6 OCTOBER 2025

Flash

Escape velocity reached– Upgrading equities to overweight

Key Messages

1. **Upgrading equities to Overweight**: Global equity markets are showing incredible strength on the back of economic resilience.
2. **Upgrading US equities to Neutral**: Despite long term fundamental concerns, we don´t want to pick a fight with a Fed in cutting mode outside of a recession. Consider FX hedged exposure.
3. **Downgrading Europe to Neutral:** Economic growth should pick up but FX headwinds could lead to earnings downgrades for foreign-exposed companies. We favour domestic exposure centered around European autonomy.

This is about momentum...

It is hard not to be impressed by the momentum with which global stock markets keep rising. The US is marking its 28th record high this year and, markets such as China, Japan, EM and even Europe are breaking out to the upside as well. The move is driven by a surprisingly resilient US economy, solid earnings and easy monetary positioning. It feels like the equity train has reached escape velocity. Hence, we upgrade our view on equities to overweight.

.....and not about (long-term) fundamentals

Does this mean our concerns regarding the potential impact on tariffs or AI overspending have disappeared? No, they have not. We remain sceptical and still wonder if AI can produce the expected productivity gains that will force the implementation rate required for these investments to yield enough return to justify the valuations. But do these concerns matter now? Let us quote two investment legends to answer this question:

"*Markets can remain irrational longer than you can remain solvent.*" (J.M. Keynes) and "*Far more money has been lost by investors preparing for corrections, than has been lost in corrections themselves*" (Peter Lynch).

In other words: those concerns are most likely irrelevant for the near-term future. With little capital constraints and the ongoing optimism about AI adoption, Big Tech CEOs are likely to keep spending on their AI dreams. This, in spite of concerns over the Return on Income that this heavy investment will ultimately earn. The spending trajectory is further boosted by the impact of the OBBBA on corporate capex (see Chart 1). It enables businesses to fully write down the costs of machinery, equipment and domestic R&D immediately.

Don´t fight the Fed!

What matters is an economy that seems (for now at least) to be denying the gravity of tariffs and a slowing labour market while the Fed embarked for further rate cuts. We have updated our expectation to two rate cuts in 2025 (versus one previously) and in 2026. This should add further fuel to a market that is already enjoying tailwinds of easy financial conditions (see Chart 2). No matter where we look, history suggests that the current strength has room to run as rate cuts outside a recession has historically been a strong force pulling equities higher (see Chart 3). Moreover, our FX strategists have upgraded their 12m EUR/USD target to 1.24, which should support earnings growth for US large caps in general and US mega cap tech companies in particular.

We **upgrade US equites to Neutral.** Due to our dollar view**,** adding FX-hedged exposure might be worth considering.

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Keep course in Europe but a little less aggressively

After a stellar start to the year, European equities went into a consolidation phase during the summer. In our view, this was driven by two major impacts. Firstly, the ongoing euro strength weighed on consensus earnings expectations which was revised to -1% EPS growth for 2025 (vs. +8% in January). This didn't impact all companies equally as the earnings of US-exposed stocks were been revised down 10–15%, while the earnings of domestic exposed stocks managed to grow (see Chart 4). Secondly, the market seems to have entered a "show me" phase in respect to increased spending.

Looking ahead to 2026, stronger European GDP growth should support earnings while FX headwinds will persist. We thus think that the current consensus expectation of ~12% earnings growth is too high which makes earnings downgrades likely. Since we don´t think Europe can outperform going forward, **we downgrade Europe to Neutral.** Within Europe, however, we retain our current preferences and continue to prefer exposure to the European autonomy theme, domestic exposure (especially SMIDs) and certain sectors like banks.

Emerging Markets enjoy healthy tailwinds

We reiterate our overweight call on emerging markets. Looking forward, we think the EM equity rally can extend until year-end as macro tailwinds from Fed rate cuts and a weak dollar continue. Positioning and flow trends remain supportive amid ongoing strong demand for diversification and positive Q4 performance seasonality.

Big in Japan

We also reiterate our Overweight call on Japanese equities. We see the following factors to continue supporting the market: a constructive global economy, a recovery in the Japanese economy driven by external and internal forces (e.g. wage growth), solid corporate earnings and ongoing corporate reforms.

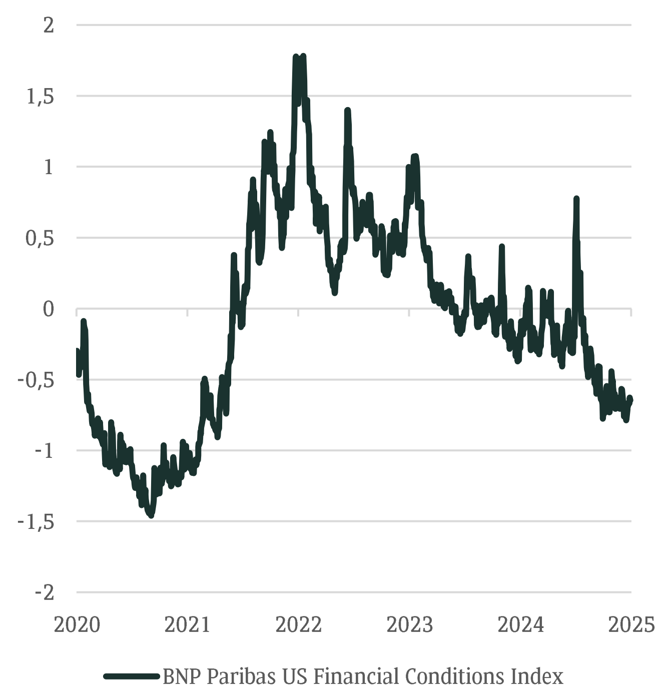
There is one key message

There is a real risk that we will see echoes of the last bullish phase of the dot.com bull market. We don´t want to fight that trend and so we increase our equity allocation to Overweight. Hence, **in this flash we focus on the main message which is that the bull market is alive and strong.** A more nuanced view will be provided in the upcoming Equity Focus.

CHART 1: US CAPEX GROWTH IS REACHING THE HIGHEST LEVEL SINCE 2021

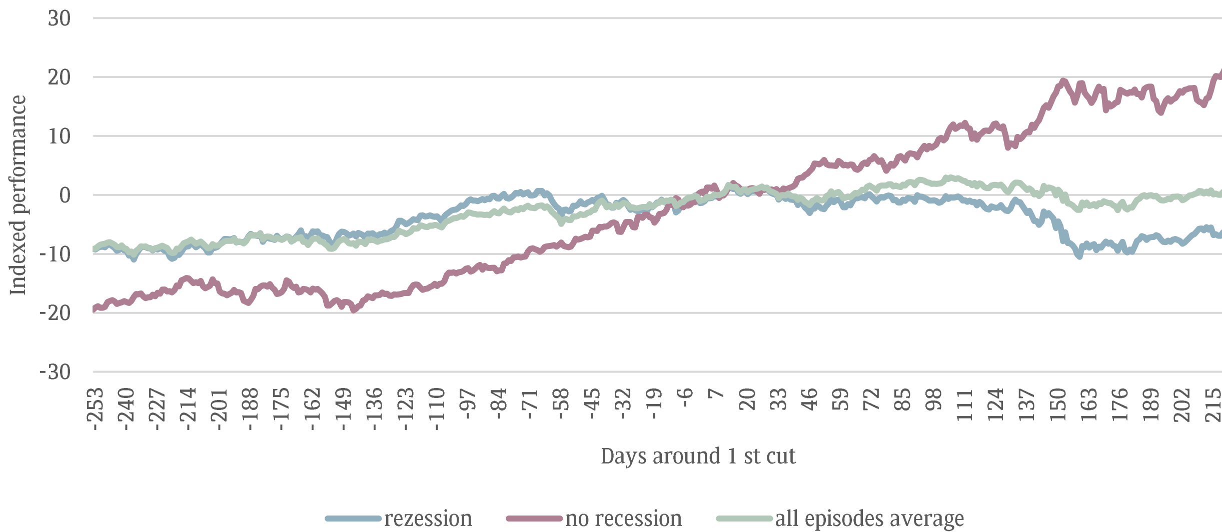
Source: BNP Paribas, Bloomberg

CHART 2: US FINANCIAL CONDITIONS HAVE EASED SUBSTANTIALLY SINCE APRIL 2025



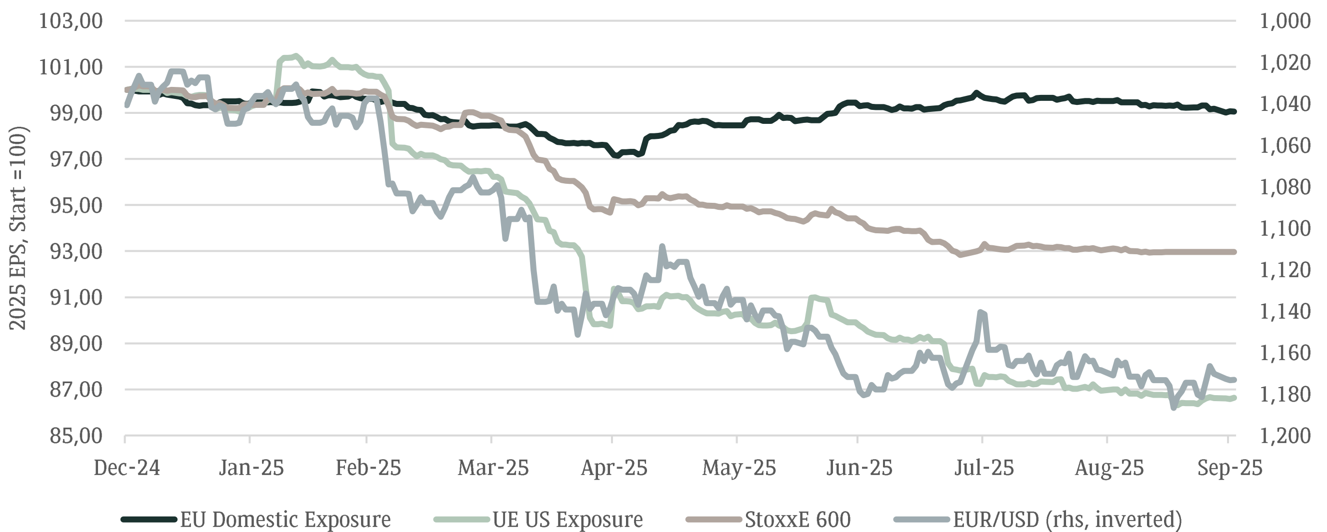
Source: BNP Paribas, Bloomberg

CHART 3: THE S&P 500 HAS HISTORICALLY PERFORMED WELL DURING NON-RECESSIONARY RATE CUT PERIODS



Source: BNP Paribas, Bloomberg

CHART 4: EU COMPANIES WITH 50%+ US REVENUES HAVE SEEN SUBSTANTIAL NEGATIVE EARNINGS REVISION ALONGSIDE A WEAKENING DOLLAR



Source: BNP Paribas, Bloomberg

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