EUROPEAN LONG-TERM UNCONSTRAINED

2024 Outlook

MARTIN CURRIE
A Franklin Templeton Company

DECEMBER 2023 For institutional, professional and wholesale investors only.

A more supportive backdrop despite challenges

A monetary policy pivot could benefit European quality growth companies

In the face of economic uncertainty, European equities offer opportunities for the selective quality growth investor. In 2024, we foresee inflation to be stickier and longer lasting with slower economic growth, particularly in the US and China. In Europe and the UK, we continue to forecast ongoing stagflation. Despite the muted growth outlook, the expected pivot by the European Central Bank (ECB), and other central banks, has the potential to be supportive for equity markets and quality growth stocks in particular. European equities also offer more valuation support relative to history and other developed market equities. We see opportunities for long term investors in structural growth segments such as high-end consumer goods, energy transition and disruptive technology.

Zehrid Osmani
Head of Global Long Term Unconstrained
Senior Portfolio Manager

Inflation is likely to continue to ease in 2024, but there remains the risk of persistent inflationary pressures. The result of: (i) wage inflation, (ii) deglobalisation, (iii) technological and geopolitical fragmentation, and (iv) energy transition.

Wage inflation is the predominant contributor. Although easing in some geographies, it has the potential to persist as wages need to catch up with the elevated Consumer Price Index (CPI) levels. This sticky inflationary backdrop is likely to put more downward pressure on corporate margins. It is therefore, in our view, critical to focus on companies that have pricing power and are able to protect their margins effectively.

Monetary policies have peaked or are close to peaking. We do not expect any cuts from the European Central Bank (or any western central bank) until the second half of 2024, neither do we think they will hit their inflation targets until 2025. Central banks have shifted towards being data dependent and reactionary in their policies. This can fuel further volatility, as the markets speculate on central bank policies each time new inflation data is released. Given such environment it is important for investors to look at the bigger picture. When the time comes and central banks do pivot towards rate cuts, we believe this will provide more support for long-duration equities, particularly quality growth stocks.

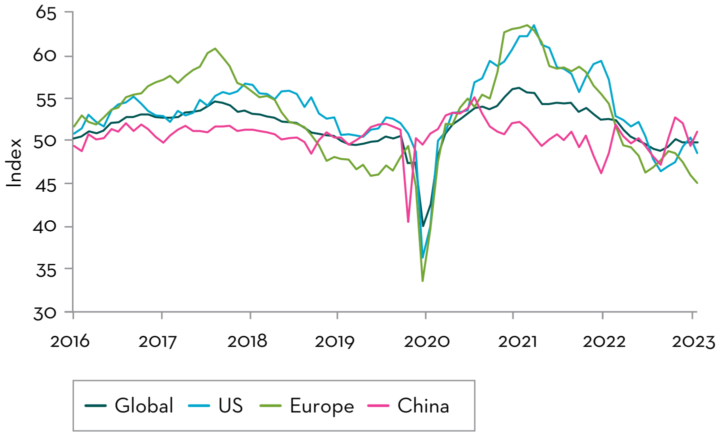
> "We see opportunities for long term investors in structural growth segments such as high-end consumer goods, energy transition and disruptive technology."

European stagflation to remain in 2024, with lacklustre corporate earnings growth

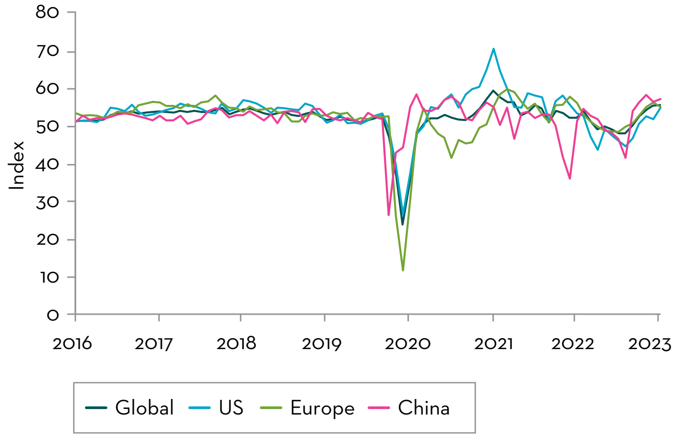
In 2024, Europe's leading indicators point to a backdrop of continuing stagflation. The region is more cyclically sensitive to both the global and Chinese economic cycles. These show signs of losing momentum, due to the impact of last year's rapid interest rate rises, slowing US economic growth (with the potential risk of recession), and China's post-lockdown reopening tailwind dwindling. The Inflation Reduction Act in the US could potentially have negative implications for European competitiveness, which could lead to further nationalistic tensions between blocs.

Purchasing Managers' Index (PMIs)

Manufacturing PMIs



Service PMIs



Source: Martin Currie, FactSet and OECD. As at 31 October 2023.

Against this backdrop we believe investors need to focus on companies with strong structural growth opportunities. Companies that can generate their own weather in an environment of low growth. In Europe, one such opportunity is high end consumption, which is gained through luxury stocks.

The magnitude of rates rises will likely bite the consumer in our view, with the impact likely to be more marked in mass-market consumption. It is therefore important to be selective on consumer stocks. Our preference is for well-established luxury names and those mass-market brands with strong momentum, notably sports-apparel. These are more immune to some of the cyclical headwinds that we foresee in 2024. Downtrading and private labelling, the purchase of cheaper brands, and retailers using their labels on other manufacturers brands will be notable trends.

Although slowing Chinese growth is a headwind to European consumer stocks, any speculation of stimuli to the Chinese economy will be supportive to these companies. Therefore, focusing on structural growth becomes even more important. We put a probability of further stimuli in China at c.60-70% for 2024, given that the authorities will have to tackle structural headwinds, and slowing economic momentum.

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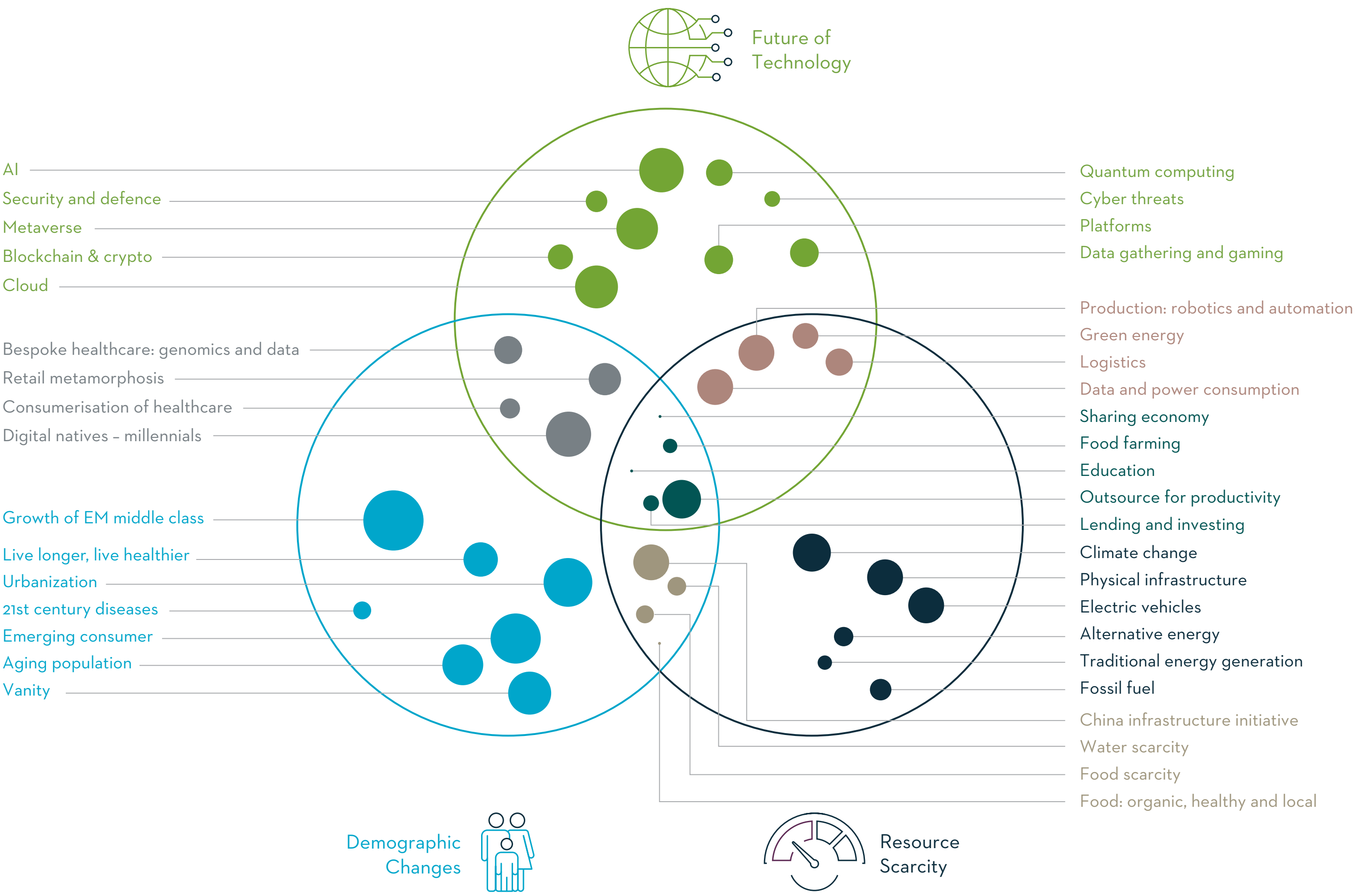
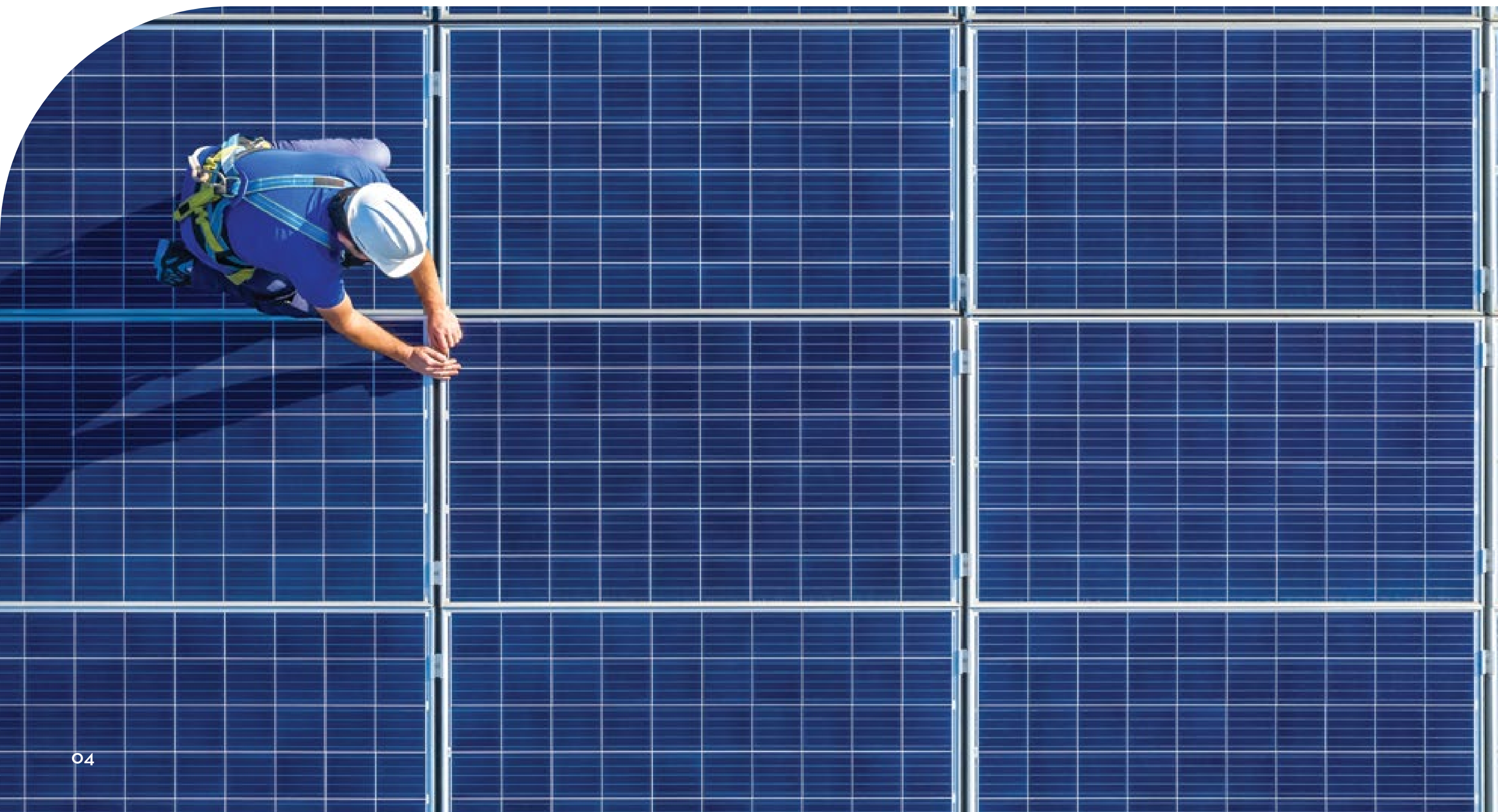
Looking at wider structural growth opportunities, there is the ongoing focus on investing for a transitioning world towards net-zero and the seismic shift brought on by Artificial Intelligence. The rate of innovation is likely to continue to increase, and with it, disruption risk to traditional businesses is likely to continue to rise. We continue to focus on eight mid-term thematic opportunities, which sit within our three mega-trends of Demographic Changes, Future of Technology, and Resource Scarcity.



Source: Martin Currie and FactSet as at 30 November 2023. Data presented is for the Martin Currie European Long-Term Unconstrained representative account.



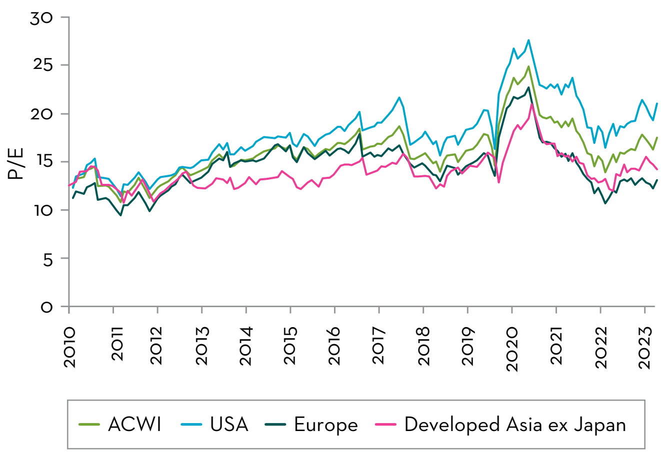
European stocks are attractively valued – but valuation discipline remains critical

European equity valuations continue to provide an attractive opportunity, trading at discount to both their cyclically adjusted ten-year averages and to US equities. This can partly be explained by the outsize influence of the so called 'Magnificent Seven'* technology stocks on the US index. Even adjusting for the prominence of technology stocks in the US index, European equities still have supportive valuations versus the US. It is in any case important to remain disciplined in terms of valuation approach, which we always assess on a stock specific basis.

On European corporate earnings, with a background of stagflation, consensus estimates of +6% growth seem too high to us (we estimate +3%). This brings the risk of earnings downgrades, meaning it is important to focus on companies with resilient earnings. Companies that can resist downward revisions, or that can actually surprise positively, notably if helped by exposure to structural growth drivers.

Source: FactSet. Forward PE as at 30 November 2023.

Forward P/E (FY1) of given equity markets



Source: FactSet as at 30 November 2023.

Risks remain in 2024

Even if we are entering a year where monetary policies will become more supportive for financial markets, risk remain. The most pertinent for European equities are:

- **the geopolitical risks related to China**, given the sensitivity of Europe to the China and Global cycle
- **the European parliamentary elections**, where the risk could be a shift towards the right, impeding EU policy initiatives
- **energy independence**, and the ongoing risk related to securing alternative energy sources.

> Even adjusting for the prominence of technology stocks in the US index, European equities still have supportive valuations versus the US. It is in any case important to remain disciplined in terms of valuation approach, which we always assess on a stock specific basis.

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