

Europe's revival



Europe's economic prospects are improving at a time when the US is facing mounting challenges. This can only brighten the long-term outlook for European equity and private asset markets.

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1

A European renewal



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Europe’s long-term economic prospects are suddenly much brighter than they have been for decades. Kick-started by Germany’s decision to loosen its fiscal fetters, a number of other stars are also aligning, in the form of euro zone-wide public investment and structural reform (see FIGURE 1).

Whether these programmes are implemented quickly or more gradually, the overall effect will be a very significant boost to the European economy in both the short and long term.

We forecast that the pace at which the euro zone economy grows over the coming few years will more than double, while longer term, trend growth will jump to some 1.5% from 1.1%.

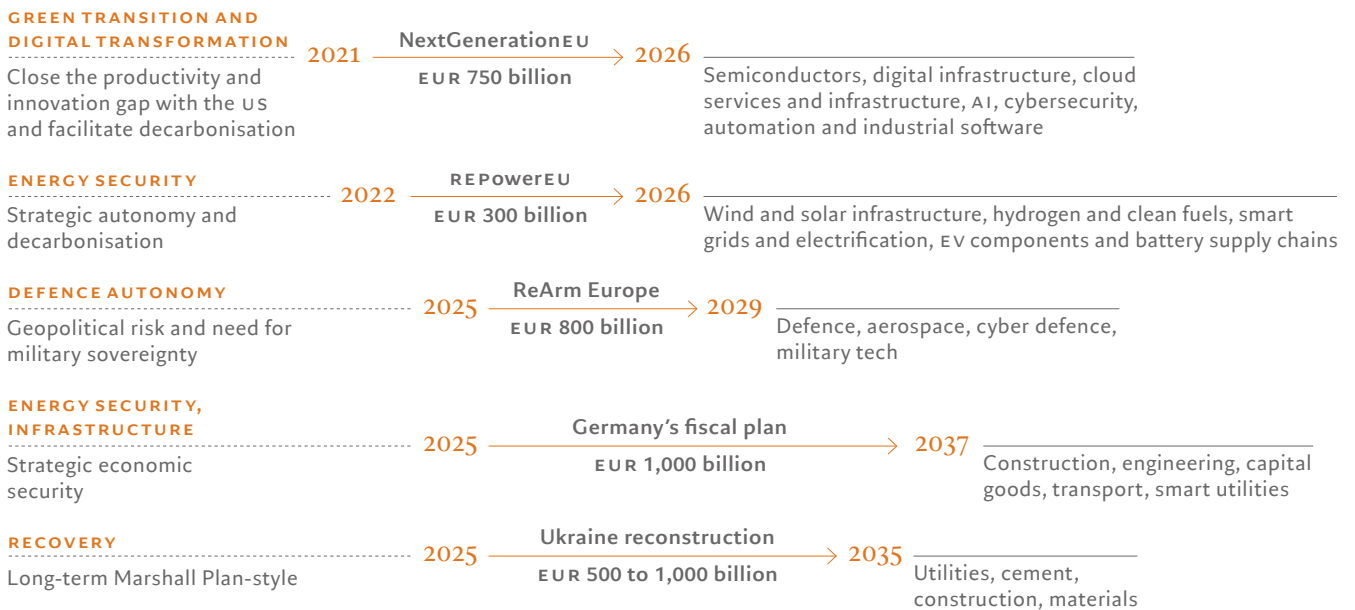
Some of these drivers are internal – such as more realistic approaches to energy policy and a new determination to address structural weaknesses, for example, through investment in infrastructure or capital market reforms. Tech investment in particular will provide a significant boost to productivity, which has long lagged behind the US’s.

But there are also external pressures forcing change. President Donald Trump’s “America First” agenda has been instrumental in incentivising European countries to become more independent in a number of areas, particularly defence, trade, geopolitics, energy and technological development.

FIGURE 1

Spending timeline

European macroeconomic objectives, policy tools and sectoral impacts



Source: Pictet Asset Management, European Commission, German Ministry of Finance. Data/projections as at 03.07.2025.

Just as Trump's policies have forced European governments to ratchet up their defence spending and boost domestic growth – for example, by investing more in infrastructure – they have also stirred up debate about how to improve productivity such as through the development and adoption of cutting-edge technologies and make it easier for the region's businesses to access capital.

The result of these internal and external forces will be larger fiscal deficits and the simultaneous removal of barriers to trade and growth within the bloc.

Another big step forward will be the deregulation of capital markets. Removing both the obstacles that limit the flow of savings between EU countries and the regulations that increase the cost of capital to companies will be essential to boosting productivity.

At the same time, the EU is having to take a more independent position in foreign relations, most visibly in its support for Ukraine in the war against Russia.

An overhaul of this scale will redraw the investment landscape.

As the US turns increasingly inward, a faster-growing European economy will make the region more attractive to investors. This could well enable the euro to take an ever bigger role as a reserve currency and medium for global transactions, while at the same time fuelling growth in Europe's equities and private assets markets.

GERMANY LOOSENS THE PURSE STRINGS

Recent visitors to Germany will have been unpleasantly surprised at the degree to which the country's infrastructure has been allowed to crumble. Since the mid-1990s, Germany's infrastructure spending as a share of GDP was among the lowest across developed countries, at around two-thirds of the average.

Trains frequently run late because of line faults. The once famed autobahns are second rate to Poland's new motorways. Big projects – airports, rail stations, cultural venues – suffer long delays and significant overruns.

That's now about to be reversed with the lifting of budget constraints and official promises of major spending programmes – we project the total could reach EUR 1 trillion in additional expenditure between now and 2037. For instance, defence spending over 1% of GDP is exempted from Germany's debt brake – the constitutional rule that severely restricts government borrowing. At the same time, the infrastructure programme will be further supported by additional spending from German states as they are now allowed to run their own deficits of up to 0.35% of GDP, having previously been required to maintain budget balance.

Eurozone trend growth to rise to

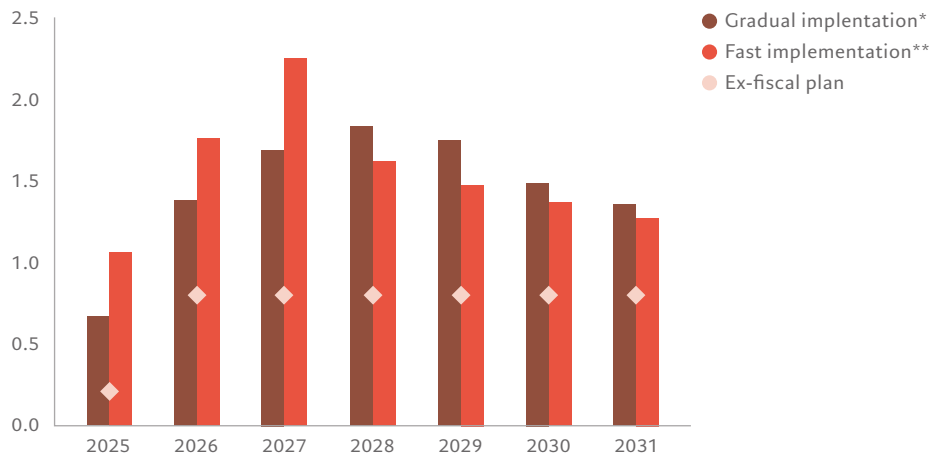
1.5%

from 1.1%.

Source: Pictet Asset Management, CEIC, Refinitiv

FIGURE 2
German kick-start

German real GDP growth trajectory 2025-32, %, under different public spending assumptions



*German defence spending increases from 1.2% of GDP to 3.5% in 2029; infrastructure spending peaks at EUR 40 billion in 2027; and German states' structural deficit increases by 0.35% of GDP, with a gradual increase of the fiscal multiplier from 0.3 to 1. **German defence spending increases from 1.2% of GDP to 3.5% in 2027; infrastructure spending peaks at EUR 80 billion in 2027; and German states' structural deficit increases by 0.35% of GDP, with a gradual increase of the fiscal multiplier from 0.3 to 1.

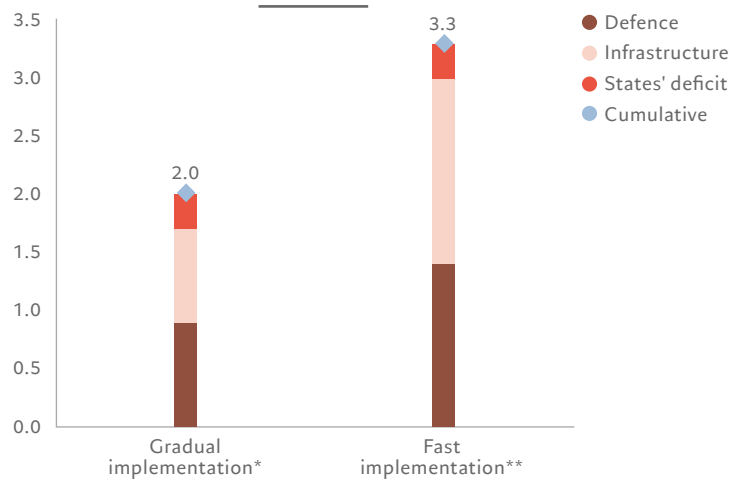
Source: Pictet Asset Management, CEIC, Refinitiv. Forecasts as at 03.07.2025.

We assume this fiscal agenda will run in one of two directions: that spending follows a maximalist, front-loaded approach; or that the sums are more moderate and smoothed out over a longer period. In the first scenario, we see spending rising from EUR 40 billion in 2025 to EUR 80 billion in 2027, with a total of EUR 340 billion spent by the end of 2030. In the second, it's a rise from EUR 13 billion in 2025 to EUR 40 billion in 2027, where it then plateaus, with EUR 200 billion spent by the end of 2030.

But that's not all of Germany's planned spending – a massive rearmament programme is also being implemented (see section Rearming and renewables). Whether rolled out gradually or rapidly, these programmes are set to have a significant impact on Germany's growth over the short and long term. Over the first few years, growth is expected to be significantly ramped up, but there will likely also be a step-change in Germany's trend growth rate (see FIGURES 2 and 3). Just as importantly, it would also boost euro zone growth (see FIGURE 4).

FIGURE 3
Adding up

Cumulative impact on German GDP growth 2025-27
by contributing factor, percentage points

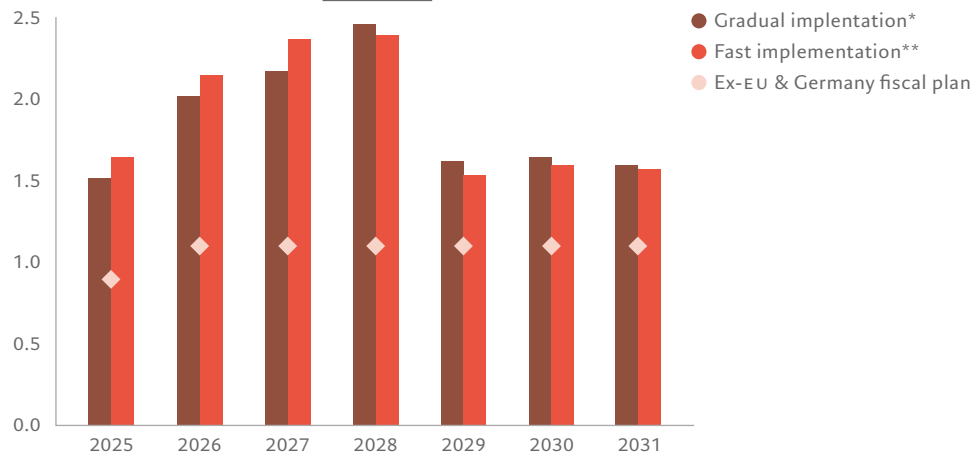


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To be sure, these plans could well bump into constraints. Some German observers question whether the construction industry has the capacity to meet all the infrastructure demands. Labour shortages are a clear risk, with poor demographics only likely to make it harder to find workers – even if this can be mitigated to some extent with initiatives to boost workforce skills and to include more women in male-dominated sectors. Decentralised governance complicates matters further – the German Länder (states) are powerful and will have their own agendas. And as with any agenda that spans many years, there is the risk of political reversal, particularly in light of the growing strength of Germany’s nationalist party, Alternative für Deutschland (AfD).

FIGURE 4
Step change

Euro zone real GDP growth trajectory 2025-35, %, under different public investment assumptions



For both gradual and fast: 75% EU participation in the EUR 500 billion Ukraine reconstruction, benefiting European companies with 50% of the funding; 4.5% of GDP in euro zone defence spending by 2028, with a gradual impact on growth; NextGenerationEU remaining disbursements by 2026 extended to 2028, with a gradual decrease of the fiscal multiplier from 0.7 to 0.3. *German defence spending increases from 1.2% of GDP to 3.5% in 2029; infrastructure spending peaks at EUR 40 billion in 2027; German states’ structural deficit increases by 0.35% of GDP, with a gradual increase of the fiscal multiplier from 0.3 to 1. **German defence spending increases from 1.2% of GDP to 3.5% in 2027; infrastructure spending peaks at EUR 80 billion in 2027; and German states’ structural deficit increases by 0.35% of GDP, with a gradual increase of the fiscal multiplier from 0.3 to 1.

Source: Pictet Asset Management, CEIC, Refinitiv. Forecasts as at 03.07.2025.

REARMING AND RENEWABLES

The Ukraine war and pressure from the US are prompting NATO's European member states to take more responsibility for their own defence. A number of countries have consistently allocated significantly less than NATO's guideline of 2% of GDP to defence spending. Germany now aims to boost its spending to 3.5% of GDP, though the pace of this rise is yet to be determined.

We offer two sets of forecasts on the effects of increased German defence expenditure, one based on spending being ramped up quickly and the other based on a gradualist approach. In the first scenario, German defence spending jumps from 2.0% of GDP in 2025 to 3.5% in 2027, where it levels off. In the second, it rises from 1.7% in 2025 but only reaches 3.5% in 2029.

Other countries are expected to follow in Germany's footsteps. We estimate that European governments overall will spend a total of EUR 800 billion during the coming four years on defence, aerospace, cyber defence and military technology.

Europe is also rolling out a stimulus package to develop green technologies, boost digital transition and ensure energy security through diminished dependence on fossil fuels in a multi-year programme running from 2021 to 2026 and with an investment pot of EUR 750 billion.

Some EUR 300 billion of that has been earmarked for boosting energy security and decarbonisation. This will include building up wind and solar infrastructure, subsidising the development of hydrogen and other clean fuels, expanding smart grids and electrification as well as developing electric vehicle components and battery supply chains.

THE EUROPEAN GROWTH STORY

The various spending programmes already underway or being lined up across Europe will undoubtedly have a significant impact on its economies. How much of an impact, however, will depend on their scale and speed. We also expect there to be a lag in the degree to which this spending flows to the economy. In part that's because a substantial amount of the extra defence budget will have to be spent outside Europe until the European defence industry has been built up. As a result, our fiscal multiplier – the degree to which fiscal spending translates into GDP growth – starts at 0.3 and then climbs to 1 over the forecast period as the domestic defence industry expands to fulfil ever more of the military's demands.

Germany's strong fiscal position and negative output gap mean that its high-multiplier spending (on infrastructure, defence and energy) will encourage private capital and boost medium- and long-term growth.

Europe has a
5%
investment gap
with the US.
Source: "The Future of European
Competitiveness", Mario Draghi,
2024

Fast and full implementation of Germany's fiscal plan, together with its increased defence spending and the decision to allow German states to run deficits of 0.35% of GDP, will have a significant impact on German growth, even without considering spending measures being taken elsewhere across Europe. 2025 GDP growth will rise 0.9 percentage points to 1.1%, for 2026 it will go up a full percentage point to 1.8% relative to where it would have been otherwise; for 2027, the peak year, it will go up 1.5 percentage points to 2.3%, before then trailing off. Ultimately, it will boost trend German growth by 0.3 percentage points to 1.1%.

Overall, EU-wide fiscal expansion that's focused on productive investment enhances Europe's growth outlook, offsetting global trade tensions and a shift in industrial policy. Germany's fiscal plan, together with increased defence spending across the single currency region, remaining NextGenerationEU disbursements and a Ukraine reconstruction package, is expected to lift euro zone growth in 2025 by 0.7 percentage points to 1.6%, by a full point in 2026 to 2.1% and by 1.3 percentage points in 2028 to 2.4%, before starting to trail off. Over the longer term, we expect the fiscal measures to lift trend growth in the single currency region by 0.4 percentage points to 1.5% (see FIGURE 4).

Deep-rooted capital market and labour market reforms would add even further to growth, while debt mutualisation would ensure a much more resilient economic structure.

CAPITAL MARKETS REFORM

For the waves of European government largesse planned for the coming years to have full effect, the continent's capital markets will need reforming. As Malin Norberg, the Norwegian oil fund's CIO markets strategist, recently argued, the EU needs to harmonise its tax, insolvency and supervisory rules to avoid falling further behind the US.

For the waves of European government largesse planned for the coming years to have full effect, the continent's capital markets will need reforming.

In 2024, a report produced by Mario Draghi identified a 5% investment gap with the US as a result of underinvestment in digital, defence and climate infrastructure.

European productivity lags behind the US not so much because of lower investment levels but because capital is not deployed effectively, particularly in high-tech industries. Savings are misallocated, with most held in bank deposits and real estate rather than being invested in high-growth sectors. That effect is compounded by fragmentation of the single currency region's telecoms and energy markets.

With 80% of productive investment coming from the private sector, according to the Draghi report, it is essential to mobilise private capital for the region's strategic initiatives. Even though the single currency region generates EUR 1 trillion in annual savings, only a fraction is invested domestically, with some EUR 300-400 billion flowing to the US.

Getting this capital flowing to the right investments is a challenge. Some 80% of EU household savings are in banks that don't lend across borders, creating a home bias and preventing optimal capital allocation. Investors face 27 tax and regulatory regimes, high compliance costs and significant intra-EU trade barriers.

It's not enough to increase the size of the savings pools or lower costs. Deeper reform is needed to expand market size and reduce administrative burdens to boost expected returns and encourage investment.

While there are high hurdles to euro zone debt mutualisation, they're not insurmountable.

The EU Savings and Investments Union initiative launched in March 2025 aims to overcome some of these hurdles. Savings will be guided into long-term, equity-based products aligned with EU priorities.

Securitisation is to be boosted through simplified due diligence, lighter capital charges and standardisation. Pension reforms are designed to allow more allocation to equity and venture capital.

The EU's regulatory framework is to be strengthened to reduce regulatory fragmentation. Fiscal incentives will be put in place to encourage retail investment. And bureaucracy is to be consolidated to reduce the costs of cross-border investment.

More generally, successful reform of Europe's capital markets will necessitate cutting red tape and establishing a pan-EU insolvency and tax framework. And the bank-

ing union needs to be completed, while a common safe asset would be important for long-term investment stability.

Achieving this depth of reform would increase cross-border capital mobility, driving down borrowing costs and improving small and medium enterprises' access to finance. It would enable start-ups to achieve significant scale, accelerate digital transformation and the green transition as well as improve productivity and competitiveness across industries.

DEBT MUTUALISATION

More than anything, the European Union's feeble stance on tariff negotiations with the US highlighted the bloc's political weakness. That same weakness has stymied efforts to mutualise EU debt, which would represent a major step towards a more unified, resilient and sovereign Europe.

Debt mutualisation is necessary to stabilise the single currency region and prevent market fragmentation such as it saw during the European debt crisis of 2009. The euro is a shared currency, but fiscal policy remains national, making member countries with weaker public finances particularly prone to economic shocks. Debt mutualisation would spread debt risk and lower yields for more vulnerable members.

Such a step would push the euro zone towards a more closely bound federal system, like the US, allowing for easier transfer of resources across member states and enabling a more balanced mix between monetary and fiscal policy. And on the international stage, it would make it easier for the euro to be adopted as a major global reserve currency by creating a deep, liquid and safe asset backed by the region's fiscal capacity – as Treasury bonds are in the US.

So far, reluctance among the euro zone's strongest economies – particularly Germany, the Netherlands and Austria – has stymied efforts at debt mutualisation. That's not least because of fears of moral hazard among countries with weaker political control over fiscal policy. But there are also institutional barriers, such as the lack of a true fiscal authority, a common tax base and democratic legitimacy for collective fiscal decisions.

80%

of productive investment comes from the private sector.

Source: "The Future of European Competitiveness", Mario Draghi, 2024

The European Central Bank is permitted to invoke its Transmission Protection Instrument (TPI) – which allows the central bank to buy national sovereign debt to counter fragmentation (a step towards debt mutualisation) should yield spreads on a country's debt widen to an unwarranted degree, provided it respects EU fiscal rules.

But while there are high hurdles to euro zone debt mutualisation, they're not insurmountable. The EUR 750 billion NextGenerationEU package is temporary and limited, but it shows that common borrowing is both technically feasible and politically achievable.

Treaty changes could extend the European Stability Mechanism – which already has unused borrowing capacity – into something more than a crisis management tool. And there are also other proposals. One solution would be to pool national debt up to 60% of GDP into senior, jointly guaranteed bonds. Sovereign bond-backed securities could create senior and junior tranches from pools of national bonds, with the senior tranches becoming a safe asset, albeit without mutual guarantees. And then there's a proposal for a Euro Treasury with limited EU-level borrowing powers to pay for agreed common goods.

Temporary engineering has bridged the gap. But only shared architecture can deliver the resilience and scale Europe now needs.

LABOUR PRODUCTIVITY

For all the importance of debt mutualisation, the euro zone's future will hinge on economic growth. And the core driver of growth over the long term is labour productivity, which has historically been weak in the single currency region.

This weakness is down to several factors. Labour market rigidities caused by excess regulation reduce mobility and adaptability, and are disincentives to working longer hours. And this is compounded by the frequent failure by EU governments to recognise each other's professional qualifications, limiting EU-mobility.

Then there's underinvestment in digital and intangible capital. Compared to the US, European firms invest less in software, data and AI. Smaller firms have been slow to adopt digital technology, particularly in the region's south and east.

The US government is expected to persistently run deficits of around

6.5%

of GDP.
Source: Congressional Budget Office

Bureaucratic hurdles slow infrastructure development and digital roll-out, while there's a mismatch between education systems and the skills businesses need. Weak insolvency regimes create zombie firms, preventing the reallocation of capital and labour to where it would be more productively used.

There are efforts in place to solve some of these issues. The EU's Recovery and Resilience Facility is tied to structural reforms in labour markets, digitalisation and public administration. Industrial policies have been launched, such as the European Chips Act and the Green Deal Industrial Plan. AI regulation aims to boost strategic sectors.

The proposals aim to reduce structural disincentives to work by adjusting retirement ages, aligning work incentives through the tax and benefits system, and reassessing the number of public holidays. They're looking to improve labour and capital mobility by harmonising qualification recognition and expanding cross-border training, and by promoting venture capital and scaling-up financing to shift capital towards high-productivity sectors.

For example, France has included pension and unemployment insurance reforms in its national recovery and resilience facility plan to strengthen work incentives. Italy, meanwhile, is focused on modernising employment services, expanding vocational training and adjusting tax measures to increase labour market participation, particularly among women and youth.

REPOSITIONING EUROPE IN THE WORLD

Europe's renaissance is likely to come at a time when the US economy starts to look increasingly vulnerable.

The US government's persistently massive deficits – running at 6.5% to 7% of GDP – heighten inflation risk, weaken growth expectations, depress real rates and rely on the dollar's reserve currency status to finance rising debt.

Growth during recent years has been spurred by massive government deficits, but these are ultimately unsustainable – the US's credit rating was already cut in anticipation of Trump's Big Beautiful Bill. That's putting upward pressure on US bond yields and causing the dollar to weaken.

The US's vulnerability is exacerbated by an "America first" approach that is turning the US inward. Tariffs are not only a tax on US consumers but they threaten to hurt the country's growth potential by depressing trade. Inflation remains sticky and above the US Federal Reserve's target.

A steady loss of confidence in US leadership is already being seen in the simultaneous increase of US bond yields and weakening of the dollar.

By contrast, the euro zone has seen its currency and bond yields move higher thanks to the prospect of productive public investment – real interest rates are rising while the breakeven rate, which measures inflation expectations, has been falling.

Europe may lack a fiscal union yet its aggregate debt to GDP ratio remains well below that of the US, thanks to years of consolidation. Meanwhile, there has been convergence in bond yields across the continent, with spreads narrowing against Germany as concerns about credit risk across the euro zone's periphery decline.

The combined effect of reform measures that are both in motion and on the horizon will be stronger economic growth across Europe, not only over the short term thanks to the stimulus of fiscal spending but also over the long term due to higher productivity and thus potential growth.

**The combined effect
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across Europe.**

Ultimately, the result could well be that the euro plays a larger role as a reserve currency, becoming more of a rival to the US dollar. But the implications stretch far beyond that to affect the whole of the capital market. Even a modest shift from the US to Europe would have a beneficial effect on euro-denominated bonds, on the region's credit market more generally, on European equities and on European private assets.

There are many moving parts to Europe's various government programmes and while some have already been put in place, others are still in development. How quickly they are implemented, how they interact and what happens in the wider world are all complexities. But from what we know so far, Europe is set to gain strength over the coming years. Europe is likely to be on its way to an economic renaissance.

2

Investment implications

A stronger European economy is good news for the region's equity markets.

EQUITIES TO SHINE

In our view, Europe's stocks are poised for a significant re-rating thanks to the economic revival, reversing a quarter century of underperformance.

Euro zone equities are currently trading at a 37% discount to their peers on a 12-month price/earnings basis. Even adjusted for sector differences, the gap is 31%, which is comparable to levels observed during the global financial crisis in 2008-2009. We expect this disparity to narrow as European economic health improves, regulations and tax regimes become more business-friendly, and growth industries expand.

The single most important reason to believe that Europe's comeback is for real, after so many false dawns, is a dramatic loosening of fiscal policy from its largest economy. We believe Germany's fiscal turnaround, coupled with region-wide increases in public spending, create the economic conditions that could at the very least lead to a halving of the discount at which European stocks trade relative to their US counterparts. If the second-round effects of such investment exceed expectations, the gap could even close completely.

FIGURE 5
Equity returns driven by growth dynamics
 Europe vs US – growth and equity market performance differentials



Source: LSEG, MSCI, Pictet Asset Management.
 Data covering period 28.05.2002-20.06.2025.

Our analysis suggests that a percentage point of additional European GDP growth per annum should translate into around a 3 percentage point increase in corporate earnings growth from 2026 to 2028. An incremental earnings pickup of that magnitude, if sustained, should lead to multiple re-rating of about 10%. In other words, traction on the fiscal spending plans in and of itself should boost European equities by an additional 20% over the next three years.

We believe Germany's fiscal turnaround, coupled with region-wide increases in public spending, create the conditions that could at the very least lead to a halving of the discount at which European stocks trade relative to their US counterparts.

FOCUS ON INDUSTRY, DEFENCE AND BEYOND

Defence companies are clear winners, but we expect the positive impact on European equities to be much broader – not least because defence spending is among the most productivity-enhancing of all types of public expenditure.

We also see strong potential in cyclical sectors and in stocks with higher exposure to domestic revenues in areas such as industrials, infrastructure, utilities and financials.

Defence

This is a key priority – and not just for Europe. At the NATO summit in June, member countries agreed to a new defence spending commitment of 5% of GDP (3.5% core + 1.5% related spending) by 2035. This marks a big step-up for Europe, where defence spending averaged just 1.9% of GDP last year. Investment will include defence infrastructure and cybersecurity. European defence companies could also benefit from increased national security focus in other countries, for example through joint procurement deals, such as the one recently signed with Canada. According to our models, European aerospace and defence stocks offer similar earnings growth prospects as their US counterparts (with a compound annual growth rate of around 22% for the next two years), while trading at more attractive valuations.

Industrials and infrastructure

As European governments strive to improve regional resilience, autonomy, and competitiveness, industrial and infrastructure companies will be direct beneficiaries. Germany alone has earmarked EUR500 billion for an infrastructure investment fund. Re-shoring and re-industrialisation initiatives will see money flow into construction, engineering and transport infrastructure, among others. This should present opportunities in the mid-cap sector, where the concentration of industrial stocks is greater than among Europe's large caps (at 24% versus 18%, based on MSCI indices), and valuations are attractive. Better digital infrastructure will also be prioritised, and we expect to see spending to improve connectivity and strengthen Europe's presence in digital value chains in areas such as artificial intelligence, cybersecurity, data and cloud infrastructure and quantum computing. Our analysis shows that, of the major European equity sectors, industrials are the most sensitive to German IFO business climate index; they should thus be well-placed to capitalise on any improvement in business sentiment. Valuations suggest potentially higher returns for the sector, with 12-month forward P/E ratio for the MSCI EMU Industrials index (excluding aerospace and defence) at around 10% below that of global equities.

Re-shoring and re-industrialisation initiatives will see money flow into construction, engineering and transport infrastructure, among others. This should present opportunities in the mid-cap sector.

Utilities

Re-industrialisation will drive demand for power, exacerbating the pressure from burgeoning data centres and the electrification of everything from cars to central heating systems. Utility companies will play a key role in meeting this demand, as well as in supporting two other European priorities – the green transition and improved energy security. The increased use of renewables hinges on investment in network interconnections to transport power from remote solar- and wind-rich areas to demand centres, and connect renewable energy production to the grid. Electrification, meanwhile, will require grid reinforcement and modernisation. European utilities have underperformed in recent years, creating an attractive entry point from a valuation point of view. At around 14 times, the 12-month forward P/E ratio is the lowest among European and US sectors.

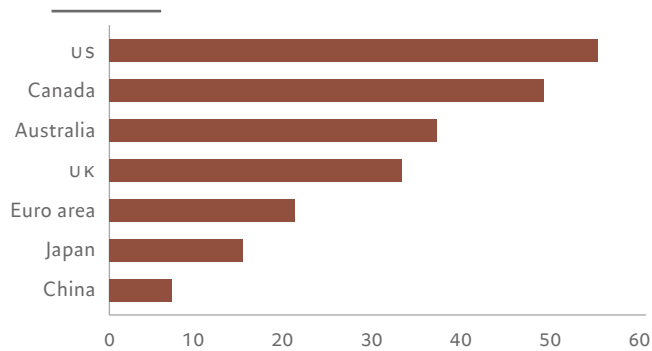
Financials

Banks and insurance firms will be pivotal in channeling the investment into Europe's renaissance, with authorities looking to the private sector to provide the bulk of the funding. We expect a pick up in earnings for the sector – not just because of stronger loan growth but also because the incremental government borrowing will lead to a steeper yield curve, boosting bank profitability. Valuations relative to the broader market look fair by historical standards, while prospects are further improved by prospective deregulation. The price tag of Europe's renaissance is significant: meeting NATO's defence spending target will require additional investment of some EUR150-200 bn per year, while closing the competitiveness gap with the US will cost around EUR800 bn, according to the Draghi Report. With Europeans currently sitting on significant savings (worth some 15% of disposable income), some of the money could come from the population. Particularly as, to-date, just one in five Europeans owns shares (directly or indirectly), compared to more than half of the US population (see FIGURE 6). Initiatives such as the European Savings and Investment Union could help pave the way for the capital push, to the benefit of both the financial sector and the region's equity markets more broadly.

FIGURE 6

Underinvested

Proportion of population owning shares, % of total



Source: LSEG, MSCI, Pictet Asset Management.
Data covering period 28.05.2002-20.06.2025.

And that's only one source of potential inflows. We could also see some existing equity investments redirected to Europe: the difference between what non-US investors invest in US equities versus what US investors invest internationally stands at USD26 trn.

With additional public and private investment, Europe could become a more powerful global player in fast-growing tech and environmental industries. In time, this could transform the investment profile of European equities. Growth-oriented investors who have traditionally been drawn to the US could come to see European stocks as viable alternative.

In FIGURE 7, we provide a snapshot of some of the listed European companies that we believe could capitalise on the reforms and investment we detail in our analysis. These firms form part of the investment universe of our European Revival equity strategy.

FIGURE 7
Stocks within the
European revival universe*

Sap Se
Hsbc Holdings Pic
Siemens Ag-Reg
Banco Santander Sa
Safran Sa
Deutsche Telekom Ag-Reg
Abb Ltd-Reg
Banco Bilbao Vizcaya Argenta
Uncredit Spa
Muenchener Rueckver Ag-Reg

*The stocks here form part of the Pictet European Revival investment strategy and are shown for illustrative purposes only. They may be sold from the portfolio at any time without prior notice, and should not be considered an investment recommendation.

Source: Pictet Asset Management.



3

Investment implications for private assets



ZSOLT KOHALMI
*Deputy CEO & Global
Head of Real Estate*

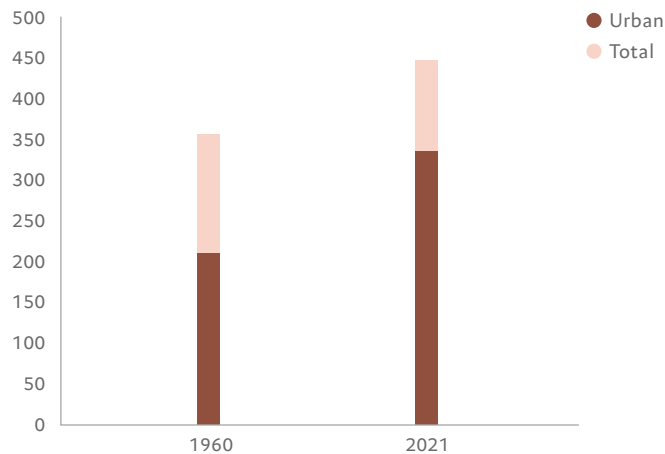
REAL ESTATE: AN IMPROVING ECONOMY POINTS TO A K-SHAPED RECOVERY IN EUROPEAN PROPERTY

For European real estate, a stronger economy could mean higher rental growth, strengthening already positive dynamics.

Unlike the US, Europe is suffering from an acute shortage of quality properties in good locations across virtually all sectors – a shortage caused by complicated regulations, old housing stock and limited new construction. This means even in times of economic weakness, desirable properties can generate attractive rental growth. In times of economic strength, that growth will be magnified.

But we believe that the resurgence of real estate will not be universal. Instead, we foresee a K-shaped recovery: the right assets in the right locations will appreciate, while assets facing obsolescence risk will never be cheap enough to be good value investments. The latter category includes, for example, many shopping centres, suburban offices and buildings that score poorly on sustainability criteria.

FIGURE 7
Europe's urban revolution
EU population, million people



Source: Eurostat

Conversely, we see some of the best potential in residential and logistics sectors, where we can add value by refurbishing or repositioning buildings to best meet changing occupier demands and improve environmental credentials.

In the logistics sector, where international trade is constrained, local supply chains are more important than ever. This means we are going to need more logistic facilities locally, putting upward pressure on rents in a sector where vacancy rates are already close to zero. Crucially, rents account for only around 4% to 7% of total production costs for logistics businesses, so they are less sensitive to rent increases because it's a small share of their cost base.

We see some of the best potential in residential and logistics sectors, where we can add value by refurbishing or repositioning buildings to best meet changing occupier demands and improve environmental credentials.

In the residential sector, supply is very constrained in Europe. Planning issues, the pandemic and a lack of financing have further exacerbated the shortage in recent years. Moreover, many of the buildings that are available do not meet today's standards of quality accommodation, often lacking in strong environmental credentials, good amenities and fast transport links. At the same time, demand is growing, driven by urbanisation and by increasing numbers of one-person households. This, in turn, leads to rental growth. In London, for example, residential rents rose by 11.5% in 2024, in contrast to steep falls seen in US cities such as Austin, which are experiencing a development glut.

A stronger European economy could also lead to higher property prices, making the current environment a particularly attractive entry point, given that prices today are some 20% to 40% below pre-pandemic levels, in contrast to other major asset classes which feel expensive.

By leveraging local knowledge as well as experience in repositioning and developing assets, investors can take advantage of this window of opportunity in European real estate, benefitting from rental growth and future price increases.



ANDREAS KLEIN
Head of Private Debt

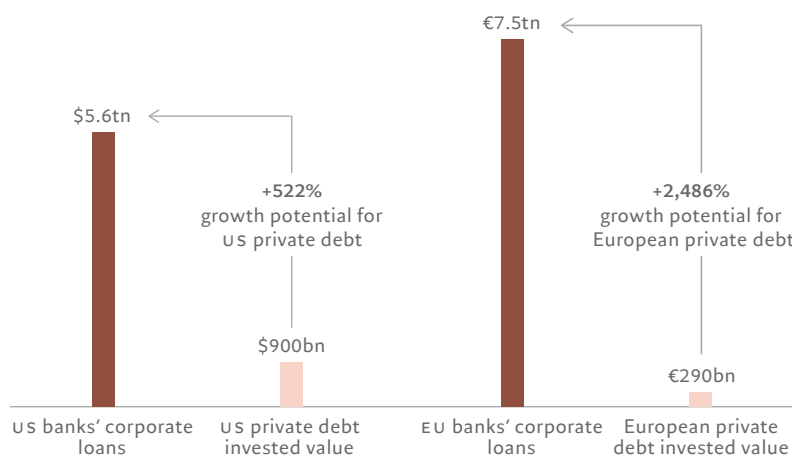
PRIVATE DEBT: EUROPE'S SMALLER COMPANIES TO THRIVE

At over EUR 500 billion, Europe's private debt market has been on a high growth trajectory, almost doubling in size in just the last four years. Europe is thus gradually increasing its share in the still US-dominated EUR 2,000 billion plus global private debt market.¹ We expect this strong momentum to continue amid favourable secular tailwinds and growing investor interest.

Traditional sub-investment-grade bank financing remains hard to access for European SMEs (largely in the wake of the introduction of Basel III and IV frameworks), and private debt is expected to continue plugging the credit gap.

Fiscal stimulus should also contribute significantly to the growth of the European private debt market. Large-scale government spending – for example, on European defence, infrastructure projects in Germany, the green energy transition in France or digital transformation initiatives in the UK – is creating increasing demand for capital at both a local and continental level. This is helping to drive demand for financing among businesses that are either directly involved in these initiatives or are benefiting from the broader economic momentum they generate.

FIGURE 8
Private debt's growth potential
Corporate loans vs private debt



Source: Pictet Asset Management, LCD, Fed, ECB. Data as at 31.12.2024.

¹ Source: Pictet Asset Management, Prequin, based on latest figures; includes invested capital and dry powder. Available data (30.09.2024) and market observations.

X2

European private debt market has doubled in size in the last four years.

Source: Preqin, Pictet Asset Management

Smaller businesses, commonly referred to as the “lower mid-market” in private debt, are often at the forefront of innovation in areas that are integral to local economies and supply chains and that are likely to be strong beneficiaries of these fiscal tailwinds. Access to capital will be critical to ensure these companies are able to fully capitalise on the trends. Private debt funds focusing on this segment are extremely well-positioned to step in and provide the bespoke financing solutions these businesses need to expand, innovate and compete.

For investors, the European lower mid-market can deliver higher all-in yields relative to the larger end of the market as capital is more scarce and less commoditised. Risk may also be lower in certain instances, notably due to smaller businesses’ greater macro insulation in niche markets or industries.

Such businesses typically have a more local or regional focus making them less susceptible to cross-border macro variables such as currency fluctuations, supply chain disruptions, trade policy or economic weakness elsewhere in the world.

Despite recent bouts of macroeconomic and geopolitical volatility, the European lower mid-market continues to showcase its importance in investor portfolios as a source of diversification, stable income and capital preservation throughout the economic cycle. And as the European economy continues to grow and develop, the lower mid-market is expected to remain a key beneficiary, driving demand for private debt and solidifying its role as a critical financing tool for Europe’s economic transformation.

The future is bright for European private debt, and even more so for the lower mid-market.



EDMUND BUCKLEY
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Equity & Head of Direct
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PRIVATE EQUITY: EUROPE COMES OF AGE

Europe already has a strong track record of private assets outperforming public assets. Over the past 20 years, European private equity returned some 20% more than its public market equivalents – more than double the outperformance achieved by US private equity, according to a recent McKinsey study.

One of the reasons for Europe's performance is the scope for operational value creation in private market investments. An improvement in the region's economic outlook can further increase that potential – therefore further enhancing the prospects for private equity returns.

Europe also offers less crowded market conditions and diversification for investors whose exposure to North America has climbed in recent years.

We see particularly strong opportunities in mid-market segment. There are some 63,000 companies in Europe with revenues of EUR 30 and EUR 300 million. To date, only around 1.5% of them receive PE investment in any given year. The growth potential looks greater still when the US is the benchmark. Adjusted for GDP, small and mid-cap PE markets are four times larger in the US than in Europe.

Europe's privately owned SMEs have already proven their worth and are now looking to take the next step; to professionalise and grow. PE investors can help such firms make progress on this path by injecting new capital and – just as importantly – by providing strategic and operational expertise.

The region's fragmented markets offer meaningful opportunities for buy-and-build strategies, driving value creation through operational improvements and consolidation without depending on macroeconomic tailwinds. This is especially true as buyout entry multiples have been lower in Europe than in the US over the last seven years, providing greater value and upside potential for long-term investors.

We are particularly positive on resilient, niche businesses offering mission-critical services across specific European markets, in sectors including business-to-business services, education and training, and industrials. These businesses benefit from recurring-revenue models and a focus on domestic business models with little exposure to international trade or manufacturing.



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