EUROPEAN INFRASTRUCTURE: POWER BOOM WITHOUT THE PREMIUM

INVESTMENT VIEWS
IN PARTNERSHIP WITH NEWTON INVESTMENT MANAGEMENT

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Global equities have recently hit a series of new all-time highs[1] but lack of market breadth has been the story of the rally. Just a handful of large US tech stocks have led the pack, on the back of AI enthusiasm. Investors wanting diversification away from the "Mag 7" can consider European infrastructure, where hunger for energy is a tailwind but valuations have not yet been amplified by the expensive AI-driven power boom.

Concentration risks

Seven large US tech companies, often referred to as the "Magnificent-7," or "Mag-7," have contributed 30% to global equities' cumulative return of 155% over the past ten years through December 31, 2024, despite comprising only 11% of the benchmark, on average, during the period.[2]

The narrowness of the market rally was even more pronounced in the US, where the Mag 7 stocks contributed 29% of the S&P 500 Index's cumulative 242% return over the previous ten years through December 31, 2024.[3]

From a sector perspective, we see that the information technology sector grew from 19% of the S&P 500 to 33% over the same period and contributed 42% of S&P 500's return despite an average weight of 25%.[4] Together, the weight of the industrials, utilities, energy and materials sectors has fallen from 25% of the S&P 500 ten years ago to 15.5% at the end of 2024. The four infrastructure-exposed sectors started 5% bigger than information technology and ended 17% smaller.[5]

This makeup poses a challenge for investors who rely on the S&P 500 for diversification. Specifically, infrastructure stocks have become notably under-represented within a typical S&P 500 equity allocation.

Looking back over 2024, the S&P 500 utilities sector appreciated 27% while European utilities were flat.[6] A key driver of the US appreciation and relative outperformance was the significant capital expenditure of US mega-cap technology companies to support the build-out of the AI ecosystem. In our view, these investments in infrastructure, especially related to power, show no signs of stopping.

Why Europe?

We see three drivers of opportunity for active managers in European utilities:

1. Government incentives aimed at decarbonization can provide tailwinds for renewables-exposed utilities.
2. We believe there is a significant sector dislocation in European utilities, potentially unlocking opportunity for active managers.
3. We believe electrification and investments in energy independence may continue to drive European electric and gas utilities.

European government support

We believe that infrastructure support for AI is a global goal essential for maintaining competitiveness in leading-edge technology. In addition, due to data privacy concerns, we believe countries will want to control their own technology and data, which will require them to build data centers domestically. Europe has fallen behind technology leaders in the US and China, and European officials have become vocal about the need to act.

Valuations favor Europe

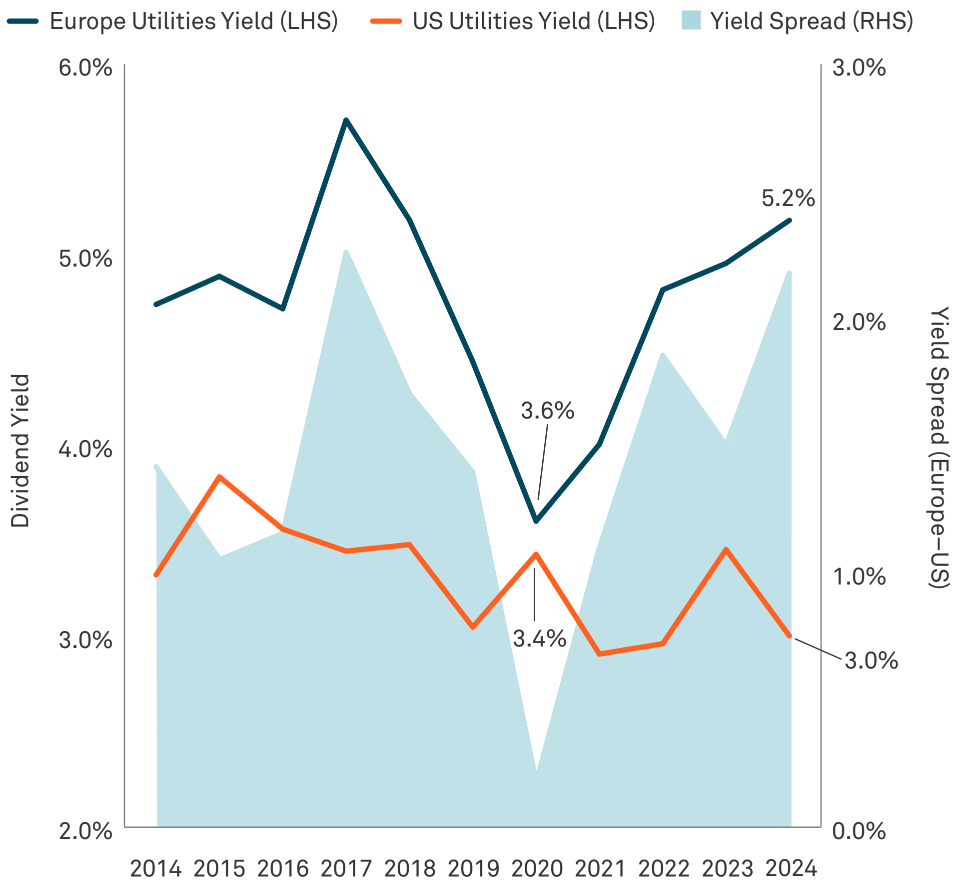
In the past 11 months, price-to-earnings (P/E) ratios of US utilities have rerated by 17% versus 3% for their European counterparts.[7] European utilities currently trade at a 31% P/E discount relative to US utilities, which is more than twice as large as the long-term average of 15%.[8]

Yield spreads

Given the movement in markets, the spread[9] between dividend yields of European and US utilities has moved from 20 basis points (bps) to 220 bps over the past four years[10] creating opportunities to find promising value investment opportunities in the European utilities sector. This is especially pertinent given the secular tailwinds[11] we expect in the coming year(s), which are identical to the tailwinds that are currently playing out in US markets and driving shares across the infrastructure space.

Based on the strength of the US utilities sector driven by the AI power boom, and relative valuations, we have increased our conviction within Europe.

DIVIDEND YIELDS AND SPREAD: US VS. EUROPE



Source: Bloomberg and Newton, as of December 31, 2024.

Data centers should create value

In our view, data-center power demand is surging as the need for greater computing power grows, driven by digitalization, cloud migration and AI. While the growth in data-center build-out may likely be strongest in the US, Europe has ample opportunity to likely grow its market and further stimulate its technology ecosystem in three key areas:

1 Increased electricity demand

Data centers are likely to drive a significant rise in power consumption, creating long-term revenue growth opportunities for utilities.

2 Acceleration of green-energy investments

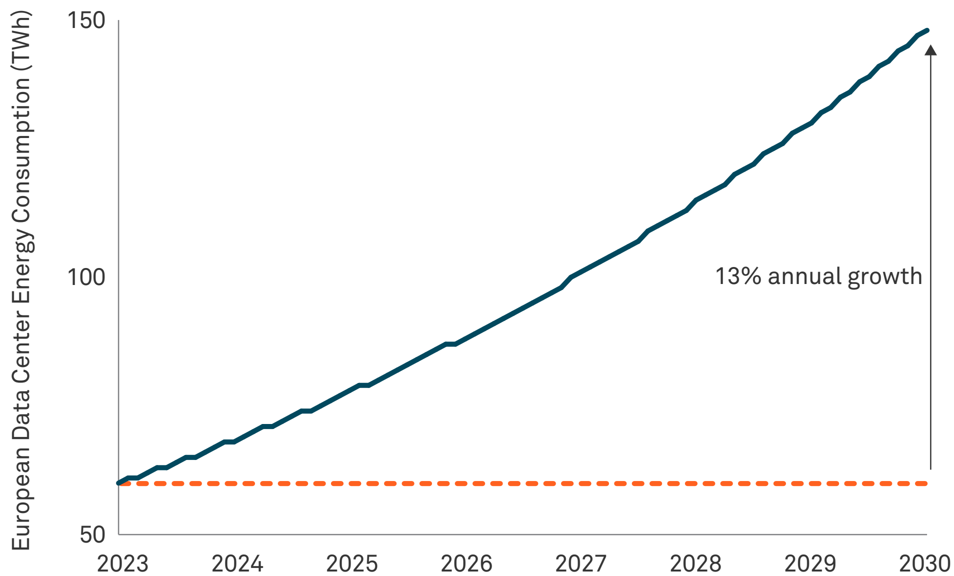
The shift toward sustainability, in our view, will likely spur investment in renewable energy, grid modernization and energy storage solutions.

3 New infrastructure development

Expanding transmission networks and upgrading substations will likely be necessary, creating opportunities for infrastructure projects.

Utility companies that proactively invest in renewable energy, grid capacity and innovative solutions like demand response and energy storage, in our view, should be well positioned to capitalize on data-center growth. Strategic partnerships with data-center operators and governments will also be crucial to ensuring a stable and sustainable power supply. The most successful European utilities will likely be those that can balance rapid infrastructure expansion with the transition to renewable energy sources, while navigating complex regulatory environments and managing water resources effectively.

POWER DEMAND FOR DATA CENTERS IS PROJECTED TO RISE MATERIALLY IN EUROPE



Source: McKinsey, *The role of power in unlocking the European AI revolution,* Newton chart. Europe = 27 Eurozone countries plus the UK.

Nordic countries well positioned

We believe the Nordic countries (Sweden, Norway, Finland, Denmark and Iceland) are exceptionally well positioned to capitalize on the data-center and AI boom.

Norway and Sweden have extensive hydropower infrastructure, providing stable, renewable baseload power. Denmark is a leader in wind energy, with offshore wind farms supplying growing portions of its grid. Meanwhile, Finland has a diverse energy mix including nuclear, hydro and biomass, which allows data centers to meet their sustainability commitments due to the renewable-rich mix.

About Newton Investment Management

Newton is a multi-strategy, active manager within BNY Investments.

[1] The MSCI World Index hit an all-time high on February 18, 2025.
[2] MSCI and Newton, as of 12/31/24.
[3] S&P and Newton, as of 13/31/24.
[4] S&P, as of 12/31/24.
[5] S&P, as of 12/31/24.
[6] S&P and MSCI, as of 12/31/24.
[7] Bloomberg and Newton, as of January 31, 2025.
[8] Bloomberg and Newton, as of January 31, 2025.
[9] In fixed income, a spread is the difference in yield between two bonds.
[10] Bloomberg and Newton, as of December 31, 2024.
[11] A tailwind is a dynamic that supports growth, performance or returns.