Deutsche Bank
Research

MEGA II – Not done yet

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Deutsche Bank Research Institute

IMPORTANT RESEARCH DISCLOSURES LOCATED IN APPENDIX 1.

Europe is back and Germany's potential seems not yet fully appreciated by markets

In early 2025, we made a bold call: we argued that Europe's 15-year history of underperformance has come to an end (MEGA and here**). We projected the P/E valuation gap between US and European equities to narrow from a record 9.0x at the end of 2024 to 4.3x. Since then, the gap has indeed tightened to 4.7x. With Germany's potential still being underestimated by markets, we expect more to come for Europe.**

Looking ahead, we see several structural factors supporting Europe's relative attractiveness:

- **Valuations**: After the tightening, we expect the gap to stabilize. Higher US growth justifies a premium but most of the below arguments argue against a renewed widening.
- **Earnings:** We expect the European earnings recovery to continue, delivering double-digit growth in 2026. While US earnings are still expected to grow faster, uncertainty around the sustainability of future growth, particularly in the Tech sector, remains elevated.
- **Germany:** The US and China are likely to continue growing faster than Europe, but much of that growth has been accompanied by widening deficits and rising debt. US fiscal deficit and debt metrics now exceed European levels. At the same time, Germany's fiscal pivot could support a relative recovery in European growth, an opportunity that equity markets have yet to fully embrace. A recovery in global manufacturing activity provides an additional boost to Europe's economy. Germany could become the powertrain of Europe's economic recovery. Having reduced its debt-to-GDP ratio over the past decade despite macro headwinds, it now has the fiscal capacity to support growth through a substantial spending plan including EUR 1tr in new debt. The economy is showing greater resilience than many expected, manufacturing activity is improving, international investor interest is beginning to re-emerge and reforms are advancing. We estimate the pension reform alone could unlock €10-15bn of annual inflows into European equities.
- **Diversification**: Europe's equity market is well diversified across sectors, providing broader return drivers than more concentrated markets such as the US and Emerging Markets. This helps cushion performance during sharp market downturns.
- **AI**: While Europe is unlikely to catch up with the leading AI developers, it is also less exposed to risks surrounding the monetisation of heavy AI investment. Instead, it should benefit indirectly from AI spending through its advanced manufacturing capabilities, its exposure to AI infrastructure and through growing AI adoption itself.
- **Political stability:** While Europe's fragmented political landscape is a structural disadvantage, external pressures from US and Chinese trade policies and ongoing geopolitical challenges have strengthened coordination across the EU on trade, defence and fiscal matters.

Closing valuation differential

In March 2025, we called for a decline in the valuation gap between US and EU equities. We have now moved significantly closer to our target.

P/E difference S&P 500 and STOXX 600 (12m fwd)

*DB forecast based on the P/E difference before the start of the Russia-Ukraine war (02/24/2022). Source: Bloomberg Finance LP, Deutsche Bank Research 09/15/2026

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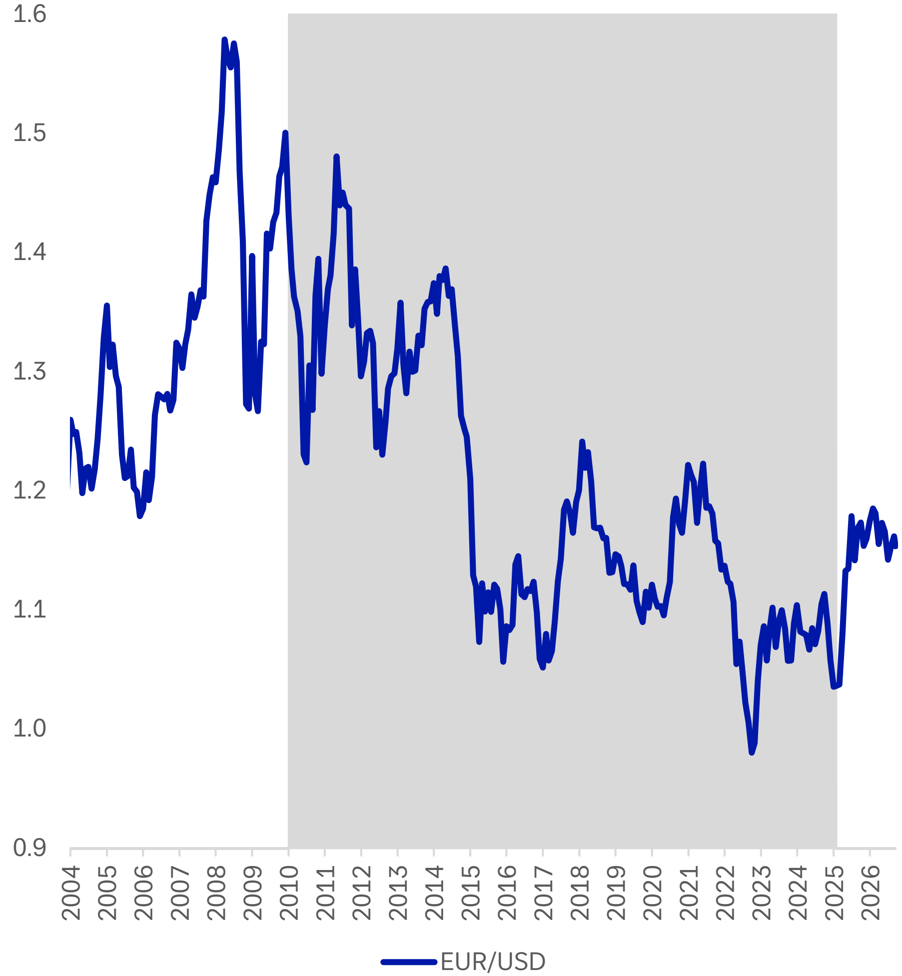
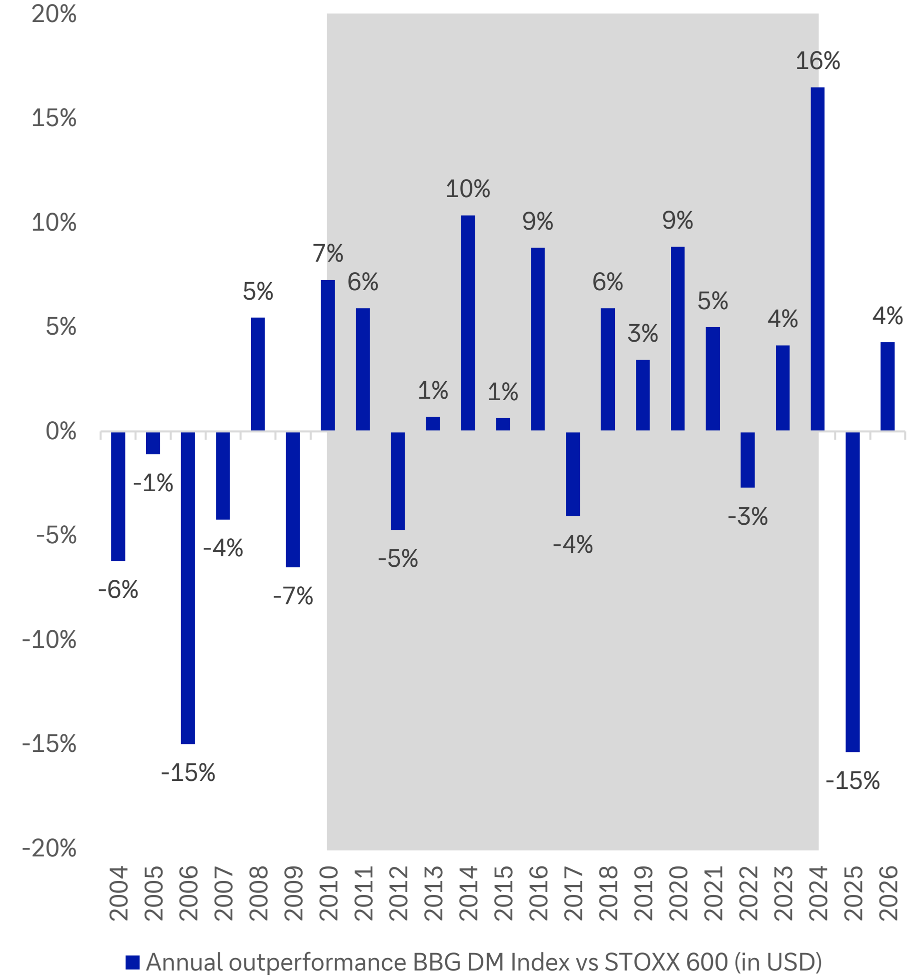
US Dominance... from 2010 to 2024?

European underperformance coincided with a 15-year USD rally. Will the USD continue to grow in its importance over the next 10 years?

In 2010-2024, the USD strengthened...



...supporting RoW outperformance

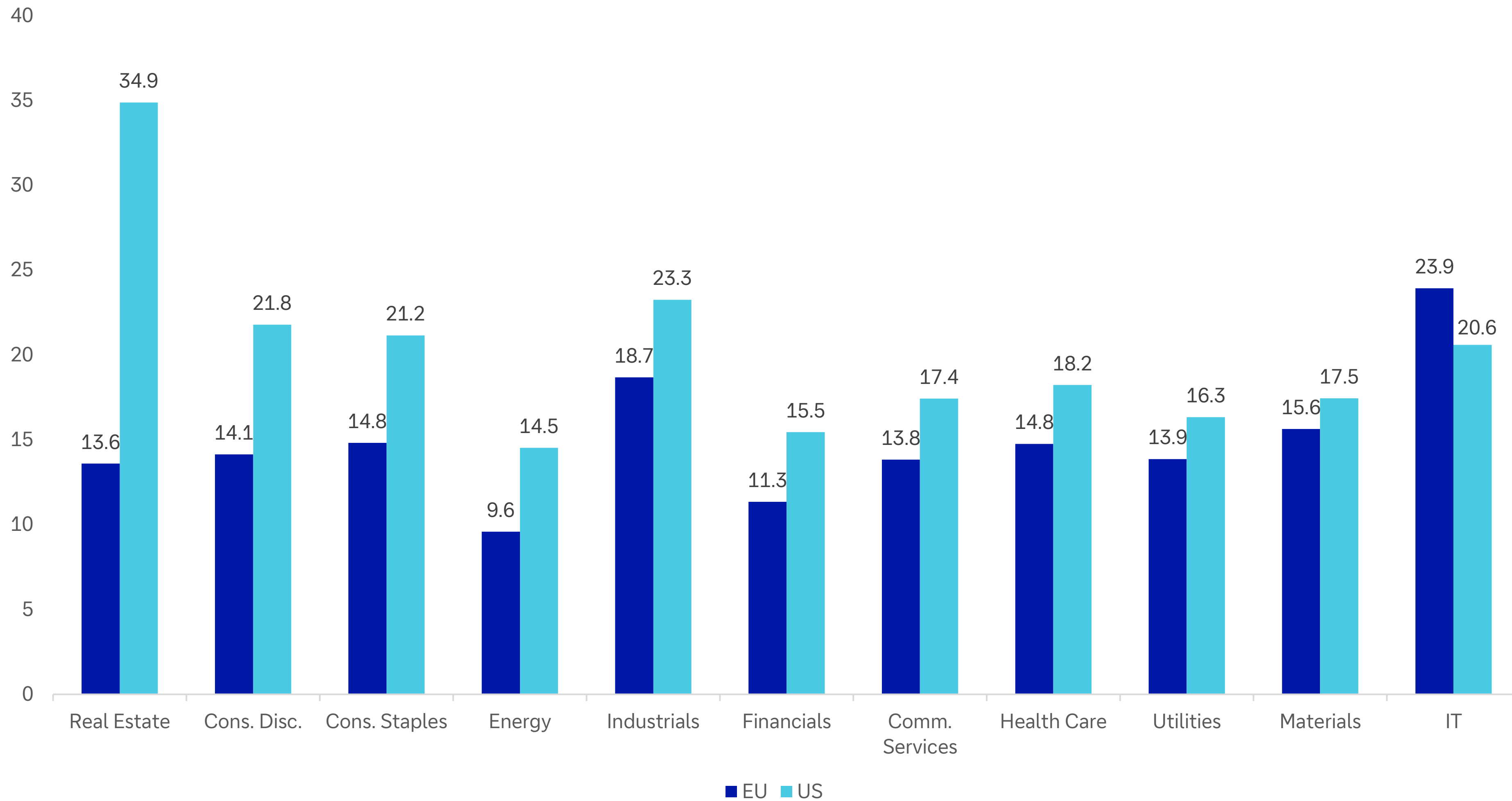


Note: Right chart is total return, 2026 is year-to-date. Source: Bloomberg Finance LP, Deutsche Bank Research 09/15/2026

Valuation Gap: applies across sectors

The valuation premium no longer stems from the IT sector. Still, every US sector, ex IT, trades at a premium versus the European sector.

Current sector P/E (12m fwd), sorted P/E difference US vs EU sectors

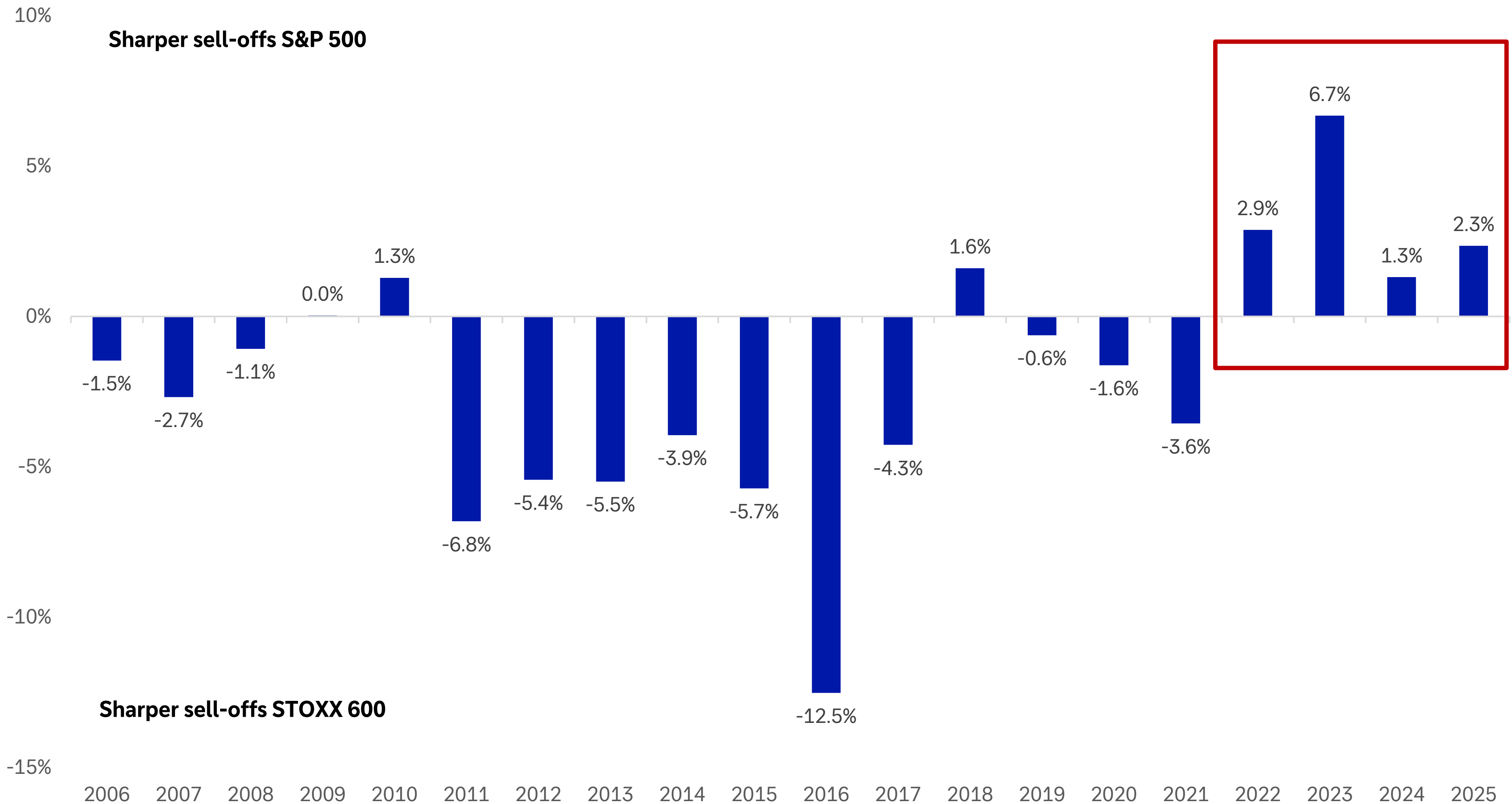


Reference indices: S&P 500 and STOXX 600, GICS sectors. Source: Bloomberg Finance LP, Deutsche Bank Research 09/15/2026

Concentration: leads to sharper sell-offs

„When the US sneezes, Europe catches a cold" no longer holds true. Drawdowns are significantly sharper in US equities. "When the US sneezes, Europe says Gesundheit".

Difference in maximum drawdown of S&P 500 vs STOXX 600 (annual, local currency)

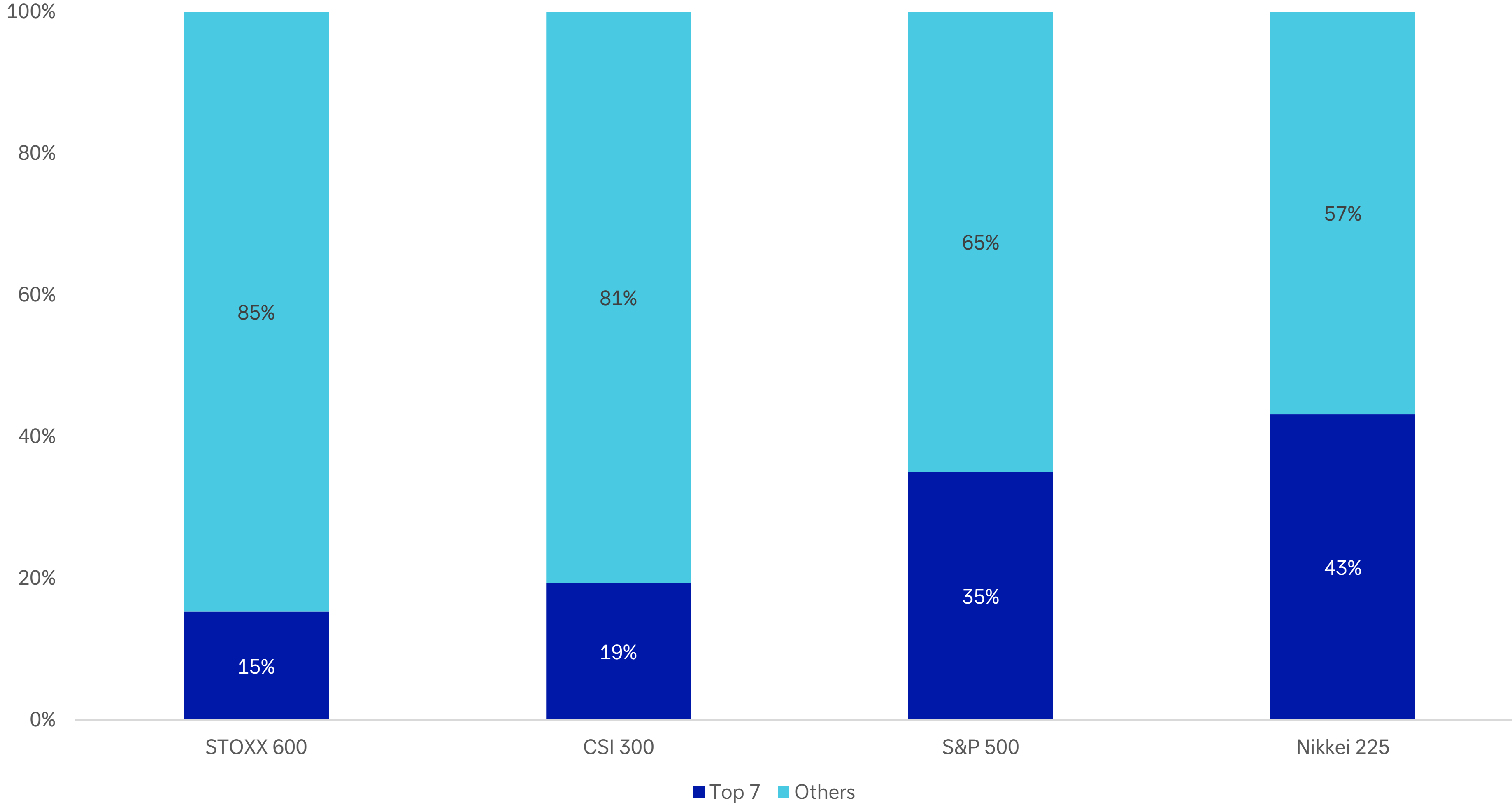


Source: Bloomberg Finance LP, Deutsche Bank Research 09/15/2026

Concentration: in index weights

The European STOXX 600 is well diversified. The 7 largest corporates make up only 15% of the index weight vs 43% in the Nikkei and 35% in the S&P 500.

Current index weights

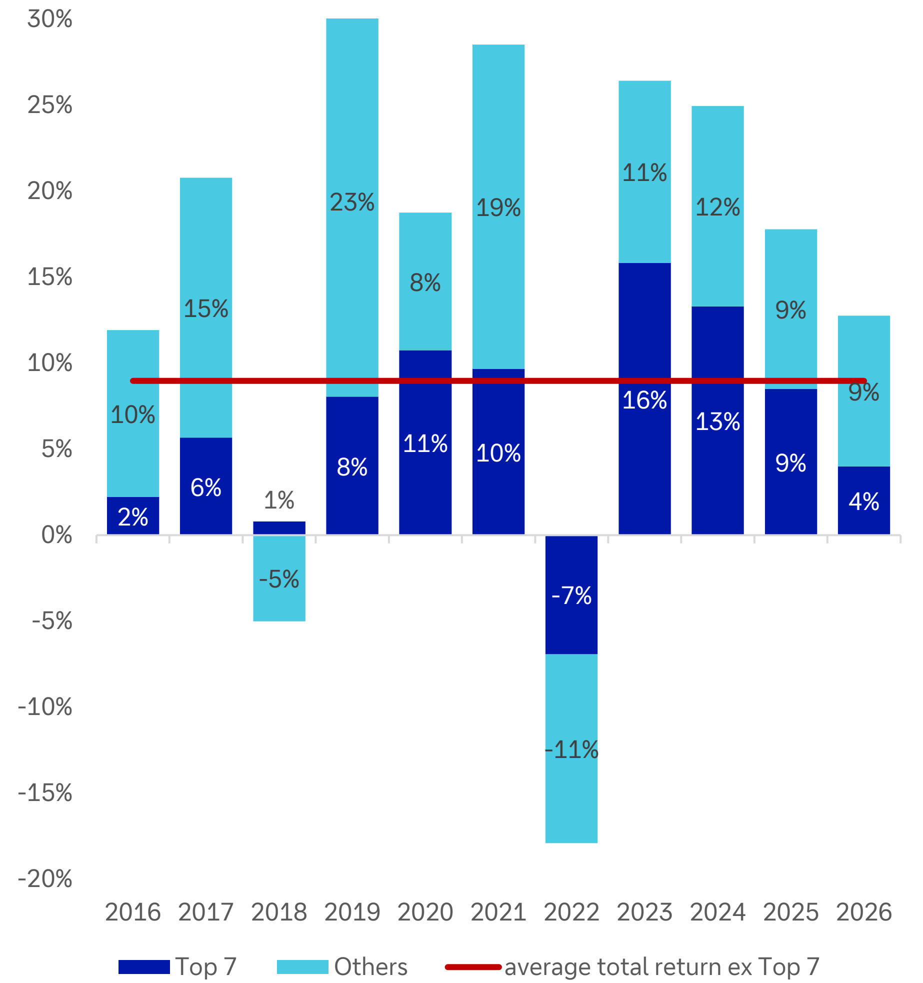


Source: Bloomberg Finance LP, Deutsche Bank Research 09/14/2026

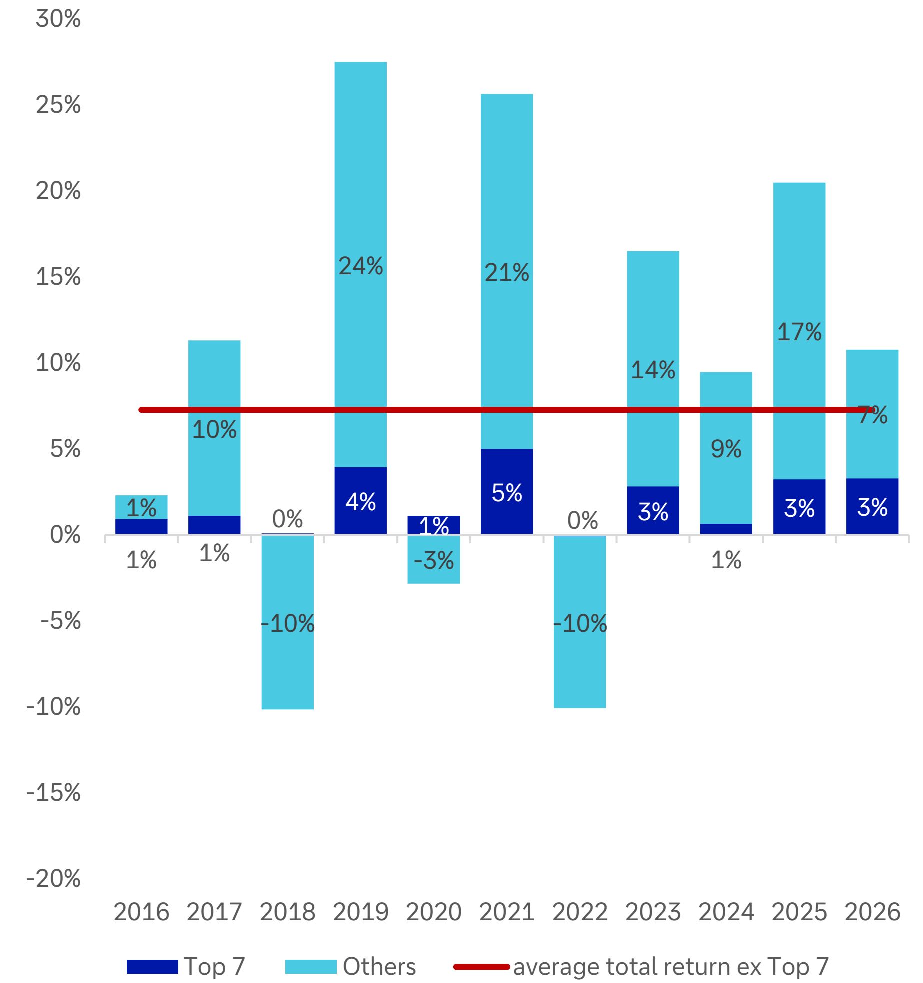
Concentration: in performance

On average over the past 5 years, the S&P returned 16% per year vs 12% in the STOXX 600. Without the top 7 companies, the S&P would have delivered an average return of 8% vs 10% for the STOXX ex top 7.

S&P 500 – total return contributions



STOXX 600 – total return contributions

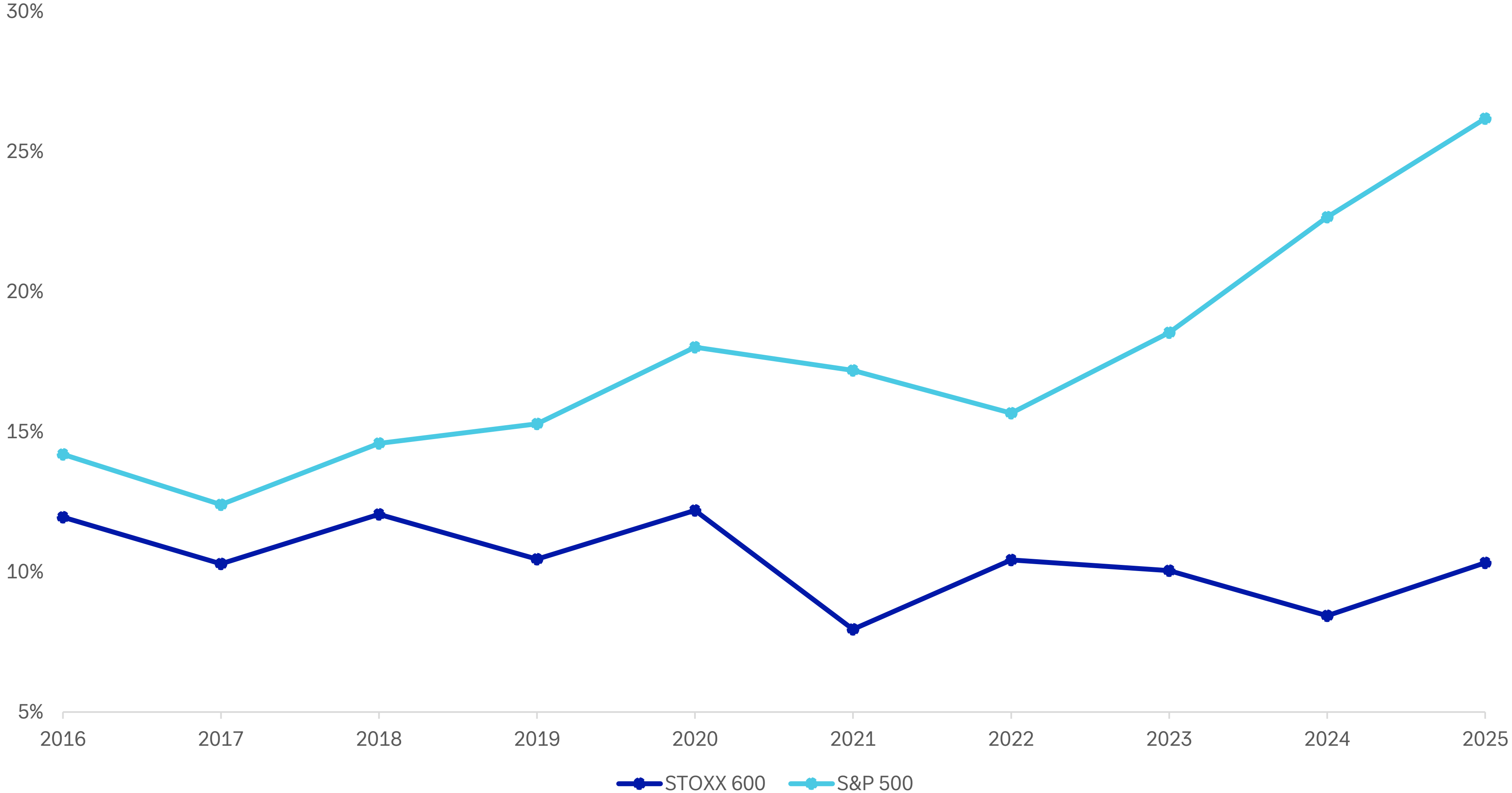


Note: 2026 is YTD. Source: Bloomberg Finance LP, Deutsche Bank Research 09/14/2026

Concentration: in earnings

The top 7 US companies contributed 53% to earnings growth since 2021. In the STOXX 600, the top 7 only accounted for 33% of profit growth over the same period.

Top 7 companies: share of aggregate index earnings

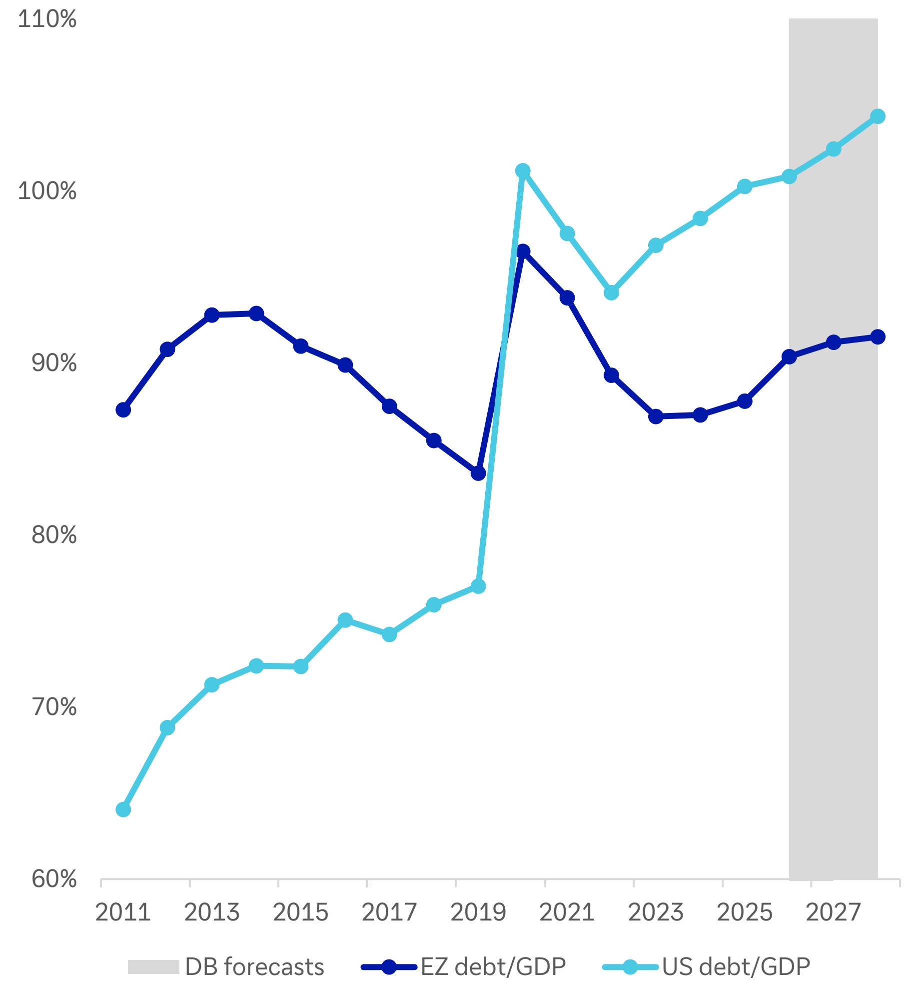


Note: based on current index members and current Top 7. Source: Bloomberg Finance LP, Deutsche Bank Research 09/14/2026

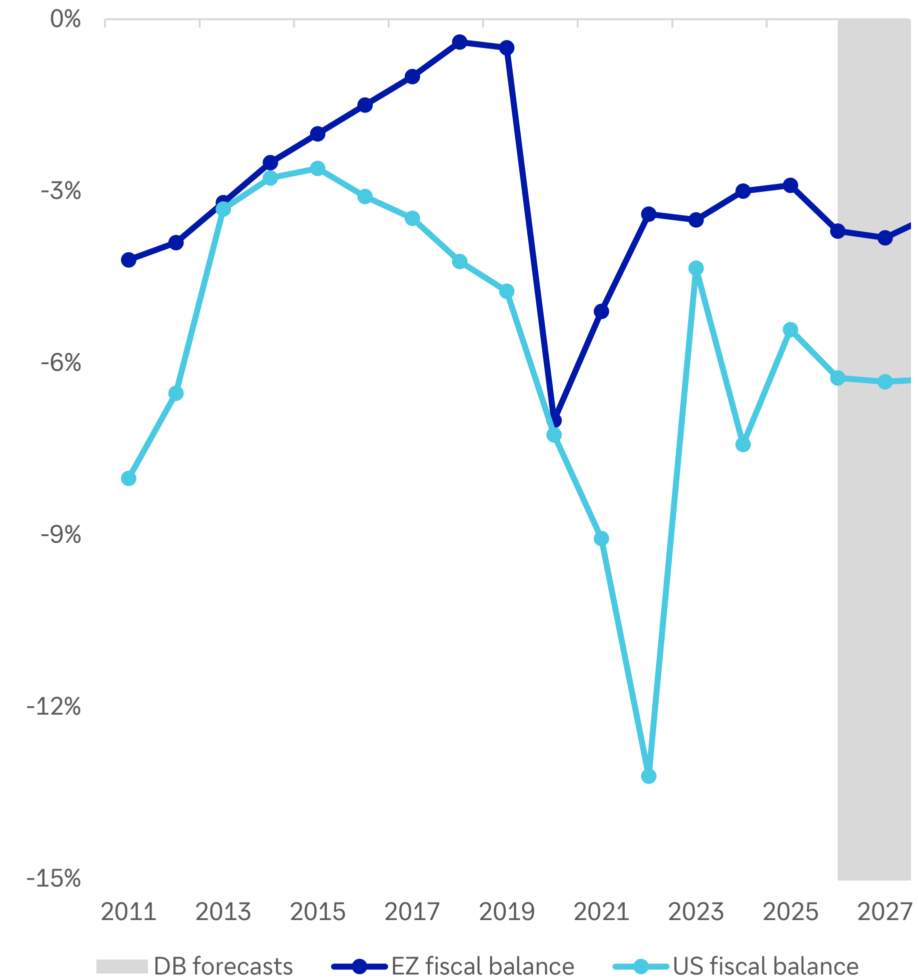
Fiscal Risks – look increasingly similar

Despite the German fiscal expansion, debt ratios are expected to worsen more in the US than in the Eurozone.

Debt-to-GDP: Eurozone vs US



Fiscal balance (% GDP): Eurozone vs US

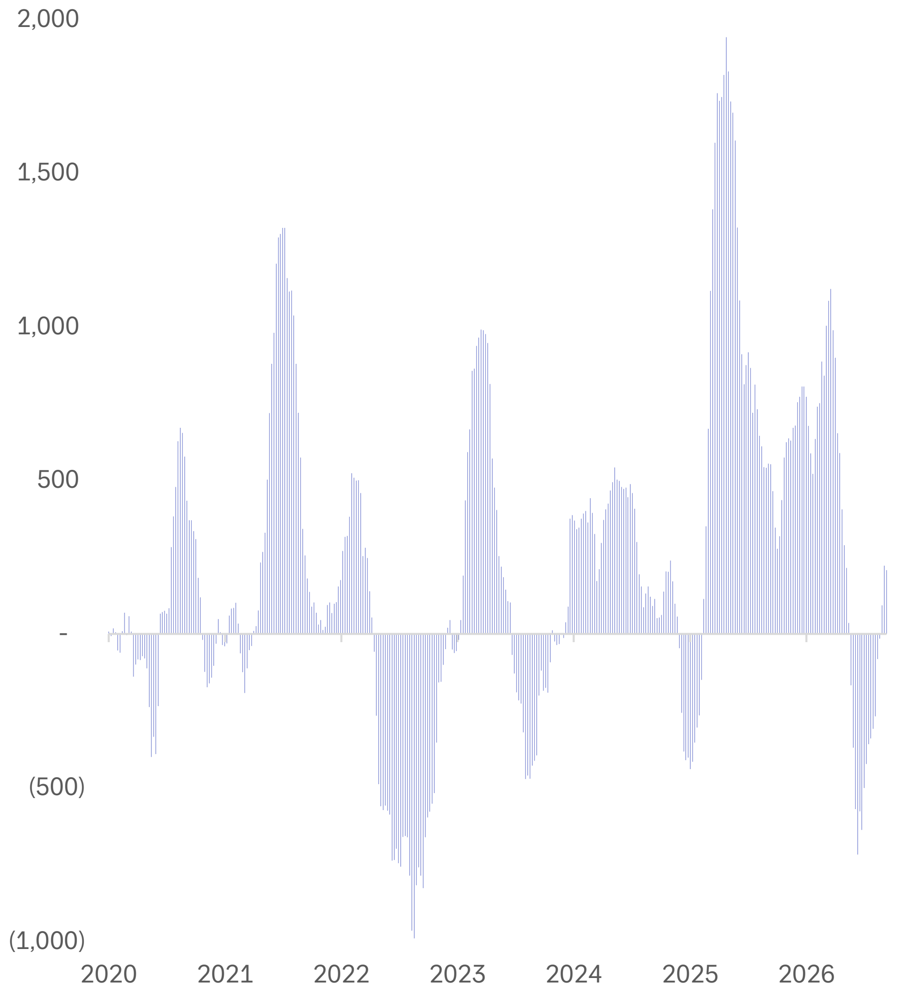


Note: Debt-to-GDP is net for US and gross for EZ to align with DB forecasts. Source: Deutsche Bank Research 09/15/2026

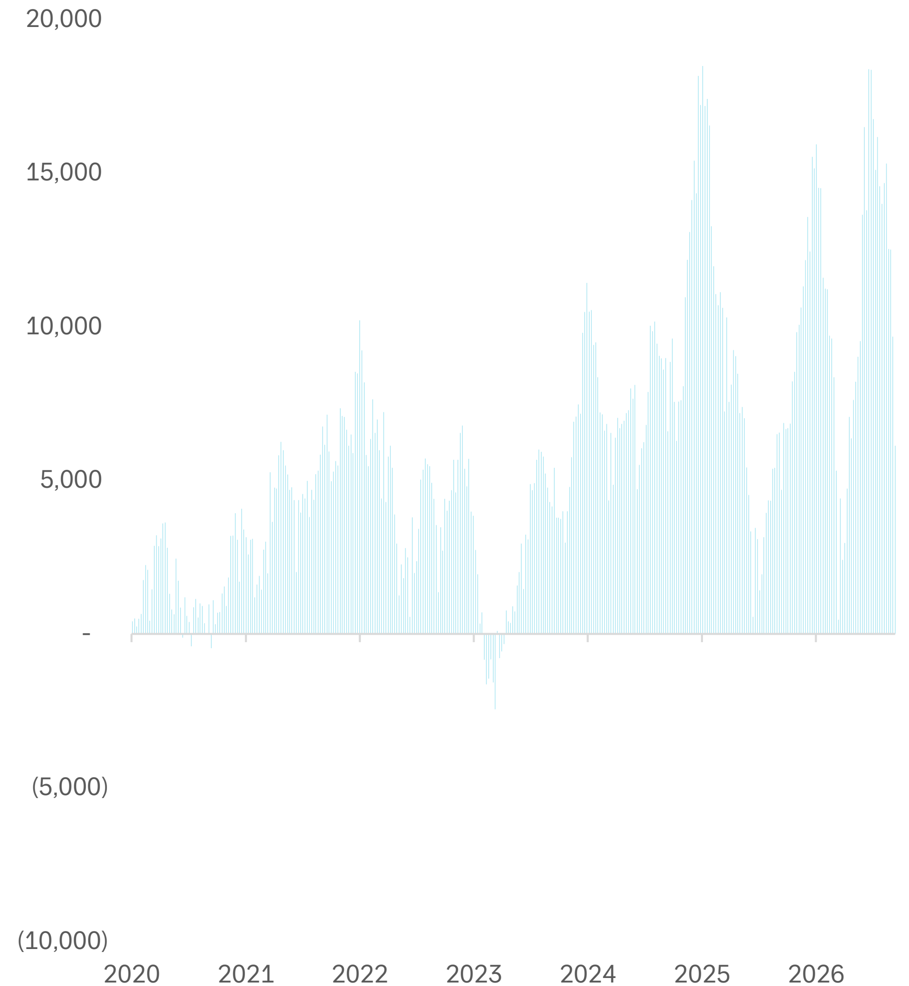
Flows – US dominates, but less than it did

Inflows into European-focused ETFs have picked up significantly over the past two years but remain much smaller and more volatile than US flows.

Europe



USA

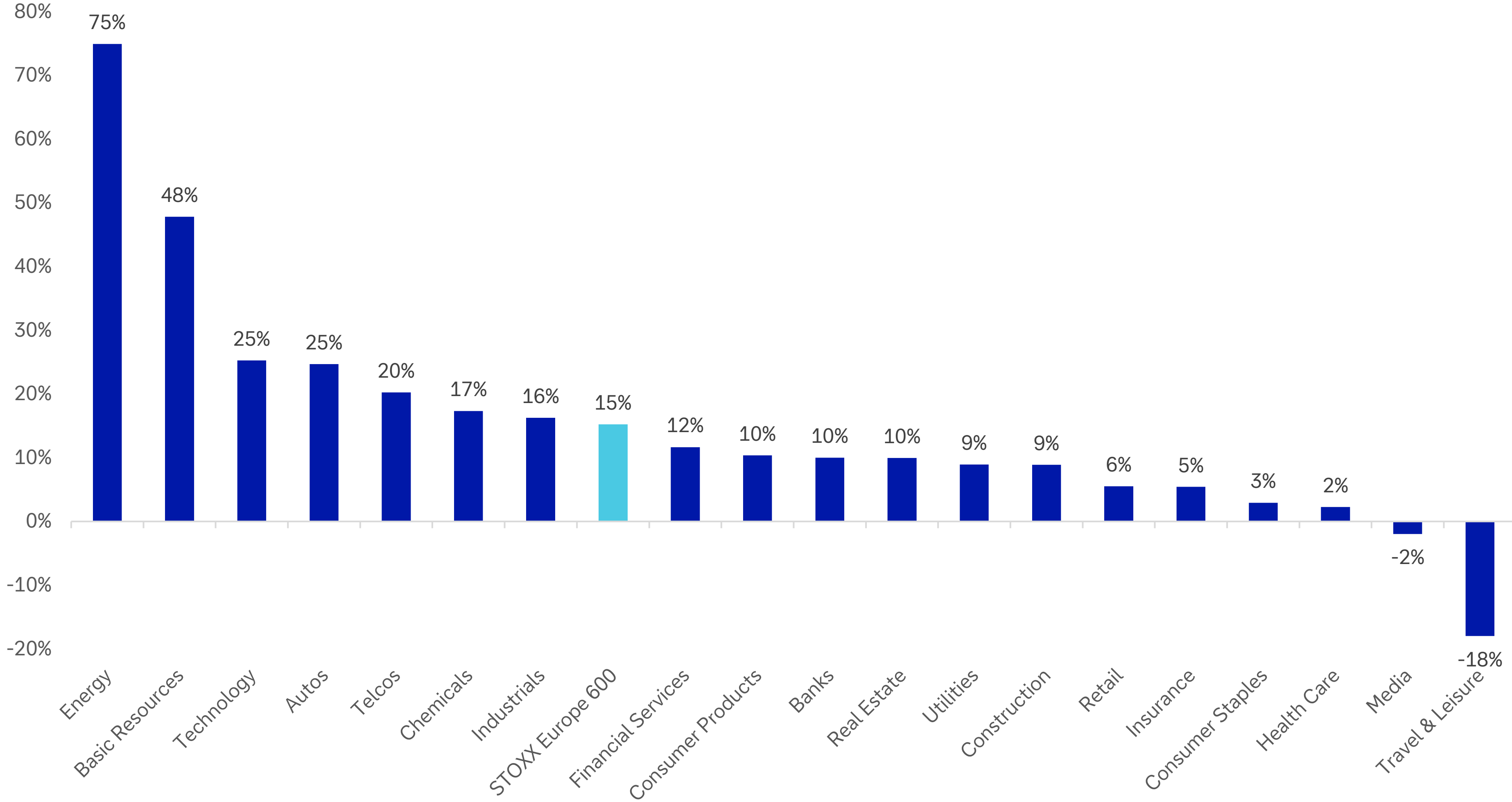


Note: Aggregate fund flow, 12w moving average, based on 50 largest ETFs for the region, in mn USD. Source: Bloomberg Finance LP, Deutsche Bank Research 09/14/2026

Earnings – Broad-based growth

The outlook for European earnings is encouraging. Almost all sectors should see positive earnings growth this year.

STOXX 600: Consensus expected earnings growth, FY26



Source: Bloomberg Finance LP, Deutsche Bank Research 09/15/2026

Deep dive: Germany

Don’t underestimate Germany’s capacity to change

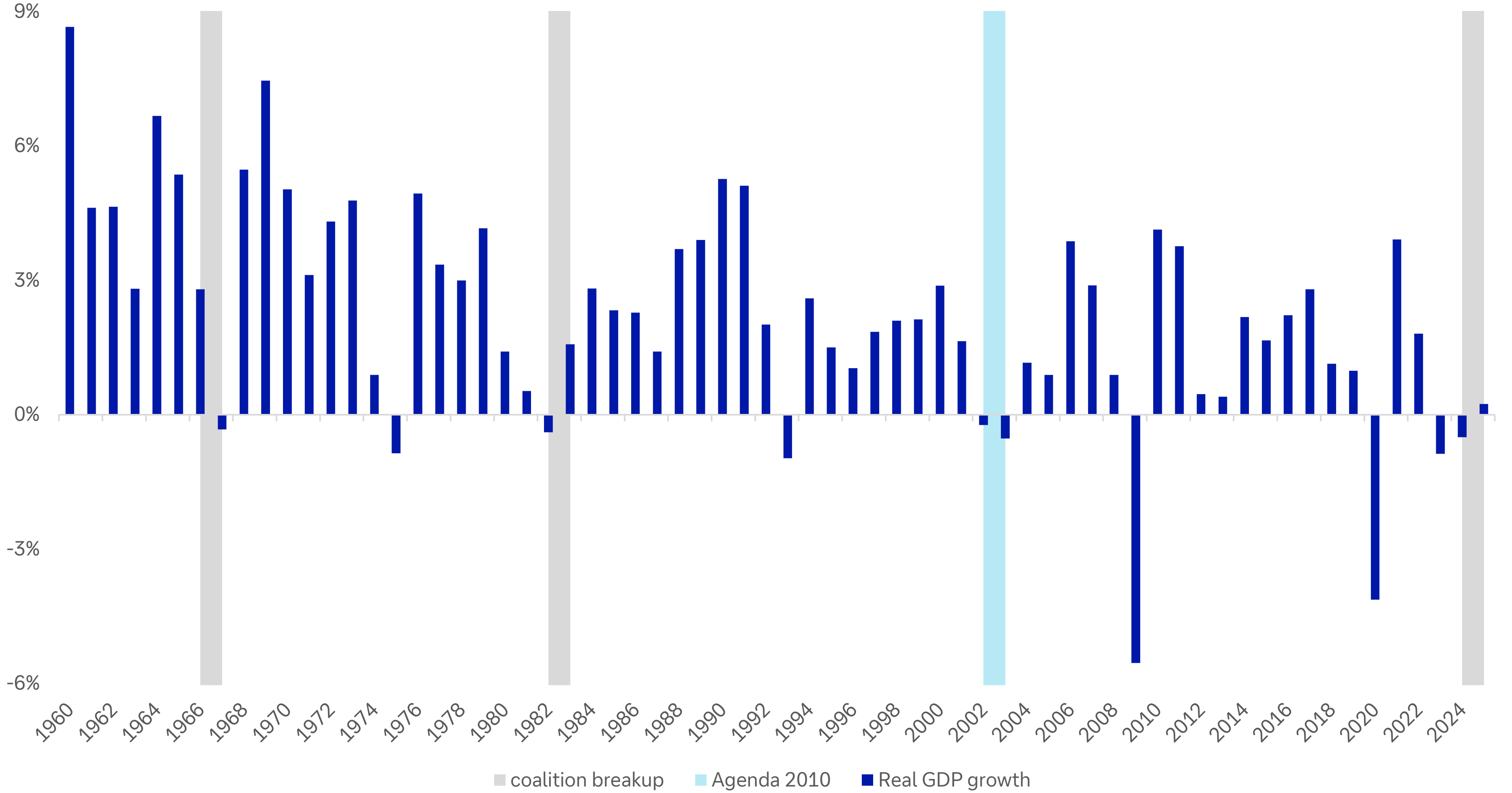
Germany has the potential to become the driving force behind Europe’s economic revival. Despite years of macro headwinds, it reduced its debt ratio over the past decade, creating the fiscal space for a major spending package. Economic activity is stabilising, manufacturing conditions are improving, reforms are progressing, and global investor interest is returning. Germany has repeatedly demonstrated an ability to adapt and reinvent itself, with major reform waves following the coalition collapses of 1966 and 1982 and the implementation of Agenda 2010 in the early 2000s.

- **Fiscal**: Few countries have faced as many challenges as Germany in recent years: rising Chinese competition in key industries, the energy shock following Russia’s invasion of Ukraine, large-scale immigration, US tariffs, and a three-year manufacturing downturn. Despite these headwinds, Germany is the only G7 economy to have reduced its debt-to-GDP ratio over the past decade. The government plans to raise around €1tn of additional debt by 2030, on top of the current debt stock of €2.8tn. Net credit borrowing is expected to increase from €180bn in 2026 to more than €200bn in 2027, while spending on defence and investment is set to reach roughly €120bn each this year, up more than 30% year-on-year.
- **Macro**: Germany's economy is showing greater resilience towards the ongoing geopolitical headwinds than expected. The manufacturing PMI climbed above 54 in August, its strongest reading in over four years, and both the Ifo and ZEW surveys surprised positively. Factory orders are gradually improving and GDP growth in H1 exceeded expectations, prompting consensus GDP forecasts to be revised up. Although higher energy prices may create short-term headwinds, the burden remains manageable, with energy costs representing just slightly more than 1% of sales for listed German companies.
- **Politics**: Germany's reform momentum is strengthening. The government is combining fiscal stimulus with measures to lower energy costs, boost corporate investment, accelerate infrastructure projects, reform the labour market, and modernise the pension system. We estimate the pension reform alone could unlock €60-100bn of annual capital market inflows. At the same time, political risks appear manageable. Regional elections are unlikely to affect federal policymaking, and we see little risk to the government's reform agenda. If anything, weaker results for the coalition parties could increase pressure to accelerate reforms.
- **Equities**: Markets have yet to price in Germany's improving outlook. While economic indicators continue to strengthen, investor flows into German equities remain weak and the MDAX has lagged the DAX by 7% since late June. As the index with the greatest exposure to the domestic economy, the MDAX is the purest listed play on Germany's recovery and has historically shown a much stronger relationship with German GDP growth. A combination of fiscal stimulus, structural reforms, and more industry-friendly policies creates substantial catch-up potential following years of underperformance. Importantly, valuations remain attractive, with the MDAX trading at its cheapest relative level in history.

BIG PICTURE: Recession → Reforms → Growth

Don't underestimate Germany's capacity to change. After the coalition break-ups of '66 and '82, Germany introduced reforms and re-emerged stronger. Reforms were also implemented when growth turned in 2003 under the Agenda 2010.

Germany was in recession in '66 & '82, but recovered quickly after the political crisis was resolved



Source: Bloomberg Finance LP, Bundesbank, Deutsche Bank Research 09/15/2026

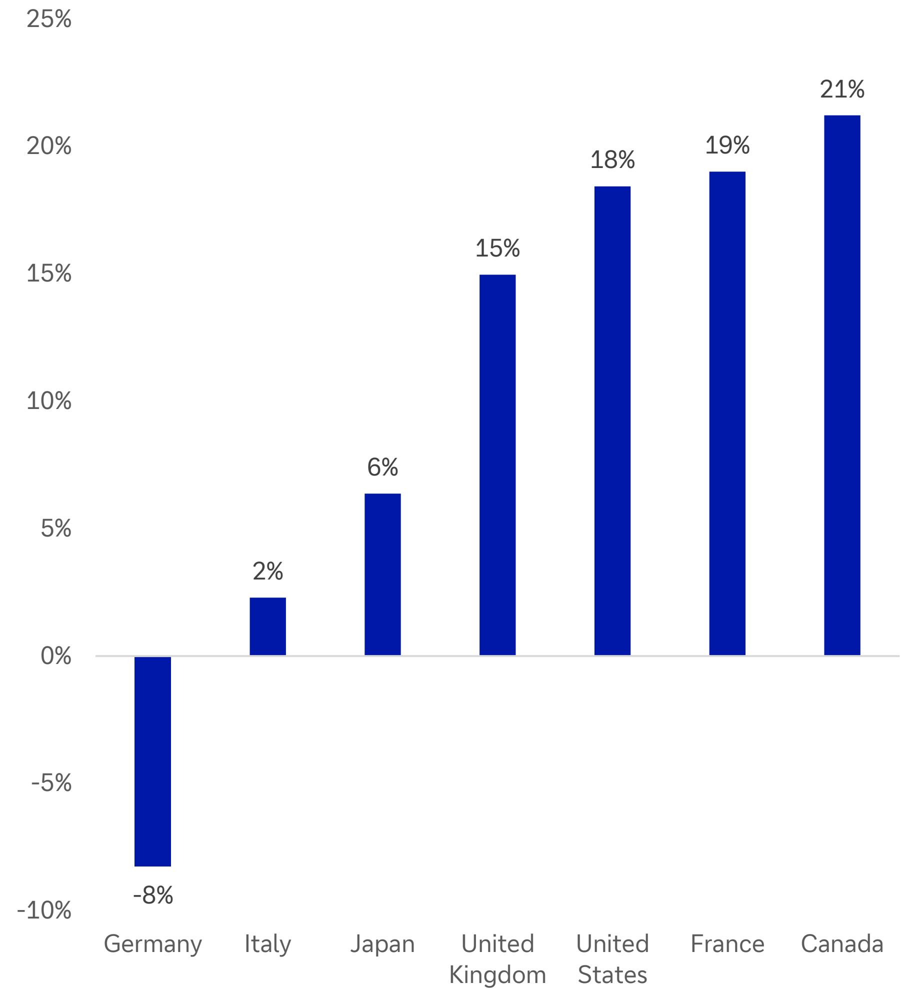
BIG PICTURE: Consolidation to expansion

Germany is the only G7 country to have reduced its debt relative to GDP over the past decade.

Key takeaways

- Over the past decade, few countries were facing as many headwinds as Germany: growing competition from China in its key industries, the energy transformation following the war in Ukraine, mass immigration, US tariffs and a 3-year manufacturing crisis.
- Despite all of this, Germany managed to be the only G7 country to have reduced its debt relative to GDP in the last 10 years.
- German debt-to-GDP dropped by 8 percentage points while e.g. US growth was largely debt-financed, with the US‘ debt-to-GDP ratio increasing by 18 percentage points over the same period.

Change in debt-to-GDP over the past 10y (pp)

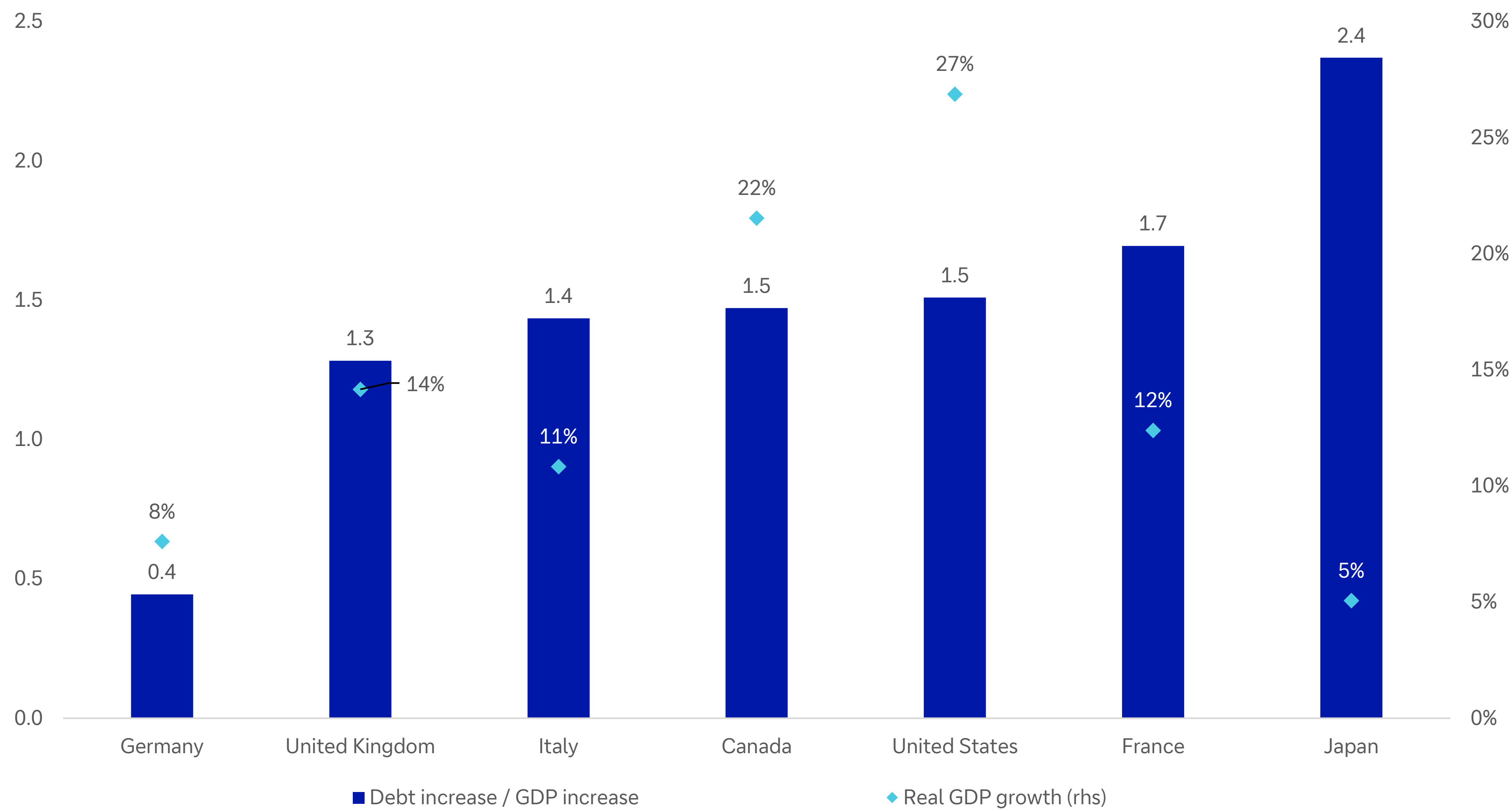


Note: All statistics in local currency, 2025 vs 2015, debt-to-GDP based on nominal GDP and gross general government debt. Source: IMF, Deutsche Bank Research 09/15/2026

BIG PICTURE: Consolidation to expansion

Germany is the only G7 country that increased debt by significantly less than 1 Euro for every Euro of GDP growth.

Bang for the buck: Germany financed its growth at a lower cost (10y)



Note: All statistics in local currency, 2025 vs 2015, debt increase / GDP increase in nominal terms. Source: IMF, Deutsche Bank Research 09/15/2026

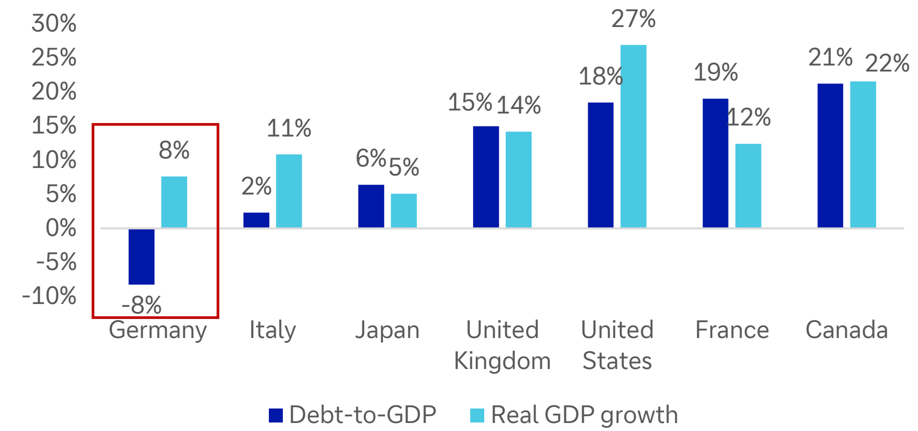
BIG PICTURE: Consolidation to expansion

Germany managed to grow its GDP despite fiscal consolidation.
An additional €1 trillion in debt by 2030 could unlock significant growth.

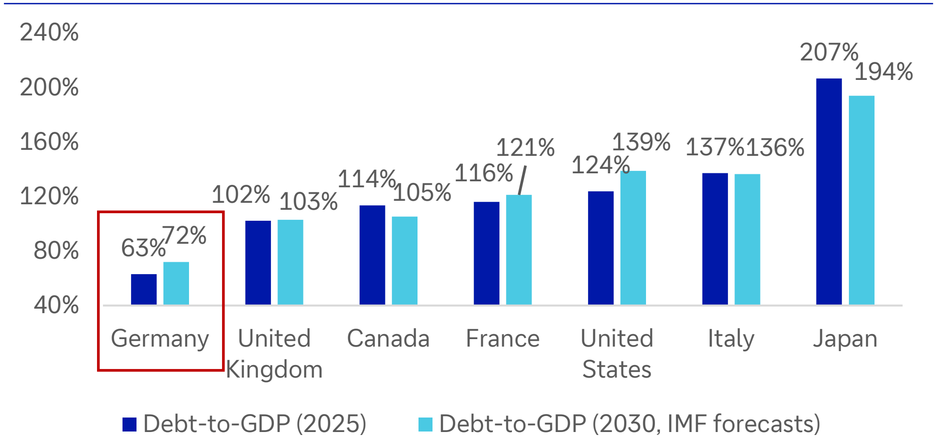
Key takeaways

- The German government plans to increase debt by more than €1 trillion by 2030, coming from €2.8 trillion in 2025 (gross general government debt). Almost 70% of the debt increase will be related to the core budget, vs 30% in off-budget funds.
- A large share of the additional debt (>€600bn) will be allocated to defence and security-related spending, almost €300bn to the special infrastructure fund (especially transportation and digitalization), and the remaining amount to other core-budget borrowing.
- For more information, see here.

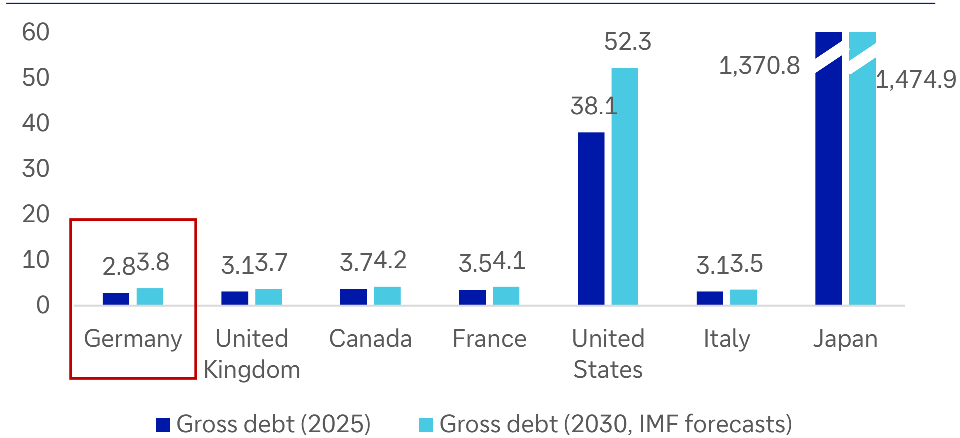
10y changes in debt and GDP across the G7



IMF projections of debt-to-GDP



Gross debt (trillions, local currency)



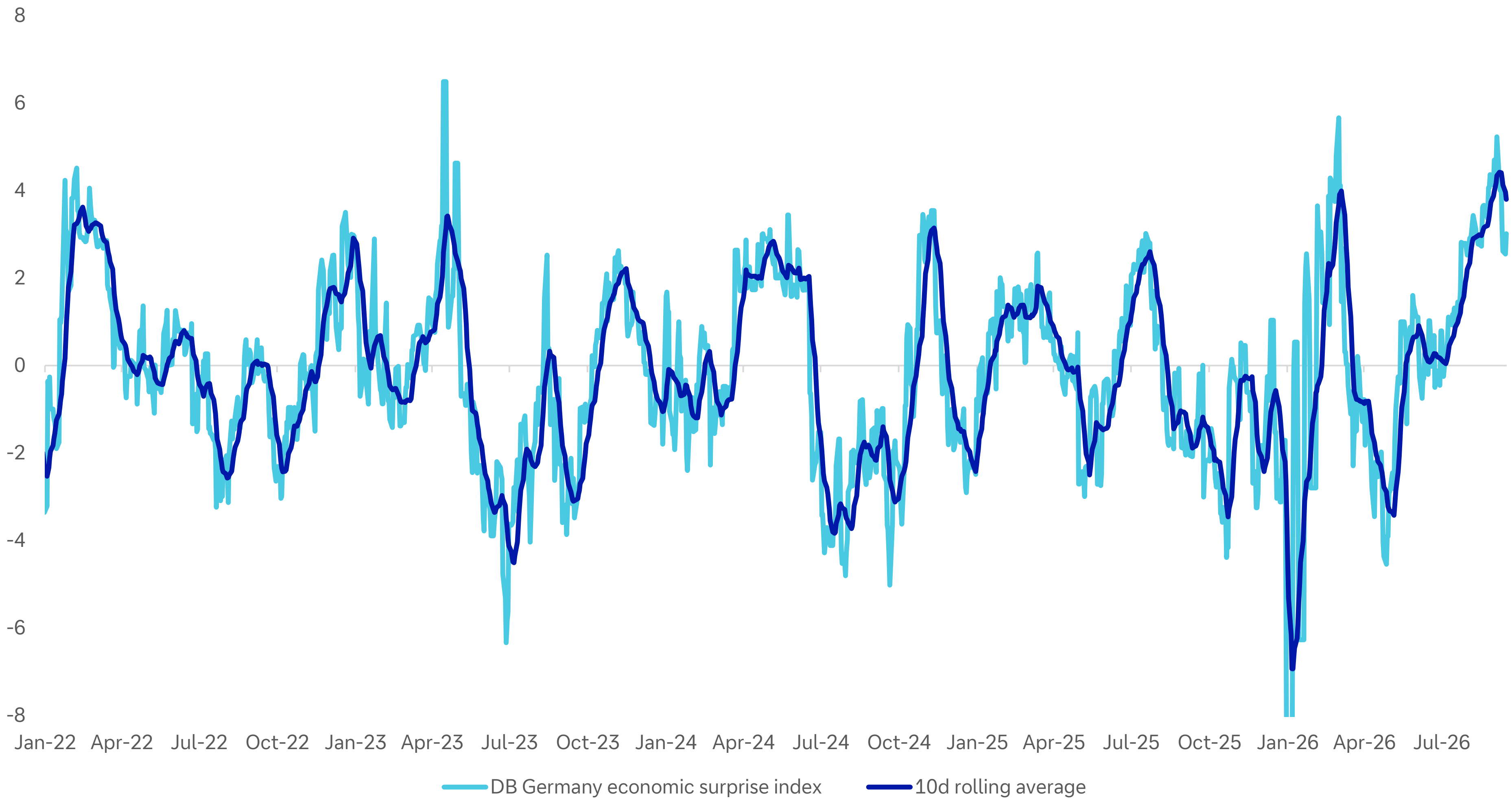
Note: All statistics in local currency, 10y changes are 2025 vs 2015, debt-to-GDP in nominal terms based on gross general government debt.
Source: IMF, Bundestag, Deutsche Bank Research 09/14/2026

Macro & political backdrop

Macro backdrop – back on track

Most recent macro data came in much better than expected in Germany.

DB Germany economic surprise index has reached its highest level since 2021



Source: Bloomberg Finance LP, Deutsche Banks Research 09/15/2026

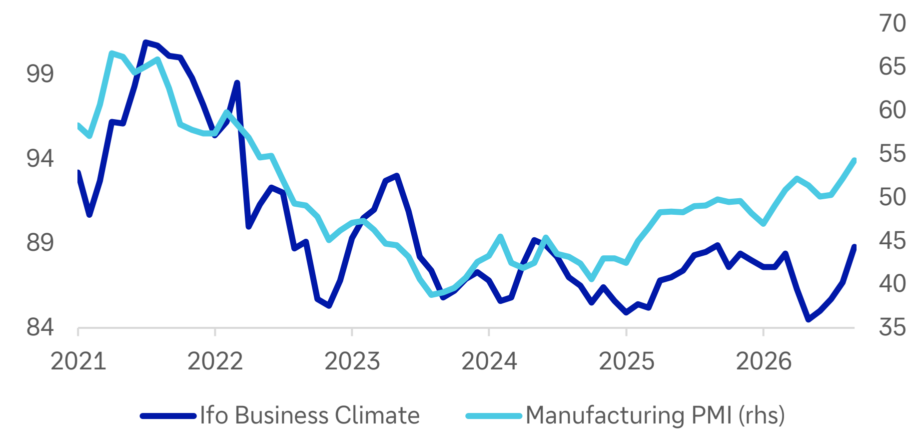
Macro backdrop – back on track

Green shoots have emerged in the German economy over recent months.

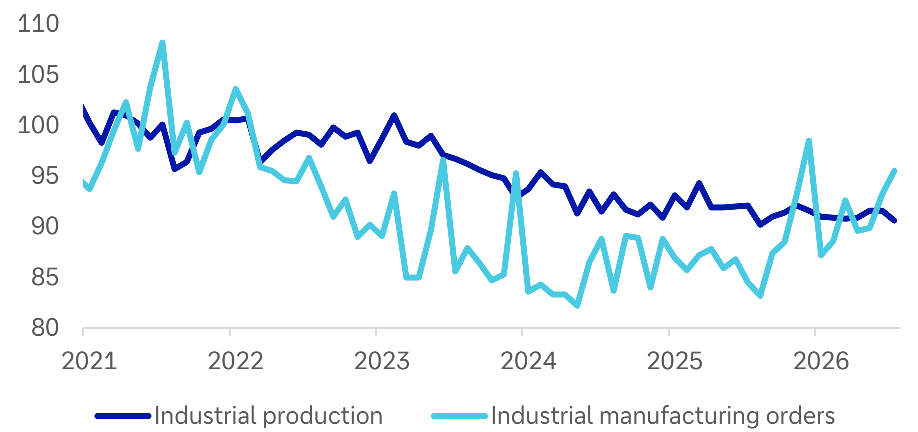
Key takeaways

- The German economy is more resilient than expected. The manufacturing PMI rose above 54 in August, its highest level in more than four years. Ifo and ZEW surveys also both surprised to the upside in August.
- Factory orders continue to edge higher, albeit still driven mainly by large orders.
- After GDP proved stronger than expected in H1, we recently upgraded our ‘26 GDP forecast to 1%.

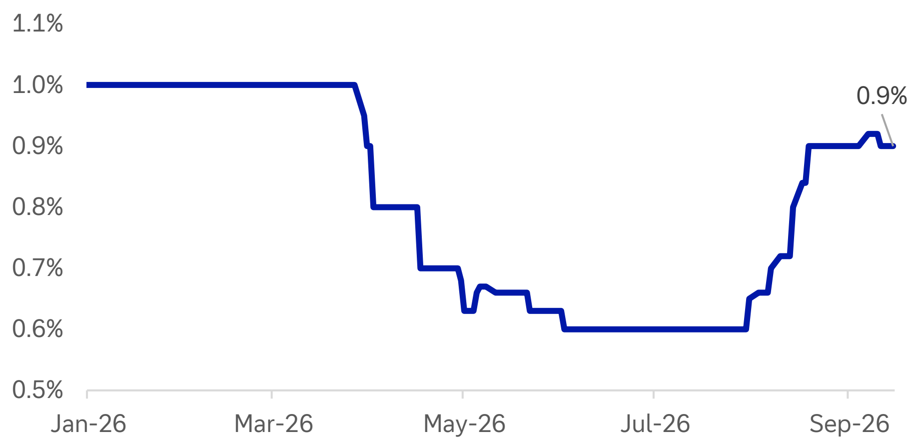
Corporate sentiment recovering



Factory orders accelerated in July



2026 GDP forecasts revised upwards*



*Median of Bloomberg consensus forecasts. Source: Bloomberg Finance LP, Deutsche Banks Research 09/15/2026

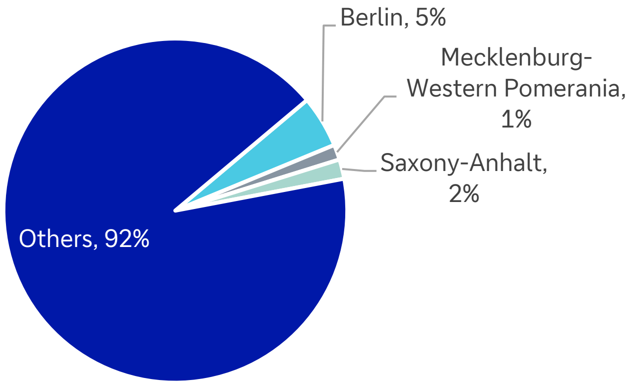
Regional elections

Higher uncertainty from regional elections. But relevance limited and pressure on government to increase pace of reforms is growing.

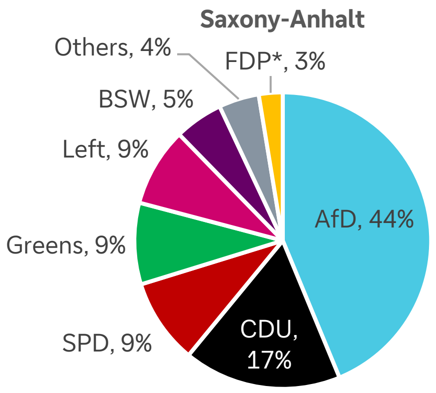
Key takeaways

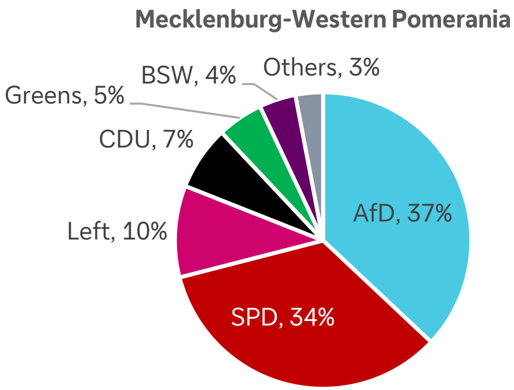
- Contrary to many concerns, the Saxony-Anhalt election triggered little to no market reaction. While the AfD will likely enter government, the economic relevance of Saxony-Anhalt within Germany is limited. In Meck-Pom and Berlin, AfD support is weaker, though fragmented parliaments may complicate coalition building.
- Regional elections have limited implications for federal politics. More importantly, we don't see the elections derailing the government's reform agenda. If anything, weaker results for coalition parties could increase pressure to accelerate reforms.

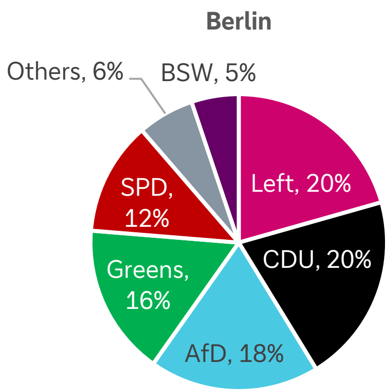
2025 German GDP: breakdown by State



Regional elections: latest results and polls (MP and Berlin elections on 20th September)







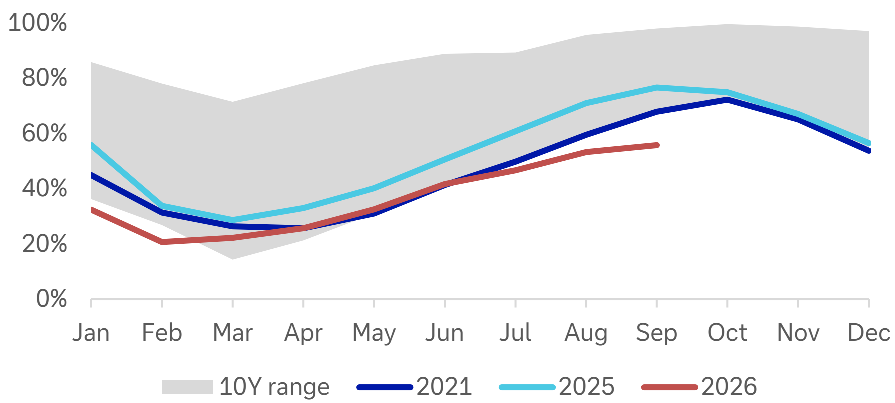
*below 5% hurdle, not in parliament

Source: Wahlrecht.de, Statistikportal des Bundes und der Länder, Deutsche Bank Research 09/15/2026

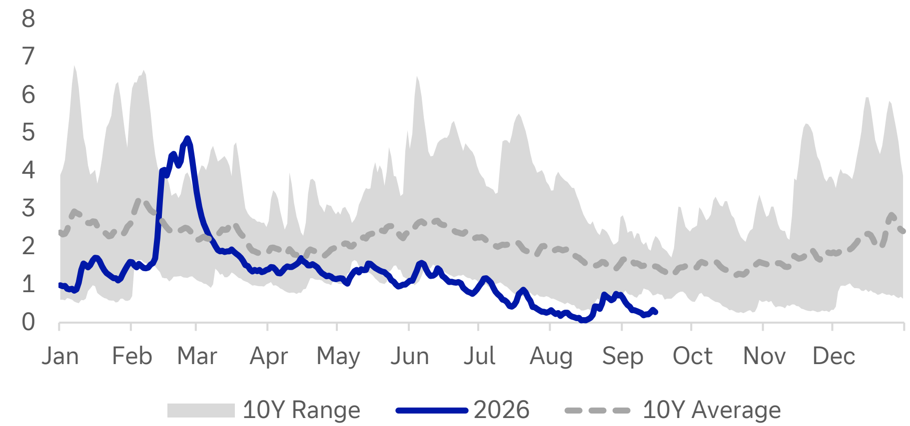
Macro headwinds – manageable?

Energy costs to weigh on short-term sentiment. However, current levels are still manageable. We estimate energy costs to be 1.2% of sales for listed German companies.

Gas storage level at only 56%

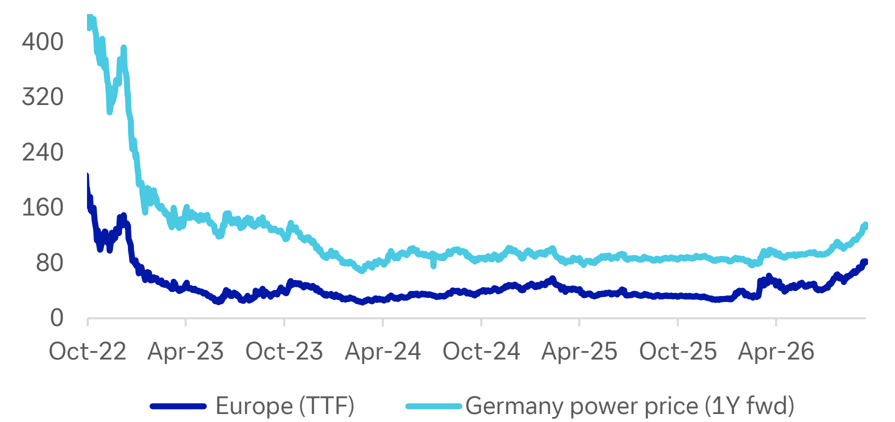


Rhine level at Kaub remains too low



Bund yield at highest since 2009

Gas and power prices up, but far below '22

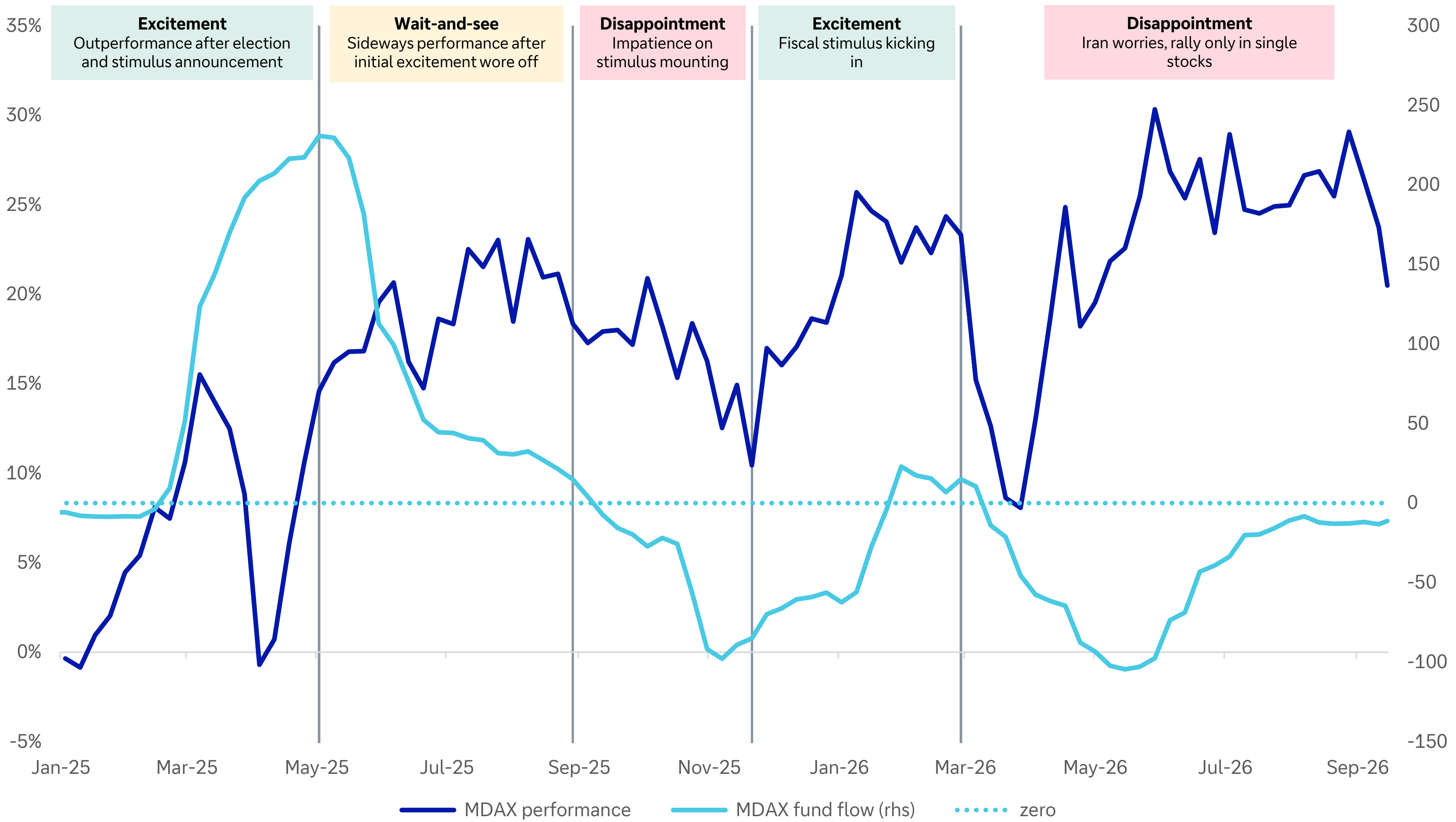


Source: Bloomberg Finance LP, Deutsche Bank Research 09/15/2026

Equity markets

Germany: Rollercoaster of emotions

We have been going through many emotions. Bring patience to benefit from the recovery.

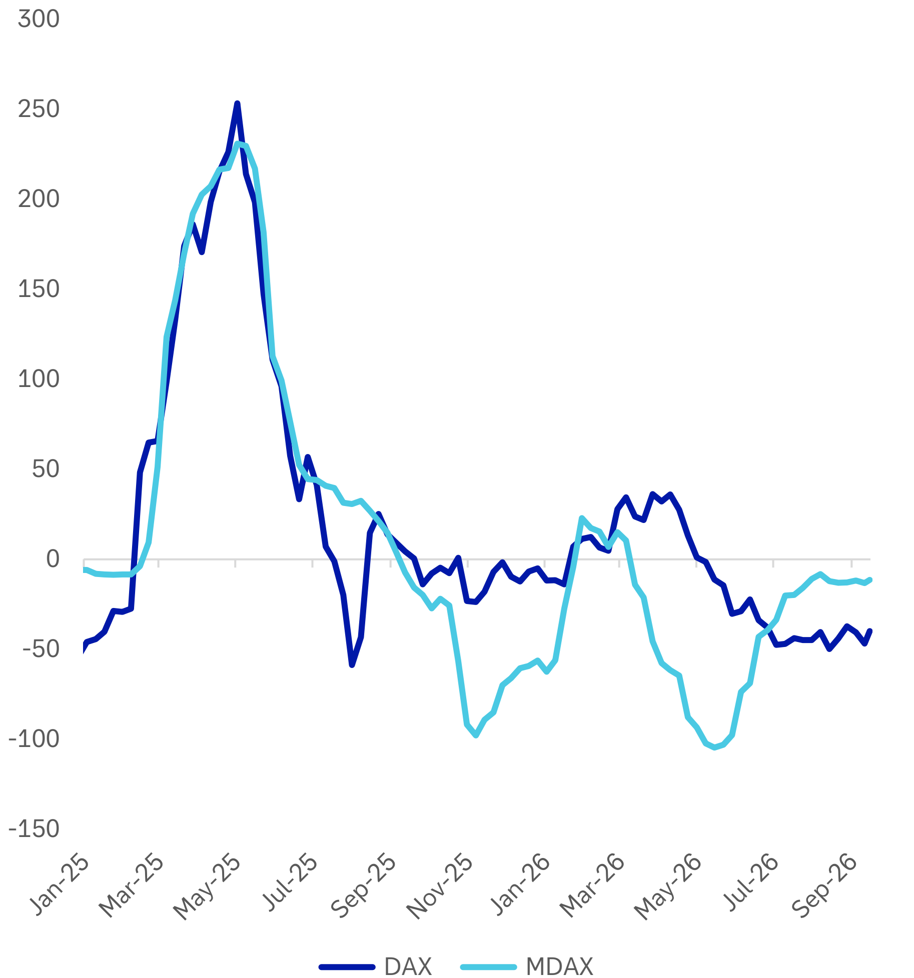


Aggregate fund flows (12-week mov. avg., mn EUR) based on up to 10 largest ETFs for the index. Source: Bloomberg Finance LP, Deutsche Bank Research 09/15/2026

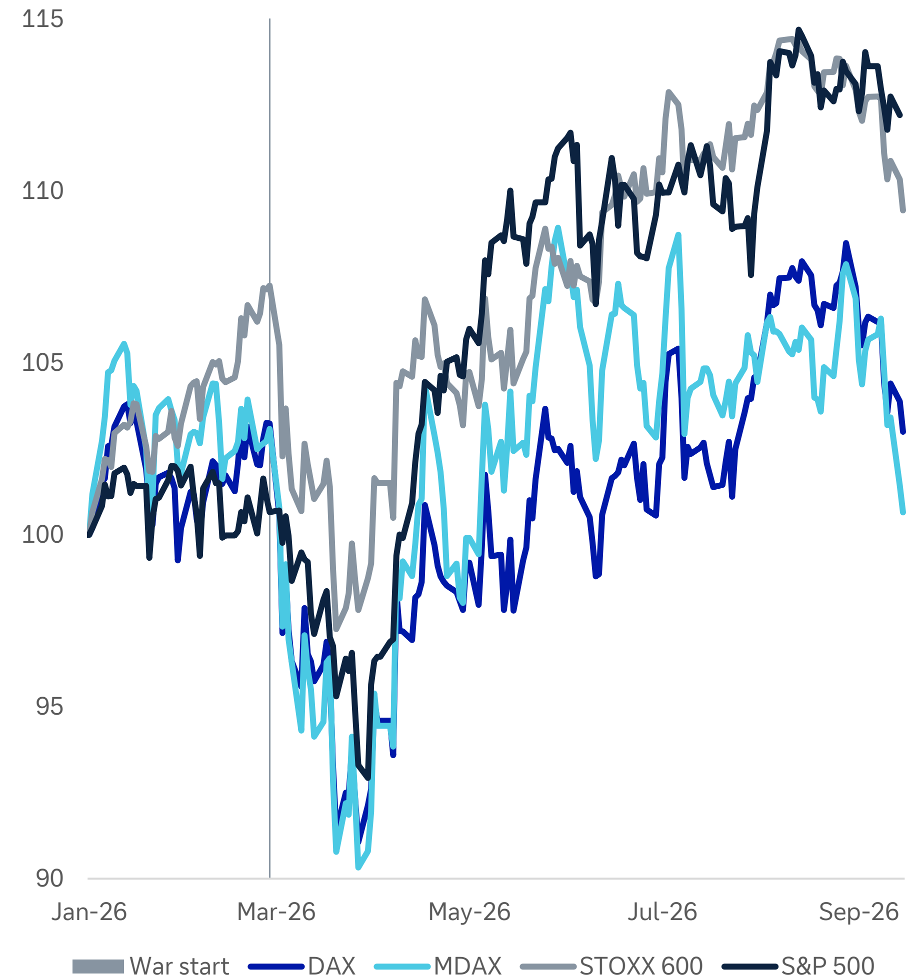
German ETF flows slowly recovering

Despite the improvement in macro indicators, flows into German equities are still depressed. The MDAX underperformed the STOXX 600 by 2% since end of June.

DAX & MDAX ETF aggregate fund flow



YTD performance (total returns, local CY)



Note: Fund flows proxied by flows into and out of largest (up to) 10 ETFs for the index, 12-week moving average, mn EUR. Source: Bloomberg Finance LP, Deutsche Bank Research 09/15/2026

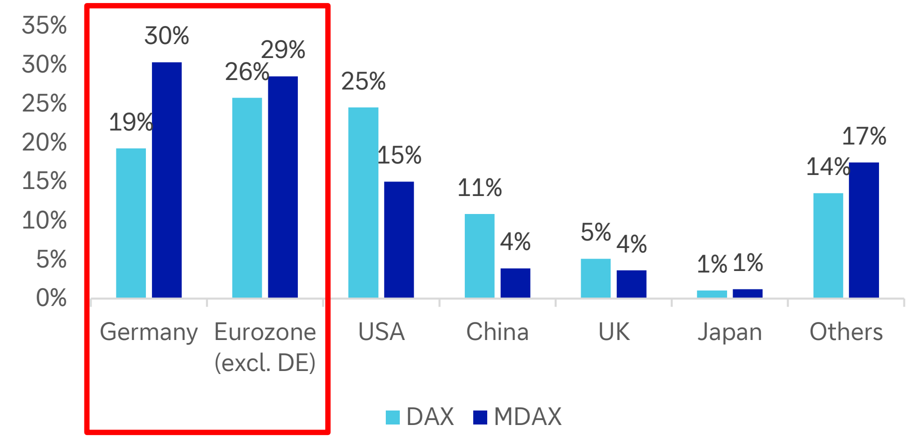
Equity implications: DAX vs MDAX

We think the MDAX is a better proxy for German growth and should benefit most from economic improvements and new reforms.

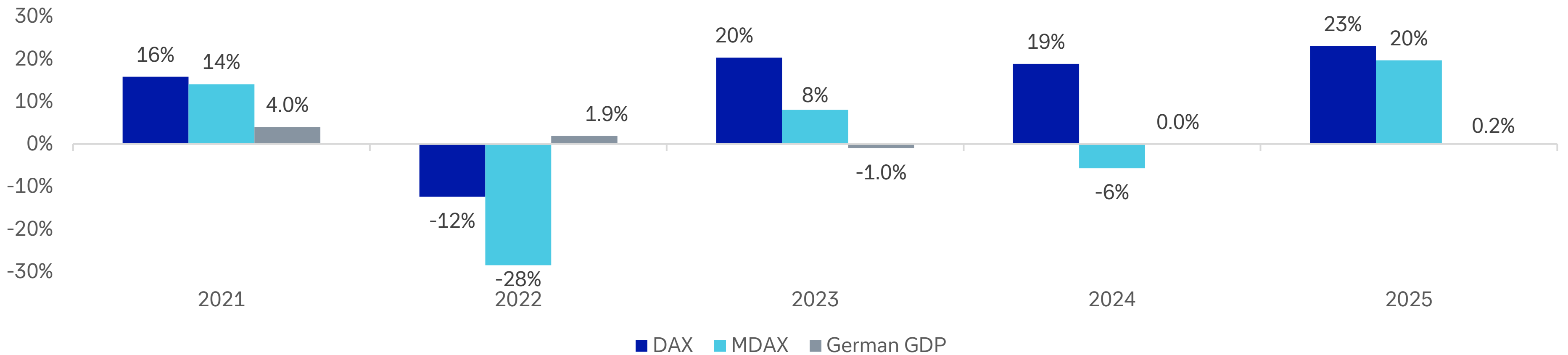
Key takeaways

- The DAX's exposure to Germany is limited; a better proxy for Germany-specific news flow is the MDAX.
- The MDAX has a higher revenue exposure to Germany than the DAX (see right chart) and its performance is linked much more closely to German GDP growth (see below chart). The new reform agenda and a more industry-friendly policy approach in Germany bear significant catch-up potential for the MDAX which has underperformed the DAX significantly over the past years (see slide 30).

Regional revenue exposure (FY24)



MDAX is the better proxy for German growth



All exposures are best estimates by our DB company analysts and are not necessarily based on published company data.
Source: Bloomberg Finance LP, Company Data, Deutsche Bank Research 09/15/2026

MDAX still offers high catch-up potential

German mid caps underperformed large caps massively over the past years. The improving macro backdrop and new reforms should support the MDAX.

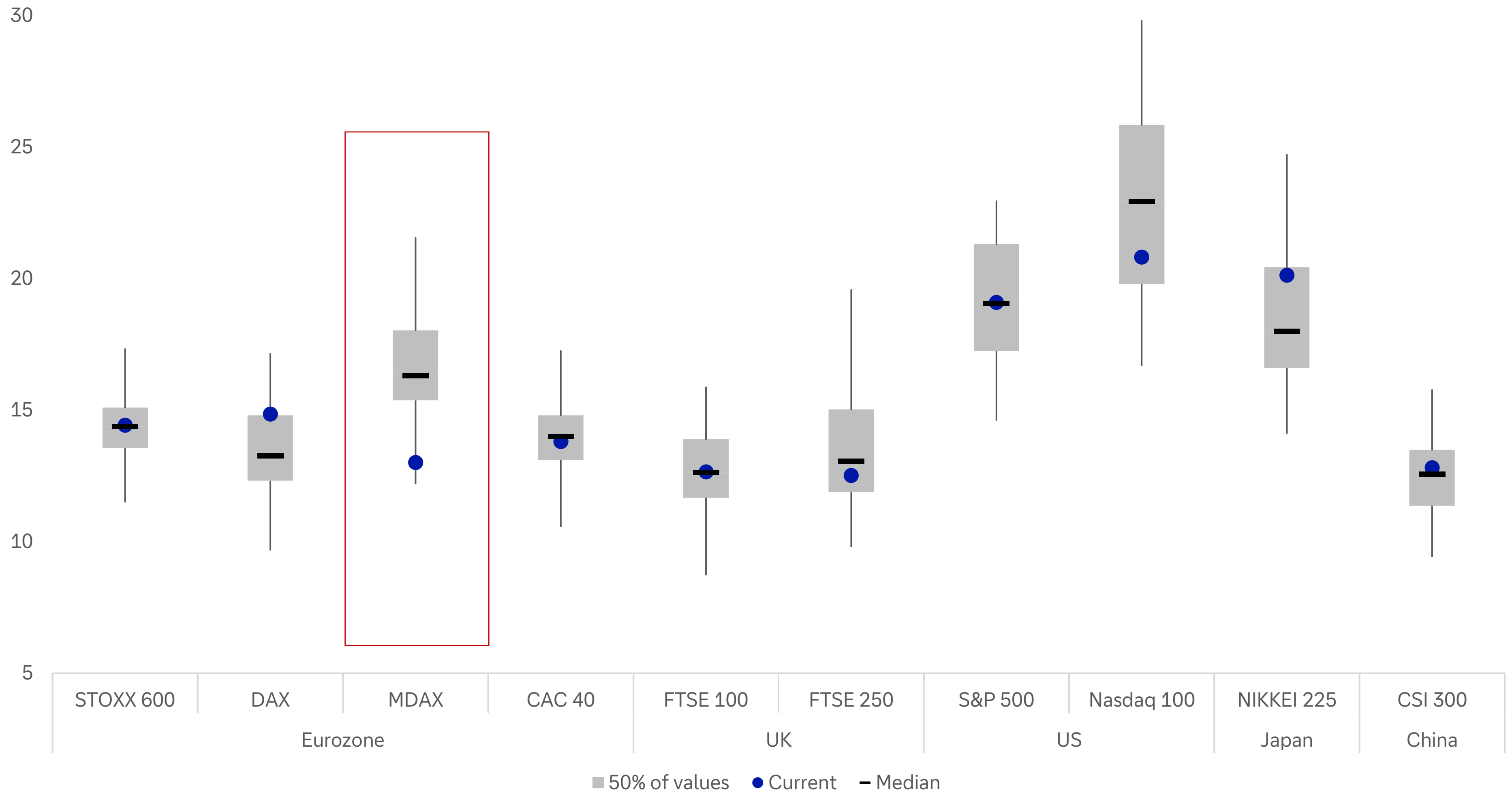
Total return since 2022

Source: Bloomberg Finance LP, Deutsche Bank Research 09/15/2026

Valuations

In our view, European valuations are not elevated. Within Europe, the MDAX trades at lowest value relative to history

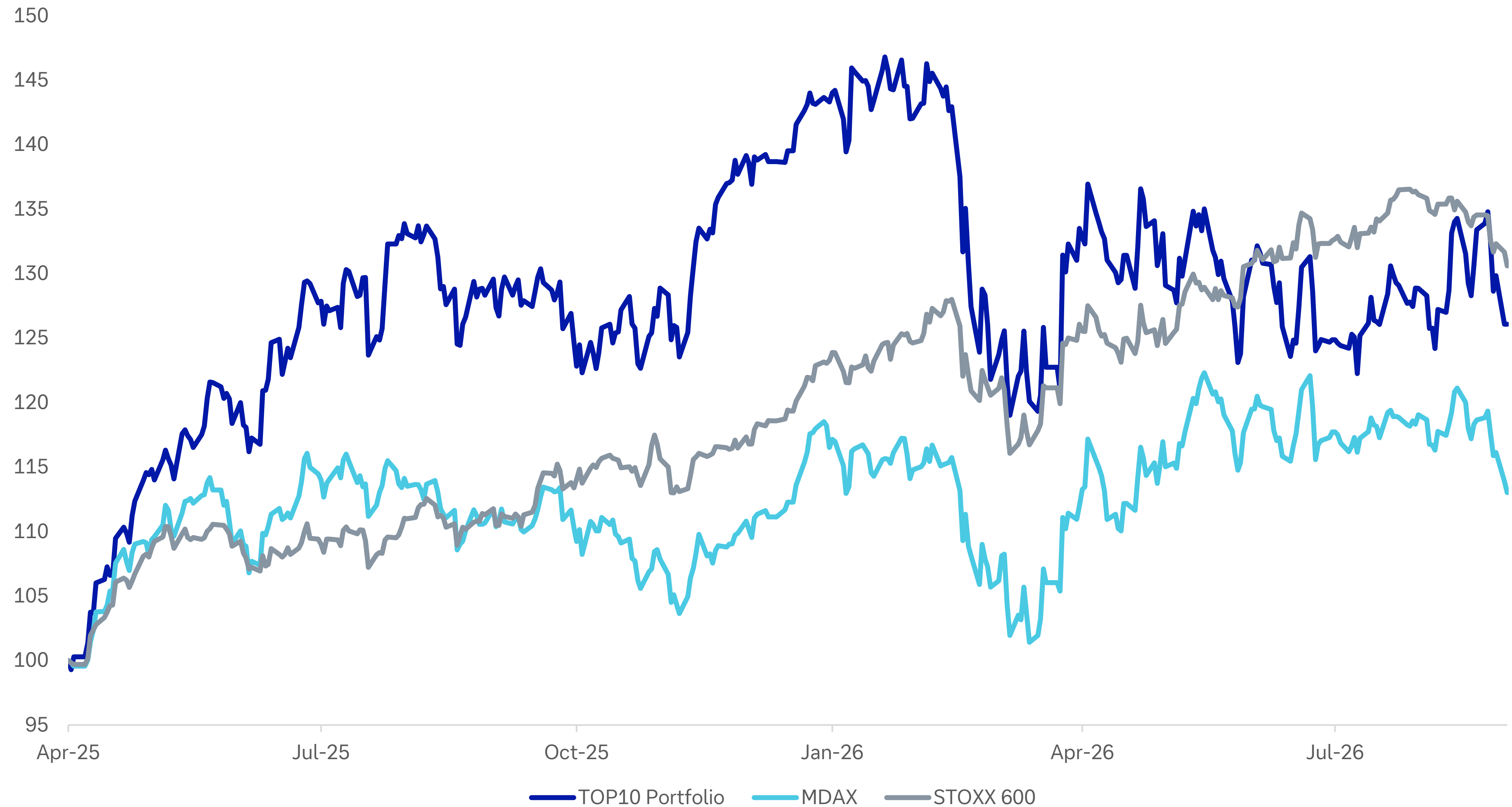
Valuation vs 10y median (12m fwd P/E)



Time period: Aug 2016 – today.
Source: Bloomberg Finance LP, Deutsche Bank Research 09/15/2026

TOP10 Germany stock basket

Total return since inception



Note: German top picks portfolio inception was on 04/15/2025. . Source: Bloomberg Finance LP, Deutsche Bank Research 09/15/2026

Reform agenda

Germany: Reform hammer in full swing

Area	Detailed measures	Status
Economic Growth	– "Growth Booster": – 30% accelerated depreciation on machinery and equipment, 75% on EVs – Gradual corporation tax cut from 15% to 10% and R&D tax credit expansion	– In place – Jul '25 - Dec '27 for depreciation – 2028-2032 for corporate tax cut
Energy Prices	– Industrial power price: electricity price for corporates lowered to 5 c/kWh – Earlier abolition of gas storage levy – Lower grid fees – Electricity tax cuts to EU minimum level is extended indefinitely – Reduction of energy tax on petrol and diesel by 17 ct/l for two months	– In place – Industrial power price until Dec '28 – Reduced energy tax only during May + June '26
Private Pension System	– "Altersvorsorgedepot" (old-age provision account): retirement savings account with tax benefits, allowing investment into products without guarantees (e.g., ETFs)	– Approved, to become effective on Jan 1, 2027
Sector-specific	– "Construction turbo" law to accelerate planning and approval procedures – Air ticket tax cut by up to ~€11/passenger – Autos: EV subsidies of up to €6,000 for buyers, extension of car tax exemption for EVs (up to 10y)	– Construction turbo until 2030 – Air ticket tax: since 1st July – EV subsidy 'til '29, EV tax exemption 'til 35
Public Procure-ment	– Law to faster and simpler public procurement processes – No need to start a contract award process for federal public contracts up to 50k EUR	– In place since 1st July
Labour Market	– Retirees can earn up to €2,000/m tax-free when working while on retirement	– In place since Jan '26
Infra-structure Accelerator Act	– Prioritizes approval process for critical infrastructure (e.g., railways, highways) – Digitalization of approval processes – Easing of environmental checks	– Passed by Bundestag on June 26

Area	Detailed measures	Status
Health Care System	– Restricting free family insurance – Higher contributions by higher earners – More co-payments by patients and less benefits (braces, dentures, homeopathy) – Price caps for hospitals/pharma	– Approved in parliament in July, – Effective in 2027/2028
Private Pension System	– "Frühstart-Rente" (early start pension): monthly public grant of €10/child (ages 6-18), to be invested into capital market products, tax-free until the payout phase. Withdrawals generally allowed from age 65.	– Approved by the Cabined in August, Parliamentary approval pending
Statutory Pension System	– Gradual increase in retirement age to 67.5 – Limiting early retirement programs – Age for old-age part-time work up to 58 – Raising number of contributors, e.g. self-employed, MPs, managers – Introduction of mandatory funded component: 2% additional contribution into centralized pension fund.	– Approved by coalition committee, Parliamentary approval pending
Labour Market	– Easier extension of fixed-term contracts – relaxed dismissal protection for top earners – Preferential tax treatment if a new job is taken up quickly – Medical certificate from first day of illness	– Approved by coalition committee, Parliamentary approval pending
Income Tax	– Increase of basic tax-free allowance – Higher deductions for families and employees – Flattening of the tax rate for low income – Increase of "rich-tax" to 45% on taxable income >€250k (47% for income >€280k)	– Approved by the Cabinet in September, Parliamentary approval pending
Bureau-cracy	– Removal of some reporting obligations – Reduction of need for company representatives – Applications (e.g for construction projects) to be automatically approved after 3m – Aim to cut federal ministries staff by 8%	– Approved by coalition committee. – Bureaucracy Reduction Act passed in May '26

Source: Federal Ministry of Finance, Federal Government, Bundesregierung , Deutsche Bank Research 09/15/2026

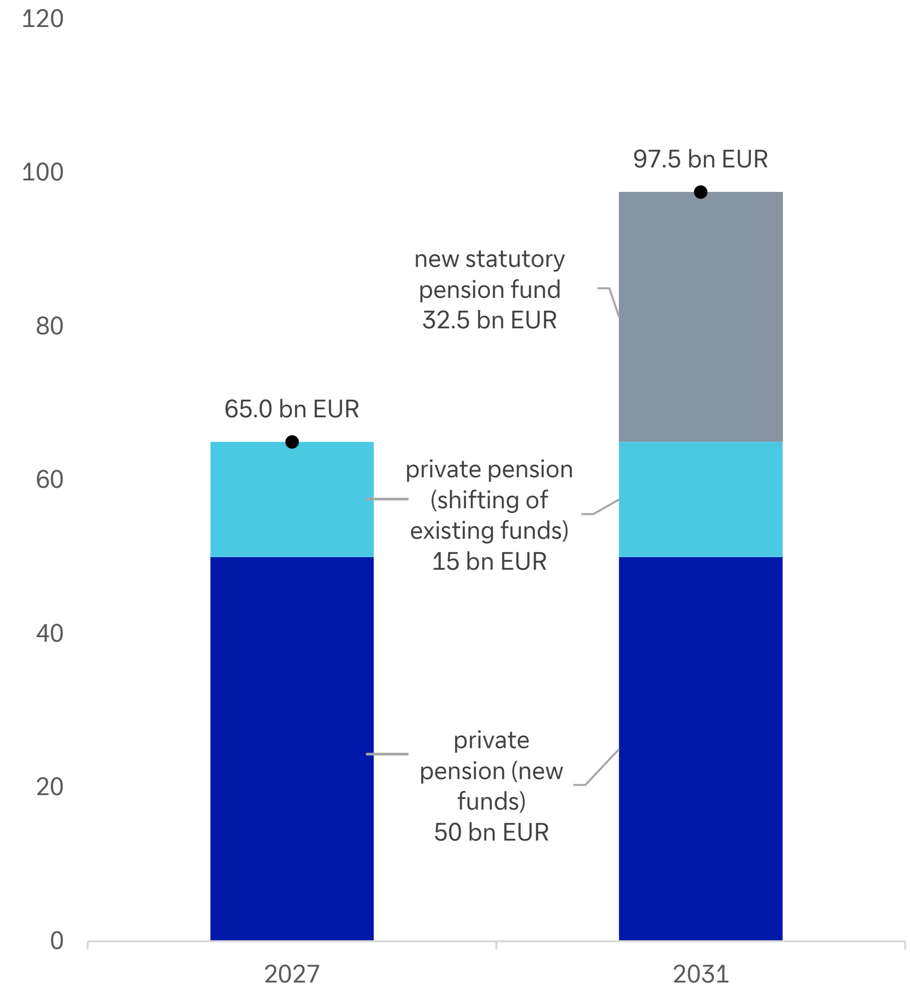
Germany: pension reform

Pension reform could lead to additional annual inflows of 10-15 bn EUR into European equities over the next years.

Key takeaways

- The planned reform of Germany's pension system could generate **significant inflows into European equities** by shifting retirement savings towards capital markets.
- On the private pension side, the new "**old-age provision account**" encourages savers to move funds from low-yield deposits and insurance products into higher-return investments. If half of the eligible population invests the annual amount required to receive the full tax benefit (€2,300), **inflows could reach €50bn per year**.
- We also expect assets to **migrate from the existing "Riester" system**. With total estimated Riester assets of €150bn, a 10% annual reallocation would generate a further **€15bn of inflows.**
- In parallel, the government plans to introduce a funded component to the statutory pension system, equivalent to 2 pp of gross salaries, to be invested through a central **public pension fund**. Contributions are planned to rise from 0.5pp in 2028 to 2pp by 2031, implying annual **inflows of €8bn initially and €30-35bn by 2031,** according to our economists.
- Overall, we estimate these reforms could generate **€60-100bn of additional annual capital market inflows**, of which around **€10-15bn (15%) may find its way into European equities**. To put this into context: the top 50 largest European ETFs saw inflows of c. €40bn in 2025.

Projected inflows into capital markets



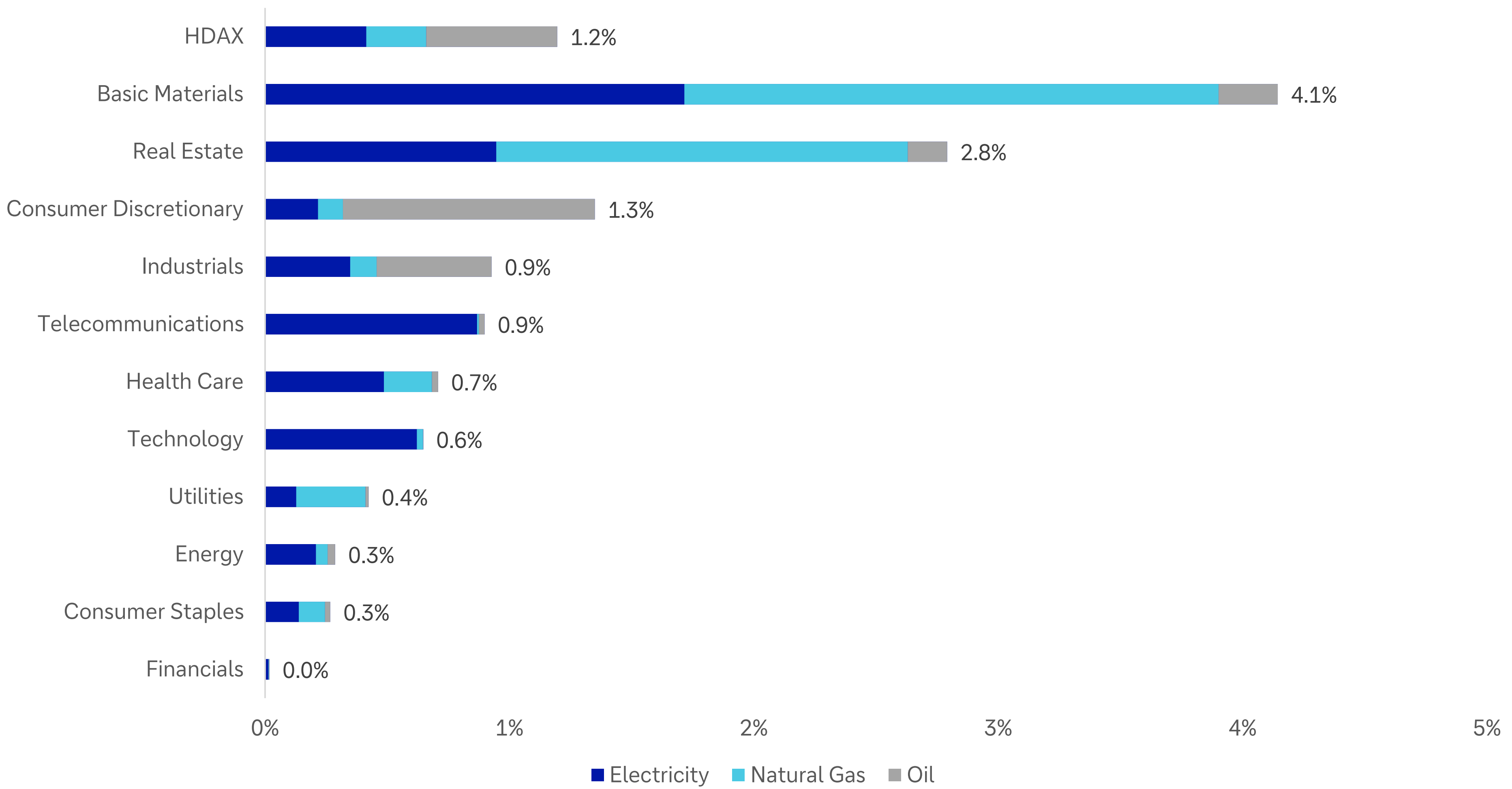
Source: BMAS, Deutsche Bank Research 09/15/2026

Deutsche Bank Research Institute

Appendix

Energy costs comprise only 1.2% of HDAX revenues

HDAX energy cost as % of sales*

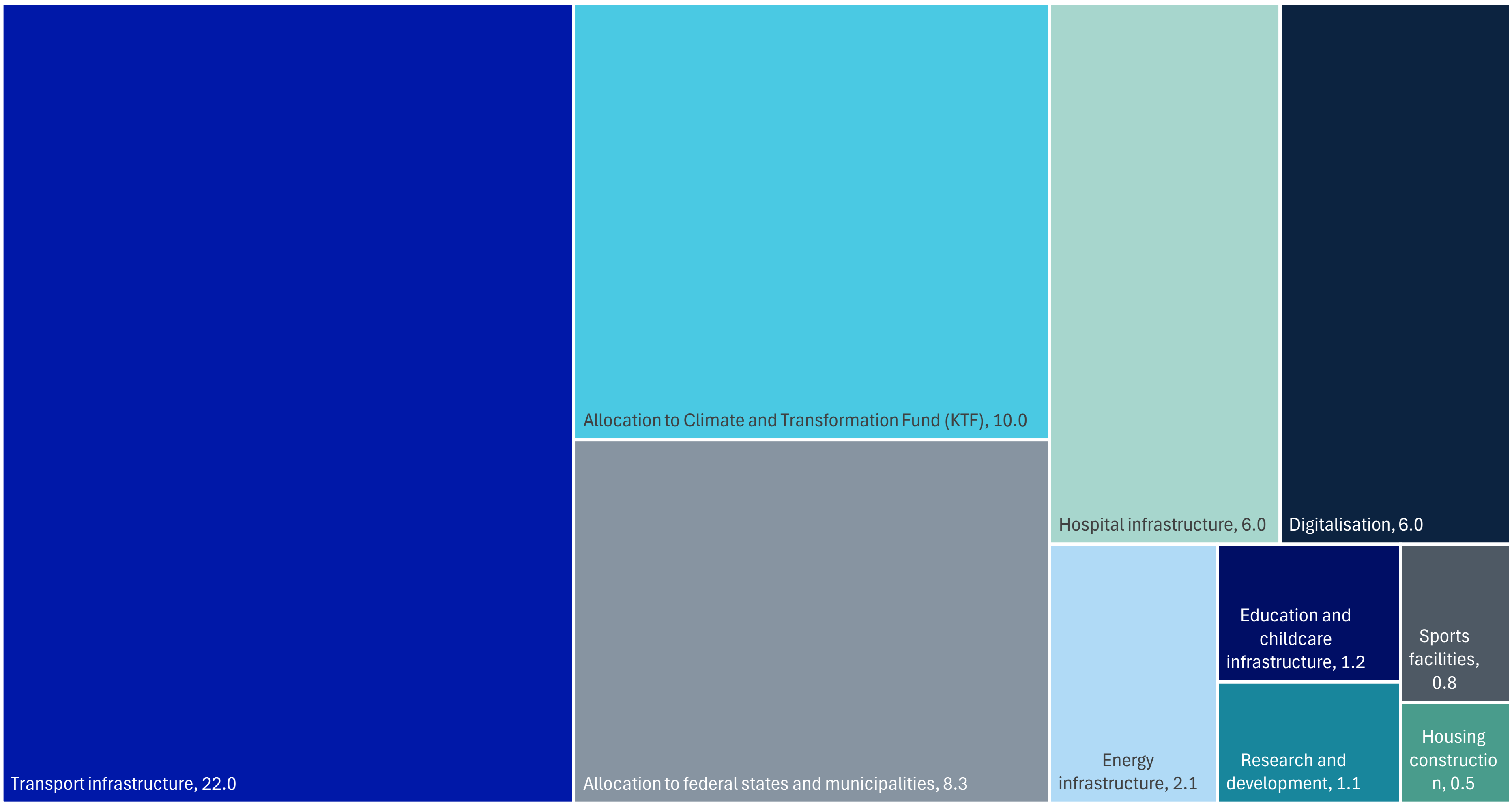


*N=50, based on 3y average German power prices, TTF natural gas and Brent oil. Source: Bloomberg Finance LP, Deutsche Bank Research 09/11/2026

Where to invest?

Most of the higher spending is going into Defence and Infrastructure. Defence has already rallied. We expect sectors with order intake from Infra spend to benefit most.

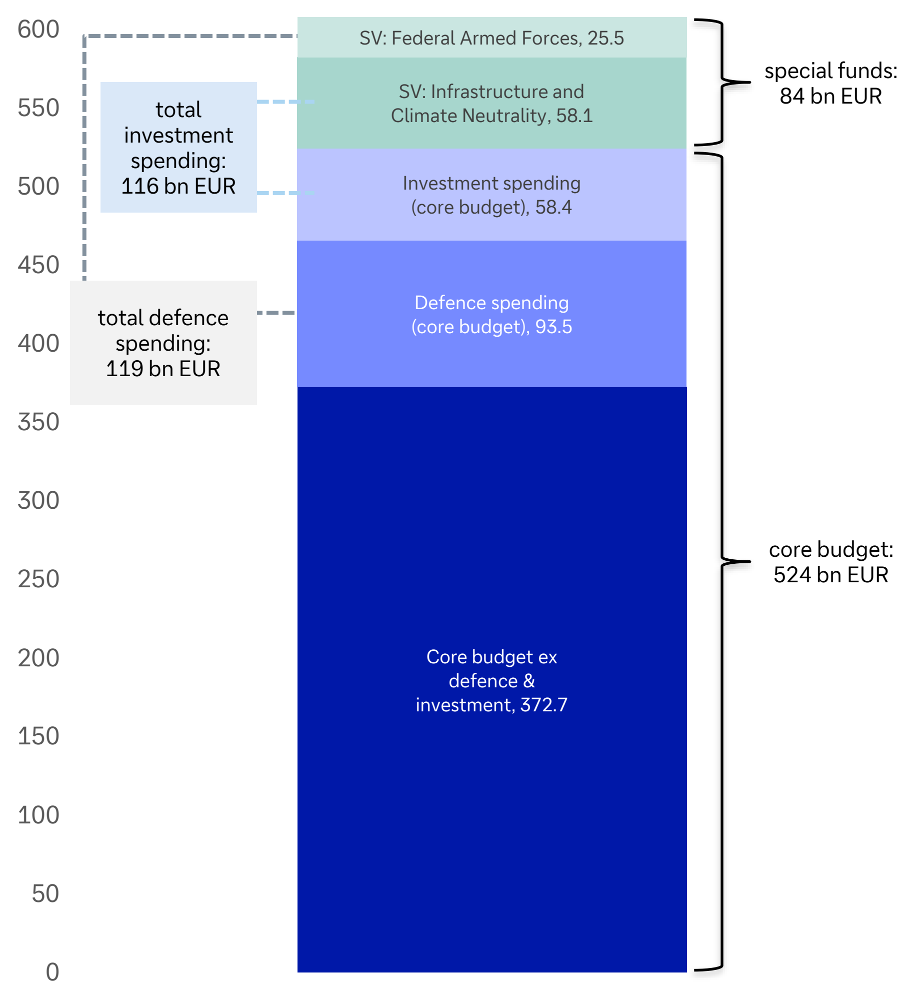
Planned investments from the special fund for Infrastructure & Climate Neutrality, 2026, mn EUR



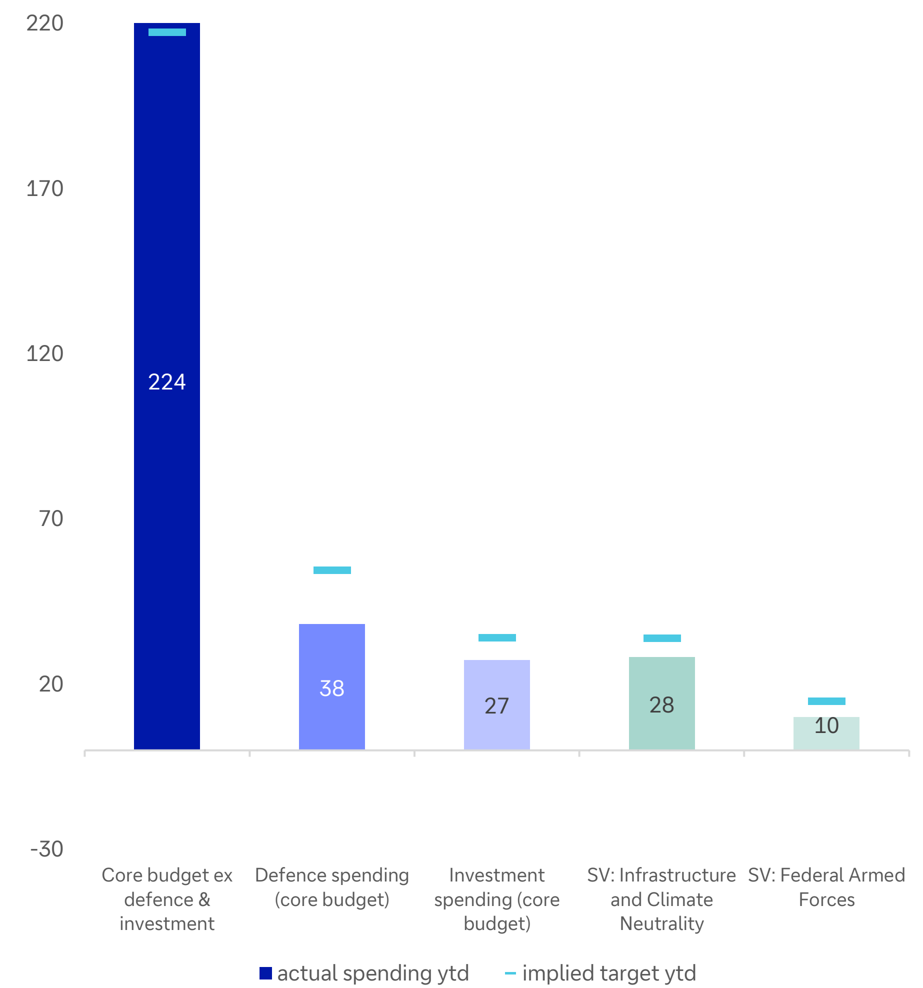
Source: Bundesfinanzministerium, Deutsche Bank Research 09/15/2026

Germany: fiscal expansion underway, with room for spending to accelerate

2026 planned fiscal spending



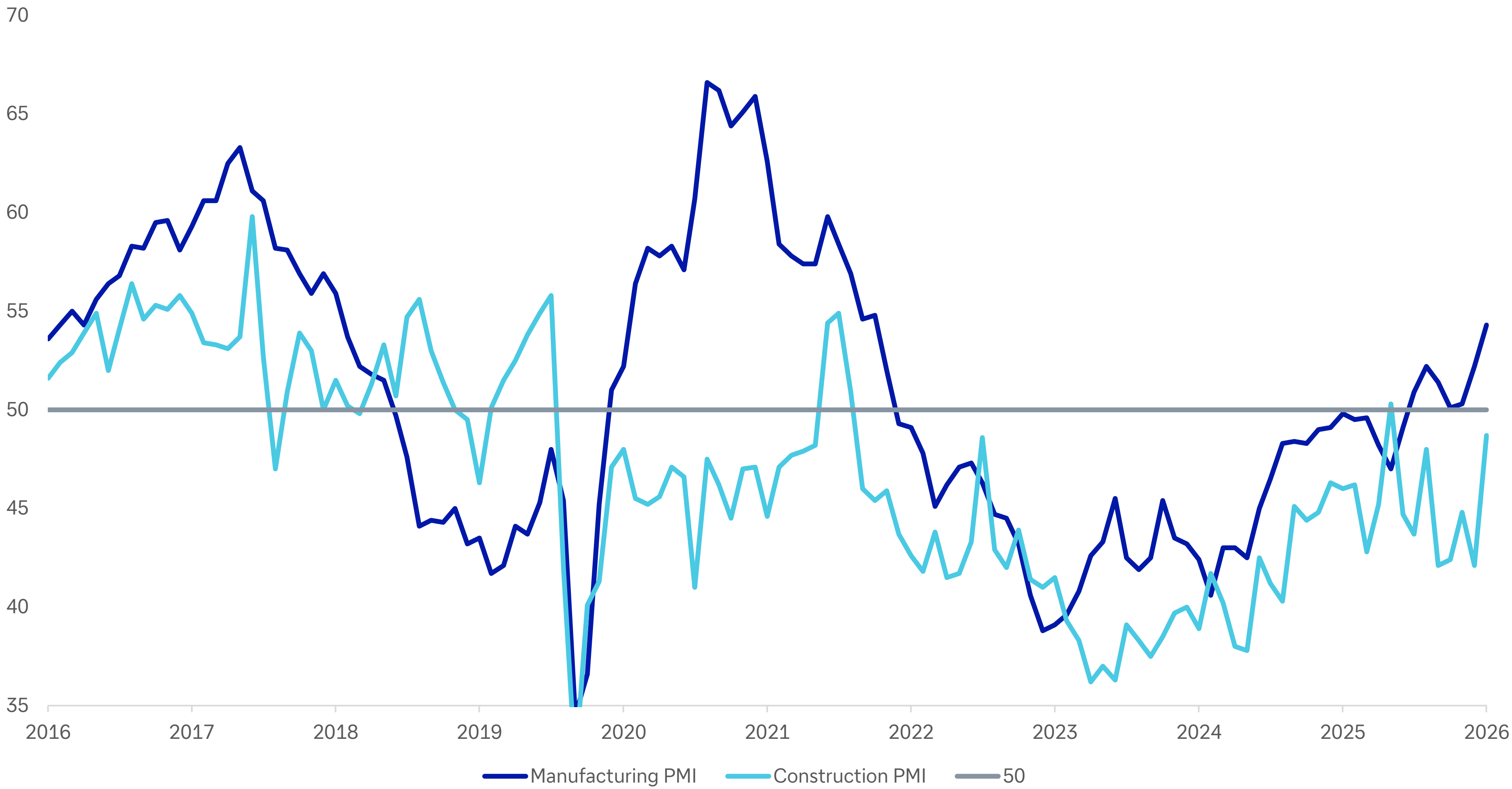
Spending still below target year-to-date



All figures in bn EUR. Actual spending data as of end of July. Source: Bundesfinanzministerium, Deutsche Bank Research 09/07/2026

Manufacturing PMI highest in over 4 years, Construction PMI catching up

Germany Manufacturing PMI



Source: Bloomberg Finance LP, Deutsche Banks Research 09/15/2026

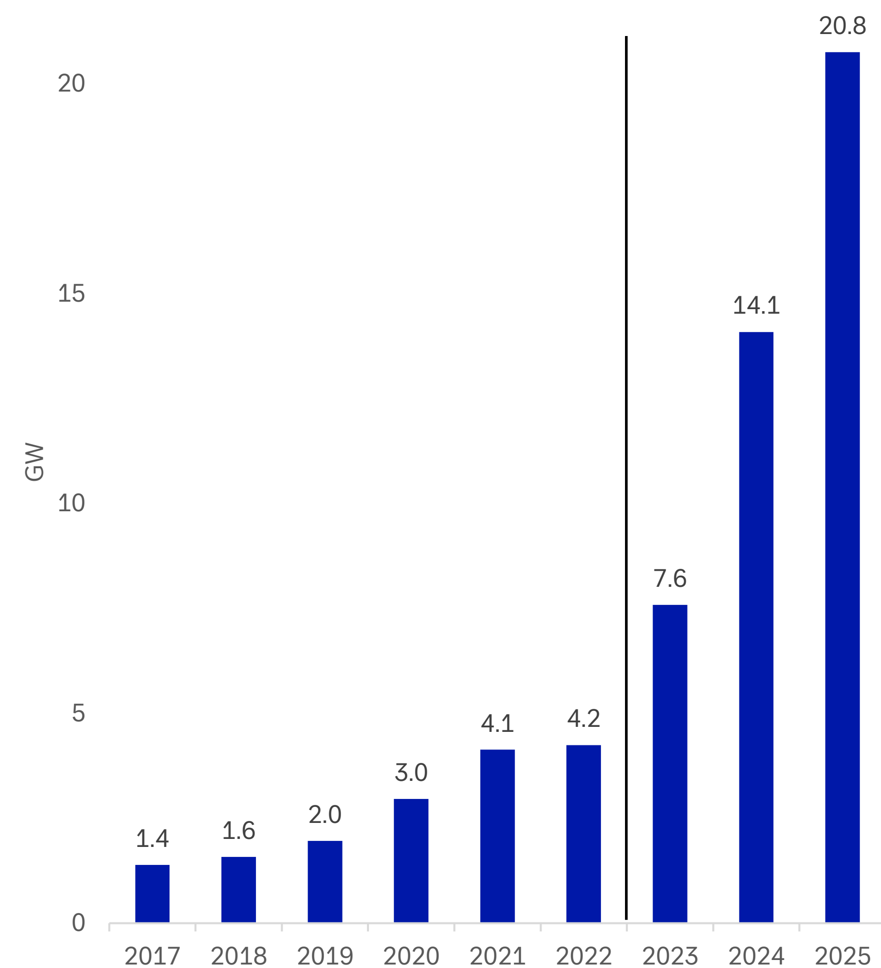
German reforms: example from the past

Onshore & Offshore Wind Act

Key takeaways

- In 2023, Germany introduced the Onshore Wind Act and revised the Offshore Wind Energy Act to accelerate the energy transition and streamline renewable energy development.
- For the first time, federal states face legally binding requirements to allocate land for wind power. The share of Germany's land designated for onshore wind is set to increase to 1.4% by 2027 and 2.0% by 2032.
- Policy reforms are already delivering results. In H1 2025, Germany approved 20.8 GW of new onshore wind capacity, nearly four times the level seen in 2022, marking a record pace of expansion.

Newly approved onshore wind energy capacity



Source: SMARD, Statista, Deutsche Bank Research 09/15/2026

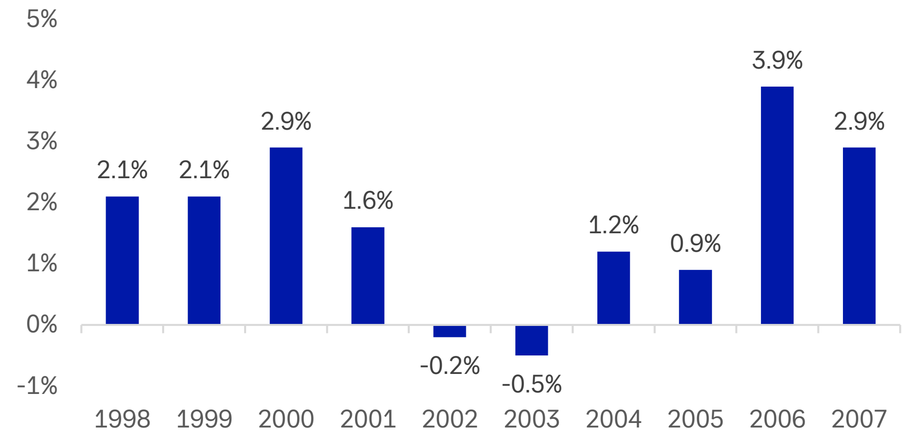
German reforms: example from the past

Agenda 2010

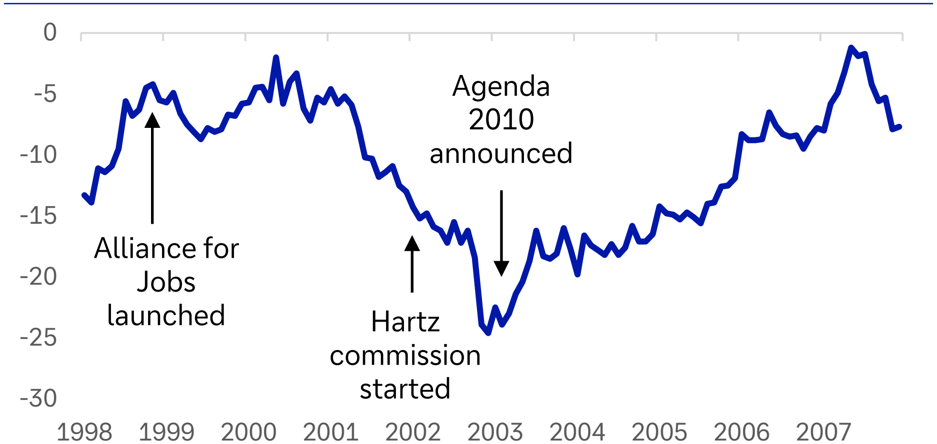
Key takeaways

- Facing stagnant growth and rising unemployment, Germany launched a series of labour-market reforms between 2002 and 2005, beginning with the Hartz Commission and culminating in Agenda 2010.
- The reform package tightened unemployment benefits, expanded labour-market flexibility, improved job placement, and reduced income and corporate taxes to strengthen incentives for work and investment.
- While initially controversial, the reforms helped restore confidence: GDP growth turned positive in 2004, consumer sentiment improved, and equity markets rebounded.

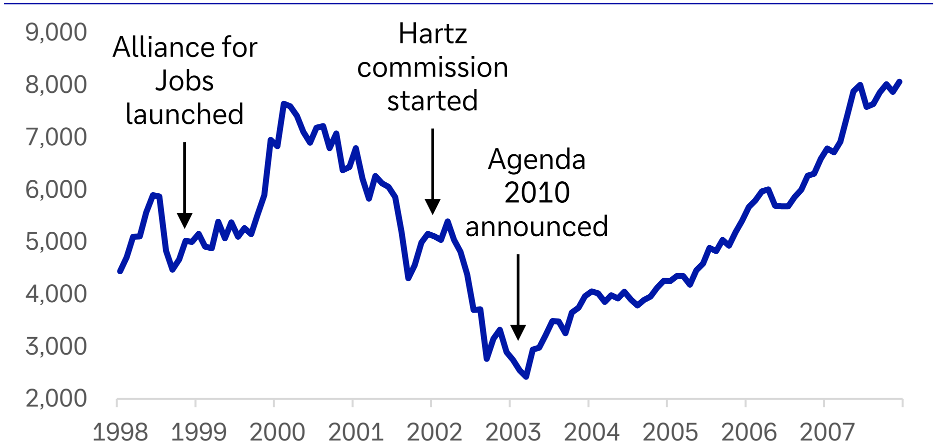
Germany annual GDP growth



Consumer confidence



DAX



Source: Bloomberg Finance LP, Deutsche Bank Research 09/15/2026

Appendix 1