

ECONOMIC RESEARCH – DECEMBER 2025

INVESTMENT INSIGHT **EUROPE**



- ✓ The ECB's pause reshuffles the cards on the interest rate market
- ✓ Another complex situation for the euro
- ✓ Securitized real estate remains undeniably attractive
- ✓ The discount on European stock market indices is struggling to disappear

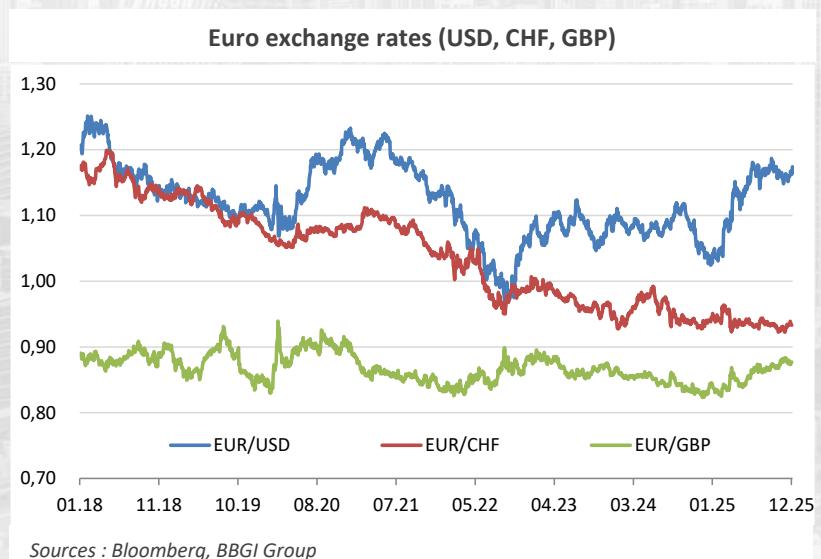
MODERATE OUTLOOK FOR THE EUROZONE IN 2026

Bond market stability and the exhaustion of capital gains

The ECB's shift toward a status quo policy has fundamentally altered the interest rate landscape, rendering previous expectations of yield easing obsolete. Sovereign yields have stabilized, with German Bunds anchoring between 2.6% and 2.8% and Italian BTPs between 3.4% and 3.6%. For investors, this marks a transition to a neutral outlook where performance depends almost exclusively on face-value yields rather than capital appreciation.

Macroeconomic fundamentals reclaim curve control

As speculation regarding ECB rate cuts fades, long-term yields are increasingly dictated by macroeconomic fundamentals such as stabilizing growth and persistent service inflation. The previous trend of curve flattening has ended; we anticipate a potential steepening of the yield curve if upcoming economic data surprises on the upside. This environment favors a hold-to-maturity strategy, as the historical driver of the bond rally—monetary easing—is no longer a factor. Investors must now navigate a market where the risk-free rate is firmly anchored, shifting the focus toward credit quality and carry rather than duration plays.



The Euro and the yield differential dilemma

A superficial synchronization between the Fed and the ECB masks a deep fundamental divergence. While both have paused rate cuts, the Fed is holding at a restrictive 3.50%-3.75% supported by a robust US economy, whereas the ECB is plateauing at a more accommodative 2.00% necessitated by fragile growth. This persistent yield differential of 150 to 175 basis points creates a toxic environment for the Euro. We expect this spread to remain the dominant driver of capital flows in early 2026, likely fueling a carry trade in favor of the dollar as investors seek higher real returns in a low-volatility environment.

Securitized real estate facing convergence headwinds

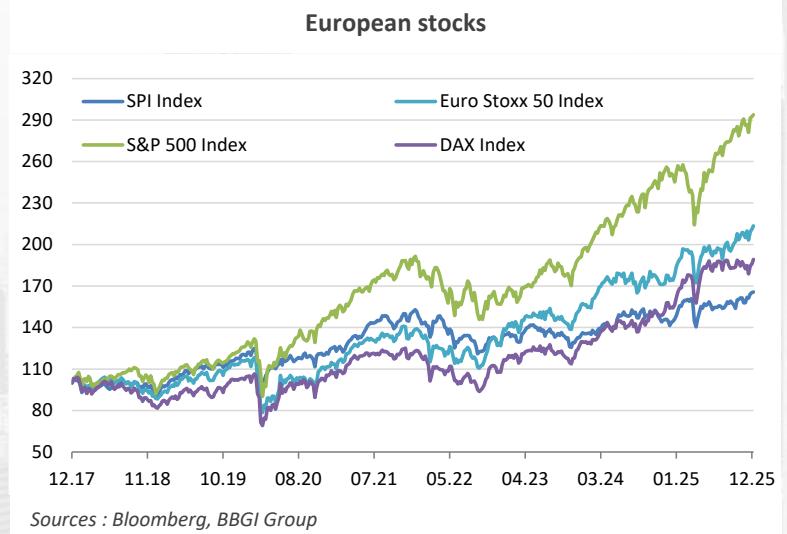
The EPRA Nareit Eurozone index has experienced a period of sluggishness as the market reevaluates risks. The transition from "monetary revaluation" hopes to "economic fundamental" fears has created a complex backdrop for listed real estate. The ECB's pause and the subsequent rebound in bond yields have narrowed the spread between real estate yields and high-quality corporate bonds, dampening short-term momentum. However, the sector remains fundamentally attractive, offering a robust yield of 7.36% and a massive 48% discount to Net Asset Value (NAV). For medium-term investors, this current pause offers a compelling entry point before the eventual recovery in financing conditions.

Equity markets and the valuation gap paradox

European equities enter 2026 with a moderately positive outlook, with the EuroStoxx 50 expected to trade within a +5% to 10% range. While the ECB pause prevents multiple expansion through liquidity, the significant valuation gap remains a primary catalyst. With a P/E ratio of 17.4x, European stocks trade at a 30% discount to the S&P 500 (25.3x). This "too cheap to collapse" status provides a floor for the market, though the lack of a dominant technology sector prevents a full-scale rally. Performance will likely be driven by modest EPS growth (+3% to +5%) and a gradual narrowing of the transatlantic valuation gap.

Strategic sectoral rotation for 2026

In an environment of capped multiples and sluggish domestic demand, selectivity will be the defining factor for equity performance. We recommend a strategy favoring high-dividend-paying companies and those with minimal exposure to domestic Eurozone risks. Sectors capable of maintaining margins despite stagnant growth—particularly global exporters and financials benefiting from the rate plateau—will be preferred. As organic earnings growth remains limited, the focus shifts toward yield-sensitive sectors and companies with strong balance sheets that can navigate the transition from a liquidity-driven market to one defined by fundamental earnings resilience.



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