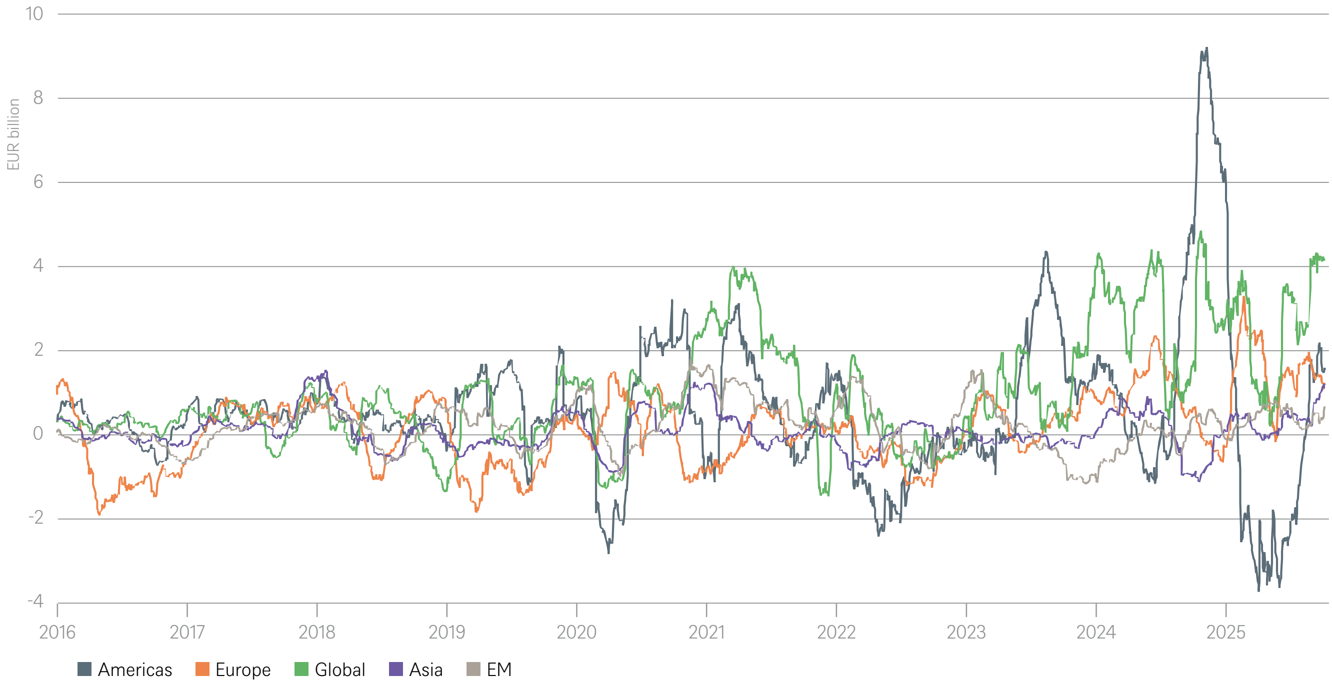
Under-allocated
In early 2025, optimism about Europe's prospects resurfaced as investors reassessed U.S. regional exposure amid lasting concentration concerns and tariff-induced performance fears, fuelling talk of a "European comeback". In reality, the impact of this episode on global equity benchmarks was negligible. Even at the peak of Europe's relative outperformance, the U.S. exposure had declined by just two percentage points in global equity indices, in favour of Europe and other regions. This underscores the inertia embedded in market-cap-weighted indices, which continue to dictate the bulk of strategic allocations. While European equity UCITS ETFs attracted approximately €400bn in net new assets in 2025, the reallocation remains tentative and has already seen reversals following the risk rally in U.S. markets during the second half of 2025[1]. Hence, it seems that a prolonged period of European outperformance is required for Europe's share in global equity allocations to rise meaningfully above its current weight of approximately 20%.

Under-valued
Europe continues to trade at a substantial valuation discount to the United States of around 35%. Forward price-to-earnings ratios for European equity indices hover near 15x, compared with roughly 22x for U.S. benchmarks. At first glance, this gap might appear to reflect sector composition differences. However, that explanation falls short. Even after adjusting for Europe's lower technology weight and higher exposure to Financials and Industrials, the U.S. market would still command a premium. The premium also holds up when market capitalisation is stripped out and equal-weighted sector indices are compared. For index investors, this is more than an academic observation as it underscores that Europe's discount is neither a short-lived anomaly nor a quirk of index construction.

Overlooked
While Europe's policy reset is creating investable themes such as defence, digital infrastructure, and the green transition, the investment ecosystem has struggled to keep pace. Unlike global or U.S.

[1] Source: ETF Book, DWS calculations, as of December 2025

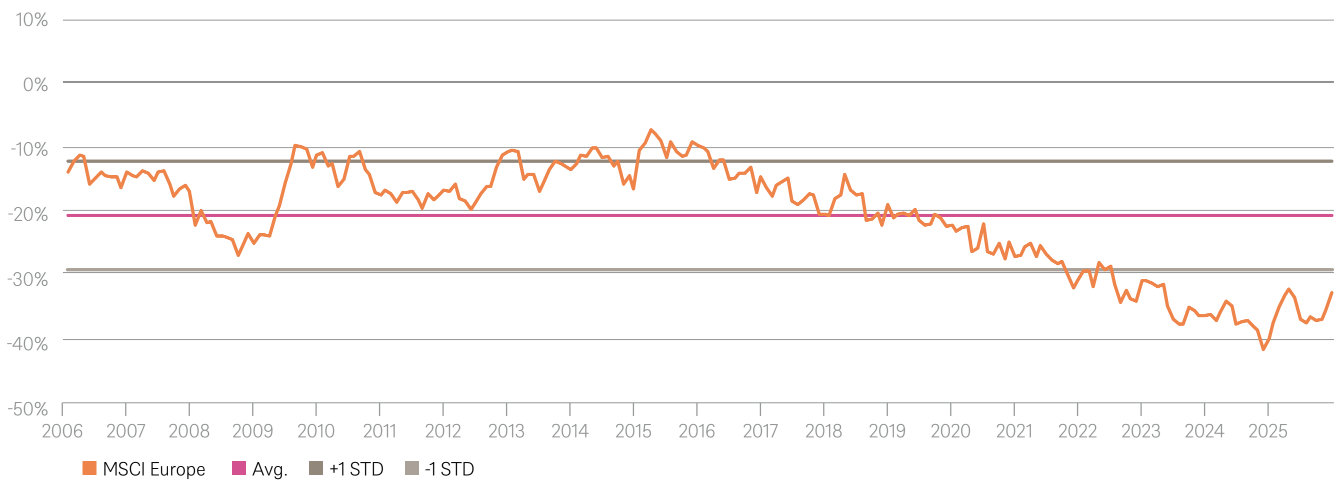
Figure 1: 90 day rolling flow in UCITS ETF by region



Source: DWS International GmbH, ETF Book, as of December 2025

equities, where index-based investors have access to a broad range of tools, Europe's landscape remains underdeveloped in terms of index breadth and specificity. Defence in 2025 illustrated this gap: in the absence of established index solutions, index investing allocations lagged the rapid repositioning of European governments on this topic. Overlooking growth drivers that are (initially) underrepresented in broad benchmarks therefore remains a key risk – and should serve as a motivation to establish index-based access beyond today's dominant themes.

Figure 2: U.S.-Europe valuation gap - Price to 12M Forward Earnings Ratio



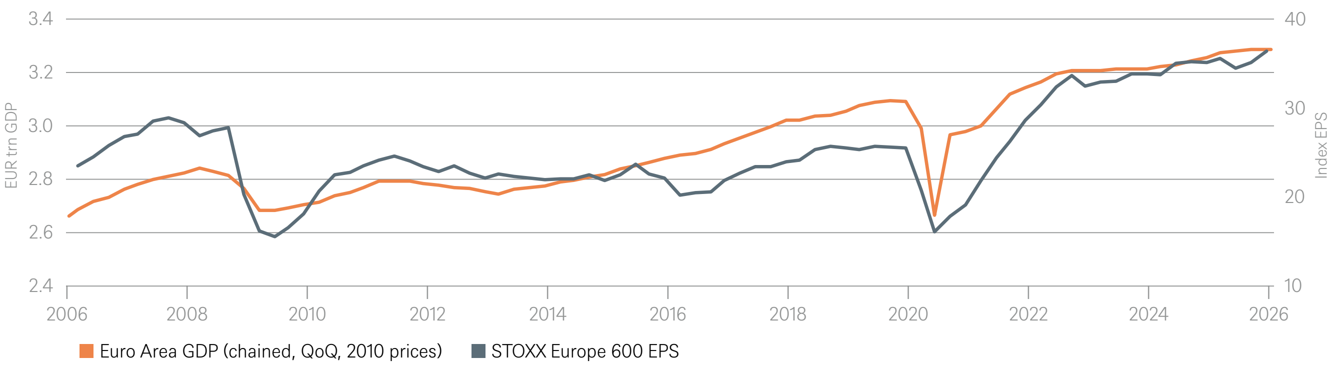
Source: DWS International GmbH, Bloomberg, as of December 2025

The road ahead for Europe

Europe heads into 2026 with a more constructive backdrop. Eurozone PMIs have stabilised around 50 and growth looks more attainable. Backed by sizeable fiscal outlays in infrastructure and defence, Germany is expected to re-ignite its growth and, for the first time in over a decade, outpace the broader Eurozone in 2026. Meanwhile, core inflation is projected to remain close to the ECB's target, at approximately 2.1% for 2025 and 2.0% for 2026[2].

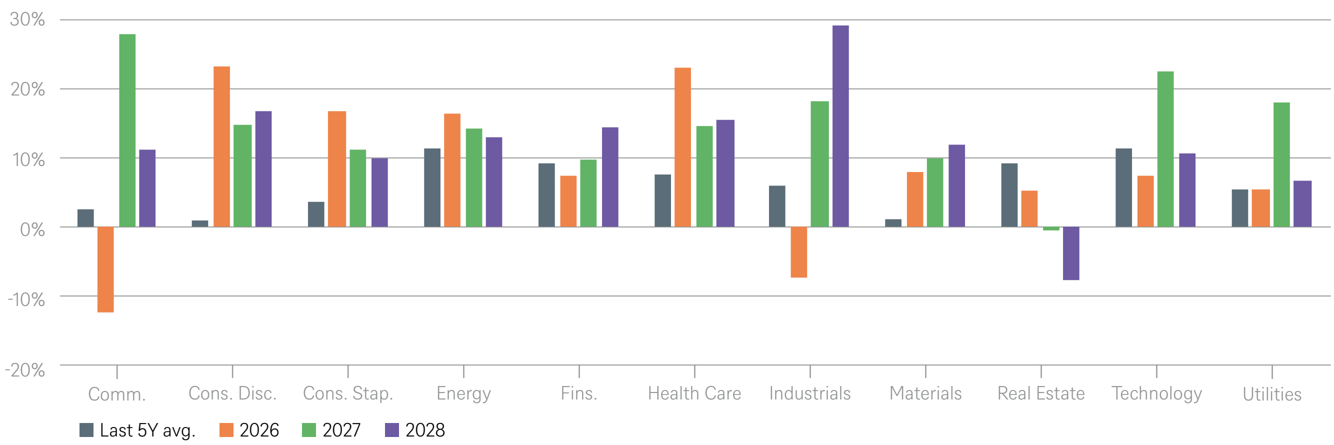
Historically, European equity earnings have shown meaningful sensitivity to such growth dynamics (Figure 3). While elasticities vary by cycle, a one percentage point improvement in Eurozone GDP has typically been accompanied by mid-single-digit EPS gains for broad European benchmarks. Reflecting this historical relationship, markets currently anticipate a sustained, multi-year expansion in European equity earnings (Figure 4).

Figure 3: Euro Area GDP Growth and EPS Growth



Source: DWS International GmbH, Bloomberg, as of December 2025

Figure 4: European sector EPS growth forecasts



Source: Bloomberg consensus estimates, as of 31/12/2025. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect.

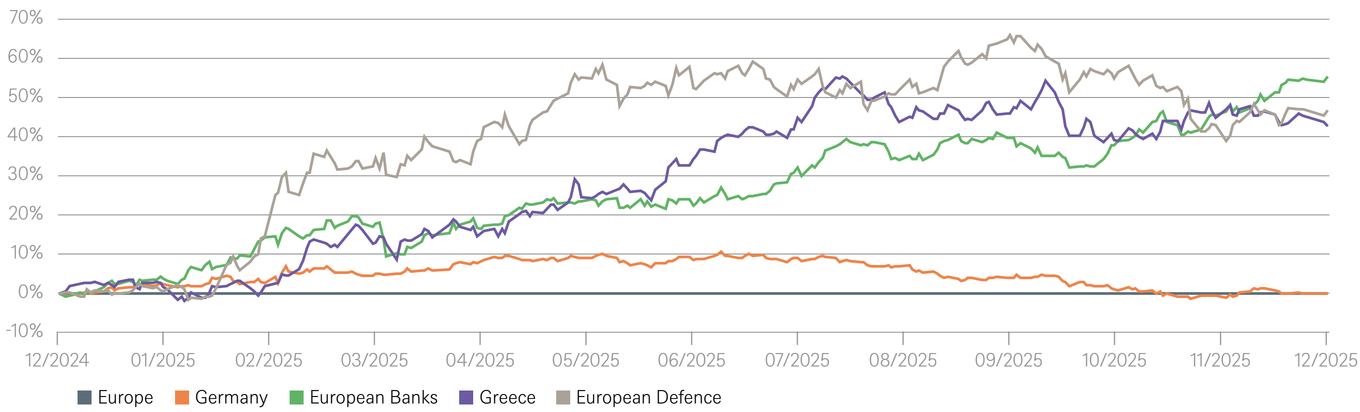
[2] Source: Bloomberg consensus estimates, as of 31/12/2025. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect.

This evolving environment has also established a couple of new performance trends across Europe;

- Defence has become a mainstream theme: Rising budget commitments across Europe and clearer procurement pipelines have propelled defence-linked equities to the top of the performance tables (+66%) in 2025[3]. Investor allocations have also surged, making defence the largest thematic category in the European market (+EUR 4bn net new allocations[4]).
- Rebound in Financials, Utilities, and Telecoms: Banks (+75% in 2025) have benefited from steeper yield curves, utilities from planned grid investment and resilience measures, and telecoms from accelerating digital infrastructure rollouts.
- European periphery outperforms the core: Markets in Greece (+61% in 2025), Italy (+36%), and Spain (+60%) have also delivered relative upside compared to core regions, with financials-heavy compositions amplifying existing trends.

For index investors, the 2025 episode serves as a timely reminder to look beyond broad, balanced indices. In the following section, we introduce three fundamental lenses to screen and identify opportunities in European equities.

Figure 5: Relative performance of selected indices vs. STOXX Europe 600 index in 2025



Source: DWS International GmbH, Bloomberg; as of December 2025. Past performance is not a reliable indicator of future performance.

How we measure

Our **Lead**, **Grow**, **Surprise** framework leverages a set of core fundamental metrics and reflects the growing trend of integrating fundamentals into index-investing strategies. Using the more than 10,000 constituents of the STOXX Total Market Index across large, mid, and small-cap companies and developed and emerging markets we construct comparisons between European companies and their global industry-group peers.

The central idea is straightforward: if European stocks within a given industry diverge from non-European peers on measures such as reinvestment, profitability, growth, and valuation, those relative differences are informative. They help identify where Europe is leading, where it is growing, and where the market may be mispricing fundamental realities.

[3] Source: All Bloomberg, DWS calculations using representative market capitalisation weighted indices.
[4] Source: ETF Book, DWS calculations, as of December 2025

"Lead" captures market dominance today. We measure leadership using RBICS business-line revenues[5], identifying companies that control at least 40% of global market share in their specific segment and are meaningfully ahead of the next-best competitor[6]. This precision provides a more accurate view of competitive positioning than broad sector groupings, though it also means a company may lead in a niche that does not (yet) move the needle for overall company earnings.

"Grow" is designed to be forward-looking. This category includes companies that have outperformed peers in earnings growth over the past three years, and where that growth is underpinned by reinvestment discipline and profitability[7]. These additional indicators matter because they signal both the capacity and the willingness to make the investments needed to sustain the current growth trajectory.

"Surprise" goes one step further by assessing the potential for a repricing. We flag companies that meet the **"Lead"** or **"Grow"** criteria but trade at a material valuation discount versus peers; we consider a 20% gap a meaningful threshold. If the market closes the discount (whether through improved growth sentiment, greater recognition of competitive moats, or a general shift in regional risk premia), this can become another performance leg.

Finally, we aggregate company-level signals to the industry, country, and index level, enabling investors to translate these insights into actionable strategies within the index-investing universe.

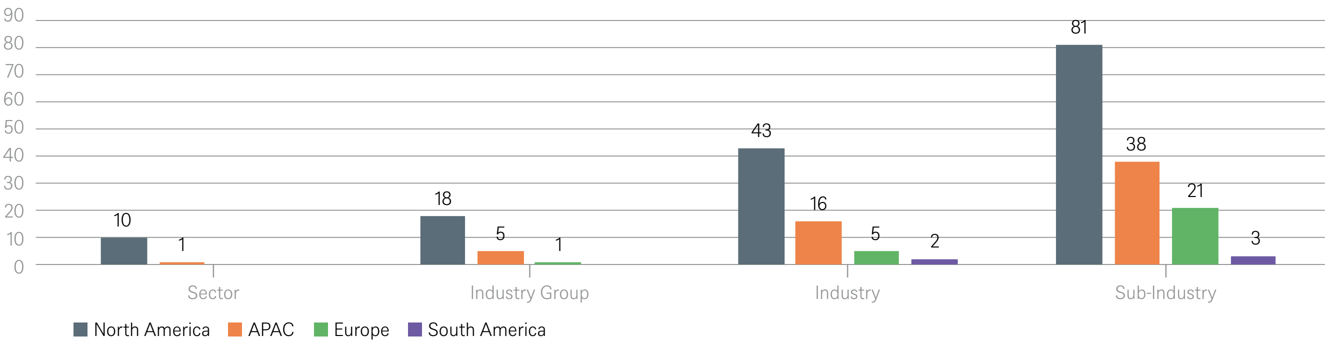
Where Europe Leads: Structural Moats and Market Leadership

We find that Europe's leadership base remains intact and, in many cases, underappreciated. Despite recurring narratives of decline, Europe continues to host a well-established set of global champions across multiple business lines – companies that benefit from structural moats built over decades through strong brands, intellectual property and gradual innovation.

One key ingredient in the current narrative is the growing tendency to equate scale, of which Europe has a lot less to offer, with market leadership. Size, however, is not synonymous with leadership. Market capitalisation may have become a proxy for dominance, yet true competitive moats are unevenly distributed even among mega-caps. Our framework shows that only six of the ten largest U.S. companies today meet the "Lead" criteria within their business lines. Capital market history also shows that most companies that once topped capitalisation-weighted indices eventually ceded their positions rather quickly. Europe's leaders may lack the sheer scale of their U.S. counterparts (the largest European stock is 1/18th the size of the largest U.S. stock) but they can still exhibit leadership in businesses that matter globally.

[5] RBICS Level 6 revenues refer to the most granular revenue breakdowns within FactSet's Revere Business Industry Classification System, identifying specific product/service-based industry segments from which a company earns money, allowing for precise analysis of revenue sources. [6] As sometimes concentrated oligopolies can be particularly harsh competitive environments. [7] Specifically we flag companies that have outpaced global industry peers on three year EPS growth and above peer capex to sales or superior (industry adjusted) profit margins.

Figure 6: Global sector dominance



Source: DWS International GmbH, Bloomberg; as of December 2025. Based dominant region by count of market leaders per industry

Table 1: Regional breakdown of "Leaders"

	"Leaders"	Number stocks	Relative frequency
Europe	71	1996	4%
North America	197	2543	8%
South America	7	282	2%
APAC	95	6790	1%
Africa	0	256	0%

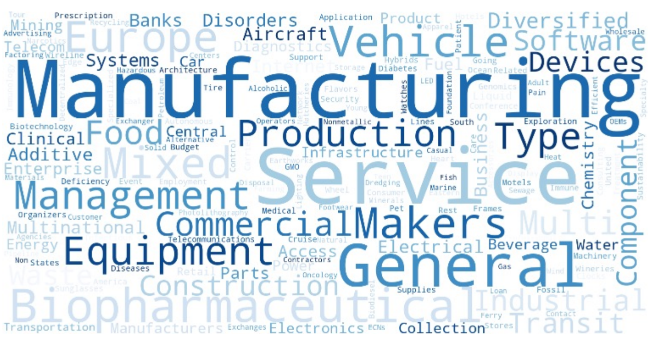
Source: DWS International GmbH, Bloomberg; as of December 2025. Past performance is not a reliable indicator of future performance.

Applying our leadership screening metrics to the STOXX Total Market Index reveals that 425 companies globally qualify as leaders within their respective niches. Nearly 200 of these are headquartered in the U.S. Asia-Pacific follows with 94, while Europe ranks third with 71 companies that dominate at least one business line. If we assess sectoral and industry leadership by count of market leaders across regions (Figure 7), it is unsurprising that U.S. players dominate most global sectors. However, Europe continues to hold meaningful positions in selected global industries.

Accessing these European companies may sound challenging, but existing index tools are far from impractical. Traditional capitalisation weighted indices in Europe already embed significant exposure to Europe's leaders. France and Switzerland, which hosts the largest number of European market leaders (18 and 8 respectively) alongside Europe's technology segment are good examples. In these indices, close to 50% of weight is allocated to leaders. Healthcare provides another clear leadership case: despite being less concentrated, roughly 60% of constituents qualify as global leaders, underscoring Europe's structural advantage in biopharma innovation. On closer inspection Europe retains clear strengths in several notable clusters;

- Healthcare & Biopharma: Leadership in immunology, diabetes and oncology devices underscores specialised innovation.

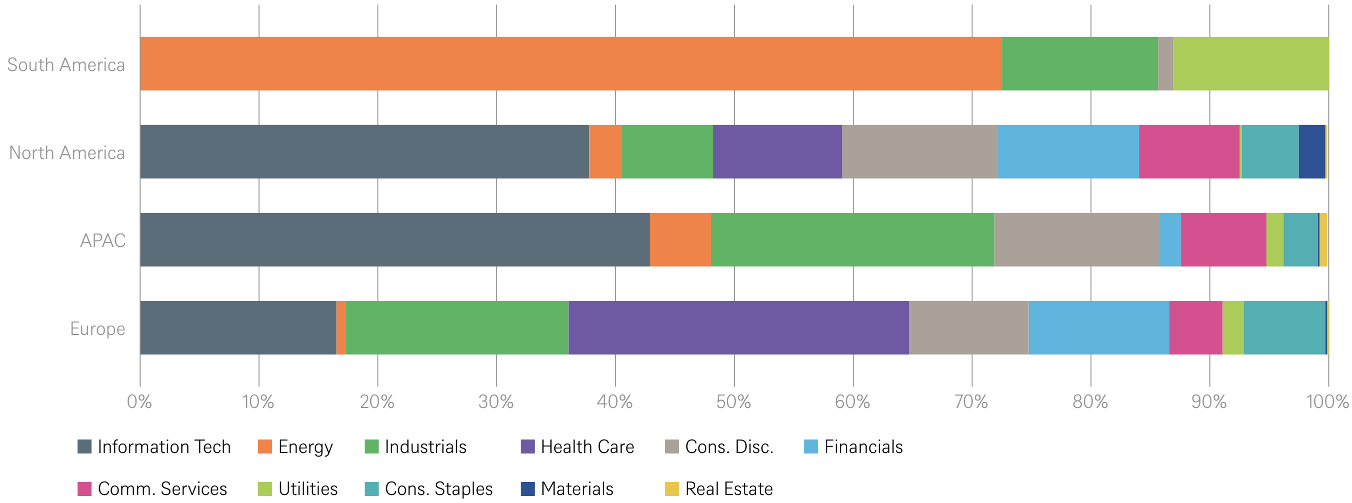
Figure 7: A word cloud of the 92 business lines in which the 71 European market leaders dominate global peers



- Industrials & Capital Goods: Europe leads in advanced machinery, automation systems, and precision engineering – core segments of capital goods that underpin global manufacturing.
- Luxury: Europe dominates high-end fashion, accessories, and premium goods with pricing power and global distribution.

Given the diversity of European leaders investors may also consider dedicated allocations. Bundled together, these companies exhibit a broader sector footprint than tech heavy U.S. and APAC leaders and offer a more defensive tilt, characterised by lower volatility and less momentum.

Figure 8: Factor Footprint of Market "Leaders" by Region



Source: DWS International GmbH, STOXX, based on market cap weighted portfolios. As of December 2025

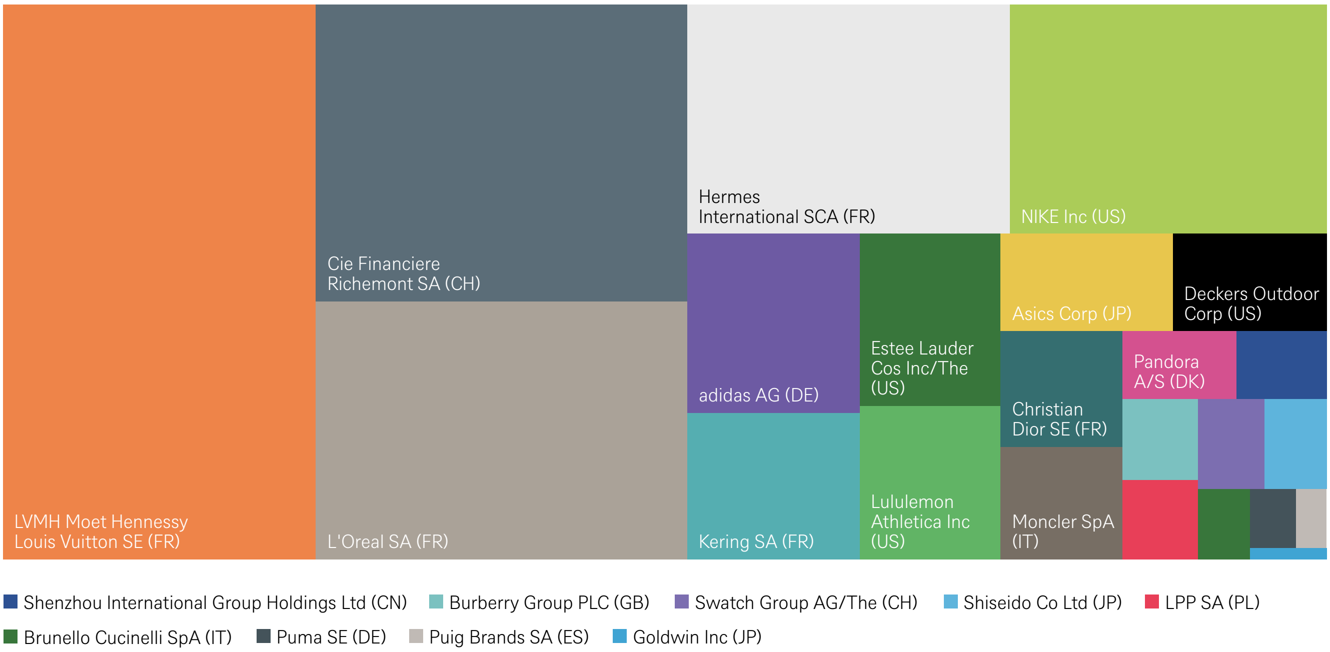
Deep Dive: European Leadership in the Luxury Goods sector

Few sectors illustrate European leadership as clearly as luxury goods. The ten most valuable luxury and premium brands worldwide are European[8], and the region accounts for 15 of the 24 ICB Personal Goods constituents within the STOXX Global 1800 Consumer Products and Services index.

Luxury brands are built on intangible assets (heritage, exclusivity, desirability) that are difficult to replicate and provide sustainable competitive advantages. This makes European luxury one of the few sectors that combines operating margins often exceeding 25–30% with diversified global reach. In some regards the sector even shares parallels with U.S. technology: both are defined by durable moats, both leverage global distribution networks, and both exhibit high margins with relatively capital-light economics. This positions luxury as one of the most distinctive leadership segments European investors can allocate to.

[8] Source: Brand Finance, Top 50 luxury & premium brands 2025 ranking

Figure 9: STOXX Global 1800 Personal Goods composition



Source: STOXX Ltd., using USD market capitalisations, as of December 2025

Where Europe Grows: New momentum

Beyond shoring up its existing leaders, Europe faces a more pressing question: how to regain relevance in sectors where its presence is thin. Growth sceptics have long pointed to structural shortcomings – IPO activity has slowed, unicorn creation lags other regions, and a coherent European growth story remained elusive. The numbers do little to soften this verdict. Over the past decade, European growth factor indices have lagged balanced benchmarks by roughly 80 basis points annually. Elsewhere, growth styles have outperformed – more than 200 basis points per year at the global level. This divergence marks the risk of applying a universal, style-based growth lens to Europe as a guide for allocations.

We would argue that an industry neutral, quality growth approach grounded in earnings growth paired with reinvestment discipline and profitability might be a more fitting lens to identify European growth. On this basis Europe also screens better than its reputation suggests. Roughly 15% of global "growth companies" originate in Europe, broadly consistent with the region's share of market leaders. Unlike conventional growth indices that are heavily skewed toward information technology and discretionary consumption, the sector neutral approach helps to identify distinct clusters of relative "Growers" across multiple industries. These include:

- Financial services: European banks have staged a notable comeback, supported by stronger balance sheets and improved profitability.
- Media and entertainment: Growth is driven by digital advertising and marketing networks.
- Telecommunications: Key drivers include integrated digital services on the back of fibre optics and 5G rollout as well as cloud and cybersecurity investment needs.

What differentiates Europe is once more its breadth and diversity. In APAC for example roughly half of the growers originate from just two sectors – consumer discretionary and information technology. In Europe, by contrast, the growth base is more diversified: communication services (~30 names) and financials (~27) comprise the largest cohorts. At the country level, Poland stands out with 17 growers, the highest in Europe and illustrates how robust domestic growth can translate into equity markets. Italy and Denmark also screen with sizeable cohorts. The U.S. market features relatively fewer growers, not only because earnings have been on a higher level for longer but also because screens on reinvestment activity are a higher bar for larger companies.

This means that Europe's "growth problem" is as much a measurement problem as a fundamental one. When growth is also defined by reinvestment discipline and durability, Europe already today presents a broader and resilient opportunity than is commonly assumed.

Figure 10: A word cloud of the 109 business lines in which European companies lead global peers on growth metrics

While traditional allocations building blocks along sectors and countries remain a sound starting point, going forward investors may want to build on these foundations by prioritising sector-neutral, quality-growth screens. This way Europe's relative growers may offer a path to achieving earnings expansion, without overpaying or concentrating risk in select sectors.

Table 2: Regional breakdown of "Growers"

	"Growers"	Number stocks	Relative frequency
Europe	109	1996	5%
North America	82	2543	3%
South America	13	282	5%
APAC	426	6790	6%
Africa	40	256	16%

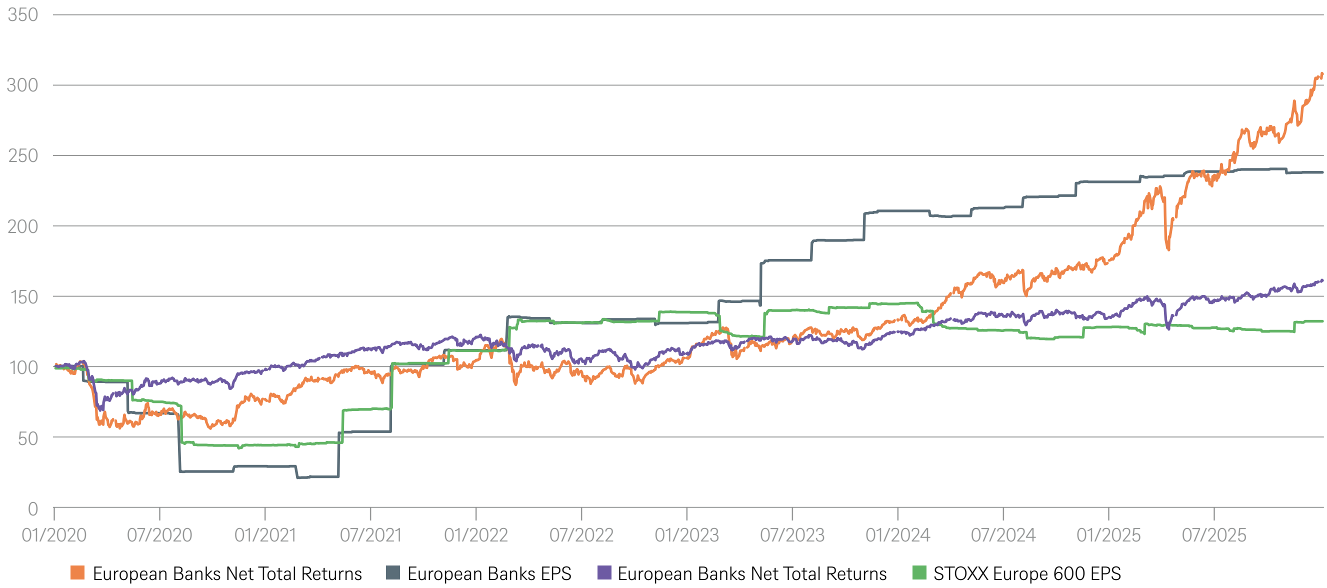
Source: DWS International GmbH, Bloomberg; as of December 2025. Past performance is not a reliable indicator of future performance.

Deep Dive: Growth in European Banks

European bank stocks surged 53% in 2025, marking the sector's strongest annual performance since 1997. On closer examination, momentum has been building for years following structural adjustments. Across one-, three-, and five-year horizons, banks have now outperformed every other European industry group, with valuations more than tripling since 2020.

A key driver behind this has been the return of earnings growth. Years of capital strengthening and consolidation have improved fundamentals. At the same time, steeper yield curves enabled greater pass-through of net interest income than investors had come to expect from the sector. In 2025, banks delivered the highest rate of positive earnings surprises across European industries. Beyond the sector's equity comeback, investors may also recognise the strategic benefit of a healthy banking system for the region's financial independence and resilience.

Figure 11: European Banks indexed performance and earnings growth



Source: DWS International GmbH, Bloomberg; as of December 2025. Past performance is not a reliable indicator of future performance.

Where Europe Surprises: When Mispricing corrects

Our final cohort comprises companies with leadership or growth characteristics, but where valuations could become a significant additional driver of returns. Globally Europe may still appear inexpensive, yet in 2025 several sectors have not only started to outperform but have also moved higher on the valuation spectrum. As investor sentiment towards Europe turns more constructive, maintaining valuation discipline is therefore a prudent exercise.

Figure 12: Value and momentum in European equity indices

Source: DWS International GmbH, Bloomberg. As of December 2025. Past Performance is not a reliable indicator of future performance.

However, as of early 2026, we find that the potential for rerating remains substantial. As outlined earlier, we apply a straightforward valuation screen to our grower and leader cohorts, identifying those that are relatively inexpensive while still demonstrating strong leadership or growth characteristics versus their global peers.

Europe delivered more than 100 such "Surprisers", suggesting that consensus expectations remain conservative. In fact, more than half of the European leaders and growers trade at a notable discount compared to peers in other regions.

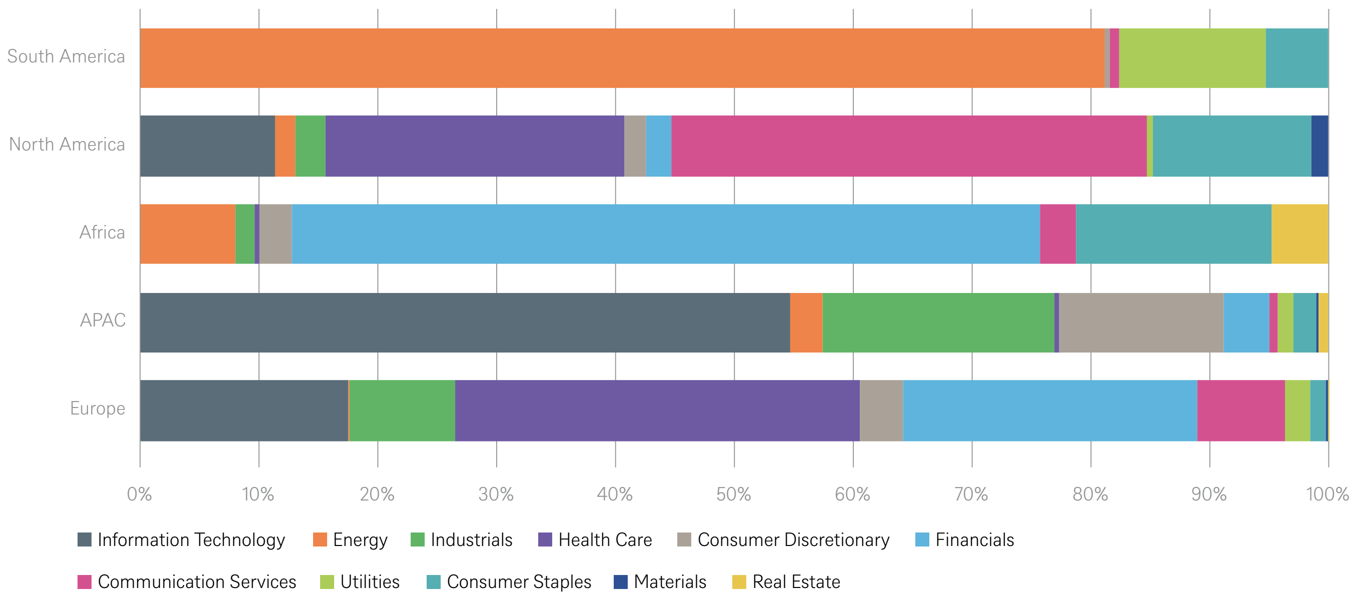
Consistent with previous observations, Europe stands out by offering these potential surprisers across all major industries, whereas other regions are naturally more concentrated in specific segments. This breadth provides confidence in allocating to Europe: the margin for error remains considerably larger than in many other regions, even when maintaining a broad exposure.

Table 2: Regional breakdown of "Surprisers"

	"Surprise"	Number stocks	Relative frequency
Europe	101	1996	5%
North America	99	2543	4%
South America	15	282	5%
APAC	302	6790	4%
Africa	33	256	13%

Source: DWS International GmbH, Bloomberg; as of December 2025. Past performance is not a reliable indicator of future performance.

Figure 13: Sector breakdown of "Surprisers"



Source: DWS International GmbH, STOXX, based on market cap weighted portfolios. As of December 2025

Scorecarding Europe

Our analysis identifies three cohorts – leaders, growers and surprises - that help sharpen the lens on Europe's evolving equity story. Our findings also map to existing allocation approaches where country and sector exposures remain the key building blocks. To highlight the overlap with this implementation approach, we present constituent counts and market cap weights for these cohorts across countries, sectors and industry groups.

Figure 14: Cohort exposure across countries, sectors and industry groups

Country	"Lead" Count	Weight (%)	"Grow" Count	Weight (%)	"Surprise" Count	Weight (%)
Denmark	3	41.18	3	41.2	4	42.22
Romania	0	0	5	53.21	2	35.38
Netherlands	3	35.62	1	2.13	2	35.07
Poland	3	9.56	17	28.42	13	28.06
Lithuania	0	0	5	20.07	5	20.07
Spain	3	30.15	3	2.69	1	19.68
France	18	47.43	7	3.08	13	17.97
Italy	1	0.58	5	16.21	3	15.67
Norway	2	2.45	13	18.19	10	13.34
Switzerland	8	46.35	5	5.92	2	12.38
Germany	11	27.26	6	1.03	10	11.58
Finland	2	11.18	6	5.27	5	10.06
Austria	2	14.65	3	1.73	3	6.79
UK	12	12.59	9	1.77	11	4.89
Sweden	1	1.58	7	2.79	7	4.08
Belgium	1	2.31	3	1.15	3	3.38

Sector	"Lead" Count	Weight (%)	"Grow" Count	Weight (%)	"Surprise" Count	Weight (%)
Health Care	13	58.2	9	10.2	8	36.5
Information Technology	4	63.4	3	0.3	6	35.3
Communication Services	5	32.7	30	27.6	14	28.0
Financials	4	12.7	27	7.8	26	14.0
Utilities	3	10.6	2	0.2	3	7.0
Industrials	18	24.7	8	0.4	13	6.1
Consumer Discretionary	13	30.2	11	10.3	14	5.7
Consumer Staples	4	20.0	12	2.1	10	2.0

Sector	"Lead" Count	Weight (%)	"Grow" Count	Weight (%)	"Surprise" Count	Weight (%)
Real Estate	1	1.7	4	0.9	3	0.7
Materials	2	0.6	0	0.0	1	0.6
Energy	4	4.6	3	0.6	3	0.3

Sector	"Lead" Count	Weight (%)	"Grow" Count	Weight (%)	"Surprise" Count	Weight (%)
Semiconductors	1	71.0	0	0.0	1	71.0
Pharmaceuticals, Biotechnology	9	61.8	9	12.4	7	43.8
Telecommunication Services	3	42.3	17	29.2	8	37.8
Banks	3	21.6	21	14.5	21	23.6
Technology Hardware & Equipment	1	14.6	3	2.1	4	16.7
Automobiles & Components	4	20.8	3	3.6	5	13.9
Consumer Services	4	7.7	4	8.4	6	12.1
Capital Goods	15	29.9	3	0.1	10	7.1
Utilities	3	10.6	2	0.2	3	7.0
Financial Services	1	6.6	4	0.5	3	7.0
Software & Services	2	73.1	0	0.0	1	5.9
Media & Entertainment	2	10.6	13	24.1	6	5.5
Consumer Staples Distribution	0	0.0	2	5.3	2	5.3
Household & Personal Products	0	0.0	3	4.4	3	4.4
Health Care Equipment & Service	4	41.5	0	0.0	1	3.2
Commercial & Professional Service	2	3.1	1	1.5	2	3.0
Consumer Durables & Apparel	2	48.0	3	19.5	2	1.2
Insurance	0	0.0	2	0.7	2	0.7
Real Estate Management & Devel	1	1.7	4	0.9	3	0.7
Materials	2	0.6	0	0.0	1	0.6
Energy	4	4.6	3	0.6	3	0.3
Food, Beverage & Tobacco	4	33.0	7	0.5	5	0.3
Consumer Discretionary Distribution	3	24.5	1	0.3	1	0.3
Transportation	1	0.2	4	1.5	1	0.0

Disclaimer