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Morning Briefing

On Taiwan, EVs, Europe & Earnings

Check out the accompanying chart collection.

Executive Summary: President Trump's Venezuelan gambit may give China cover to tighten the noose around Taiwan. That could slam global markets and supply chains, William writes, as well as unnerve global AI investors envisioning Taiwan Semiconductor winding up in China's control. … Also: In the EV market race, BYD is running circles around Tesla. But whether that will remain the case is questionable. … And: In Europe, gradual fiscal stimulus is keeping the economic backdrop stable, Melissa reports, which is keeping stock markets moving higher. Forward P/Es have been capped around 15 since March. … Also: Joe says the absence of Q4 earnings warnings by managements of S&P 500 companies could set the stage for yet another epic earnings quarter.

Geopolitics: Taiwan's Vulnerability Complicates AI Trade. Of all the ways President Donald Trump's bromance with China's President Xi Jinping could go awry, Beijing's moving against Taiwan could be the quickest.

Almost immediately after news of the Trump administration's daring capture of Venezuelan President Maduro, Chinese cyberspace pulsated with chatter about how the operation *offered a template* for Beijing to seize Taiwan. The idea that Xi will choose 2026 to check off this most vital of Communist Party boxes is no longer as far-fetched as Asian leaders and investors had hoped.

In the days before Trump World grabbed Maduro, China fired rockets into waters off the island of *23 million people* in the People's Liberation Army's most extensive war games display to date. It commenced 11 days after Washington announced a *record $11.1 billion arms package* to Taiwan.

The concern now is that the US move against Maduro might give Xi cover to *seize control* of Taiwan. The island has been on *heightened alert* since Russian tanks rolled into Ukraine in 2022, fearing that Xi might see that aggression as an opportunity. Taipei was further alarmed earlier this year when Trump *stayed silent* after Japanese Prime Minister Sanae Takaichi hinted that Tokyo would come to Taiwan's defense against China.

There are many reasons why Xi might not act. Further aggression against Taiwan could result in sweeping Western sanctions and severe economic fallout. And even if Xi resists, Trump's saying that the US will now "run" Venezuela could prompt China to defend its interests in that country. Beijing has invested big in Venezuelan refineries and infrastructure. Between 2000 and 2023, according to AidData, Venezuela was the *fourth-largest* recipient of loan commitments from Chinese official lenders, totaling *$106 billion*.

China is unlikely just to accept the loss. A new round of rare-earth bans could ensue. Plus, Beijing holds *$689 billion* of US Treasuries that it can dump. And that "grand bargain" trade deal Trump seeks could be toast.

Invading Taiwan, or just blockading it, could slam *global markets* and supply chains and pull other Asian democracies into the fray as well as unnerve the global artificial intelligence (AI) trade. Taiwan Semiconductor Manufacturing Company (TSMC) is a crucial provider of high-end AI chips—hence, the *48% jump* in TSMC shares over the last 12 months. TSMC also accounts for over two-thirds of the Taiwan MSCI's market capitalization. Alongside China's dominance of rare earths, Xi's control of TSMC would be quite a bargaining chip in US trade talks. We aren't predicting that any of this will happen in 2026. However, Trump's actions in Venezuela increase the likelihood of a reaction from China.

Electric Vehicles: Tesla/BYD Race Tough To Call. The world's top two electric vehicle (EV) automakers both face an uncertain 2026, as a variety of obstacles obscure the road ahead for each.

Elon Musk's Tesla faces China-related challenges as 2026 begins. In just *five years*, says Michael Dunne, CEO of Dunne Insights, China has progressed from a marginal auto exporter to a global leader—faster than any country has.

Tesla set Wall Street's Q4-2025 expectations low, then came up short anyway. The EV juggernaut delivered *418,227 vehicles* during the final quarter of 2025, which concluded a second consecutive year of sales decline. This is despite new incentives and *lower-cost models*. The 1.64 million vehicles Tesla sold in 2025, a 9% y/y decline, paled in comparison to the 2.26 million battery-powered cars that China's BYD sold. Its *28% y/y increase* makes BYD the No. 1 EV maker globally.

That's the good news for the automaker founded by Wang Chuanfu. The not-so-good news is that BYD's sales growth is experiencing a downshift of its own.

In December, for example, BYD's total sales *fell 18.3% short* y/y. It marked the fourth consecutive monthly decline and the most significant drop in nearly two years, as Wang's company faces rising domestic competition and questions about its technological lead in Asia's largest economy. At a conference last month, Wang assured investors that some major innovations would be announced in 2026.

It's hard to say who you'd rather be this year: Musk or Wang. Tesla is being stung by the *expiration* of federal EV tax credits—$7,500 for new EVs and $4,000 for used—last September as well as the reputational fallout from Musk's ill-fated position as head of Trump's Department of Government Efficiency. Tesla's shares have risen much less over the past 12 months than BYD's—*9.8%* versus *17.0%*.

The headwinds bearing down on BYD are macroeconomic: Overcapacity troubles bedeviling Xi's economy. Domestic sales are becoming more difficult amid waning household confidence, intense competition, and the expiration of trade-in subsidies. Abroad, tariff-related turmoil and supply-chain snafus cloud the outlook.

Though Tesla now trails BYD, the year ahead will be a tough one to navigate for both.

Eurozone I: The Eurozone Carries On. Melissa and I don't expect too much drama or momentum ahead for the Eurozone economy. Economic growth is moderate; inflation has cooled down; labor markets are stable. Regional risks related to Russia's war on Ukraine seem to have eased, for now. Stability, rather than material acceleration, appears to be the defining feature of the Eurozone economy.

The stable economic backdrop, supported by fiscal stimulus, has helped to push the Eurozone MSCI price index up steadily by 11.8% from July 1, 2025 to January 5. Since March 2025, the forward P/E has remained near 15; it crossed above that mid-range historical marker during the final quarter of last year. The index now trades at a multiple of 15.1 (*Fig. 1*).

Absent fresh stimulus or a clear sectoral catalyst, Eurozone valuations look capped, with sustained earnings growth the only plausible path to further multiple upside. The ECB's central bankers are currently content with the inflation and jobs picture and unlikely to cut rates further. And the Eurozone is not home to the large tech companies that have fueled equity momentum here at home.

The latest fiscal stimulus programs, focused on industrials and defense, likely are already built into earnings growth projections for the next couple of years and therefore priced into equities. The latest Eurozone MSCI's earnings growth forecast for 2026 is 14.9%, bumped up to the mid-teens when spending plans were announced in March 2025, but growth is expected to slow to 13.0% for 2027 (*Fig. 2*). These figures are high for the Eurozone historically and not organic but driven by governments' fiscal spending. Earnings growth should return to a single-digit annual clip between 2027 and 2030.

From an investor's perspective, the region looks like a low volatility, but also no fun, zone ahead. Its markets could benefit from being considered relatively insulated from (though not immune to) a Taiwan-related escalation of US-China tensions. In that scenario, Eurozone investors could benefit both from reduced tech concentration risk and from the region's heavier tilt toward industrials and defense.

Here's more:

(1) *Growth: positive, but nothing to write home about*. The Eurozone economy expanded at a mediocre pace of 1.4% y/y in Q3-2025, according to Eurostat (*Fig. 3*). This performance was boosted by a surge in exports ahead of anticipated tariff increases. However, investment in equipment and intangible assets also rose. The European Commission continues to *expect* growth just north of 1.0% through 2026 for the Eurozone, assuming no major shocks. Economic sentiment, often correlated with output, has increased but remains lackluster (*Fig. 4*).

(2) *Inflation: right where policymakers want it.* Headline inflation has lowered to around 2.0% since mid-2025, with services and food prices doing most of the remaining work as energy effects have faded (*Fig. 5*). With price pressures looking contained, the Eurozone Central Bank (ECB) has kept interest rates on hold, signaling comfort with the inflation trajectory. The December 2025 ECB staff projections show headline inflation averaging 1.9% in 2026, 1.8% in 2027, and 2.0% in 2028. Meanwhile, unemployment has held near 6.4%, close to cycle lows (*Fig. 6*).

(3) *Manufacturing: still the soft spot*. Manufacturing remains the laggard. Eurozone manufacturing PMIs have slipped further into contraction, pointing to weak orders and soft external demand (*Fig. 7*). Part of the pressure reflects intensifying competition from China, where excess capacity has translated into a surge of low-priced manufactured exports weighing on European producers. So far, the weakness has remained largely contained within industry rather than spilling meaningfully into services (*Fig. 8*).

Eurozone II: No Fiscal Thrill. Geopolitical matters are helping to raise the baseline for Eurozone public spending through industrial and defense initiatives. However, fiscal policy is acting as a stabilizer rather than a near-term fiscal boost.

Governments continue to run deficits to support growth and defense, but the gradual nature of the stimulus means there's no massive near-term boost ahead. Fiscal tightening in several European Union countries is expected to partially offset deficit-increasing factors. Consider the following:

(1) *Slow and steady deficit support*. Taken together, Europe's fiscal impulse is structural rather than cyclical, with the bulk of spending landing from 2026 through the end of the decade, supporting growth but unlikely to produce a near-term surge. In the Eurozone, the deficit is set to increase from 3.1% of GDP in 2024 to 3.2% in 2025, 3.3% in 2026 and 3.4% in 2027, according to the European Commission's November *forecasts*. The Eurozone debt-to-GDP ratio is projected to increase from 88% in 2024 to 91% in 2027.

(2) *Large yet deliberate fiscal wave over time*. The €800 billion boost to defense spending under ReArm Europe/Readiness 2030 will begin in 2026, with national budget increases and joint procurement and financing tools ramping up toward 2030. Additional spending will come from the NextGenerationEU's post-Covid €800 billion *program* aimed at helping the continent's economy recover from Covid. It is now in the *execution* phase, with initial disbursements having *started* in August 2021 and continuing through 2026 as national plans hit milestones.

(3) *Fiscal austerity offsets*. Offsetting some of the fiscal spending at the EU level, several individual European countries are tightening their belts to reduce their deficits. Italy *aims* to lower this year's fiscal deficit, paving the way for its exit from an EU excessive deficit procedure. France has *committed* to a multi-year consolidation path that phases in spending restraint through 2027. Spain has reduced crisis-era support while maintaining growth and *expects* to lower its deficit relative to GDP this year.

Strategy: Ten Straight Quarters of Earnings Growth! Here we are in "confession season," and you can hear a pin drop. Typically, this is the time that managements warn the Street that analysts' estimates are too high, and down they come. Not this time. Having over-cut estimates when management guidance was absent during Trump's Tariff Turmoil, analysts have been finetuning their estimates *higher* in recent quarters—that's why Q2 and Q3 earnings warnings likewise were sparse. Might this be setting the stage for yet another epic earnings surprise in Q4?

The analysts' consensus proforma Q4 earnings growth forecast for the S&P 500 companies in aggregate began the quarter at 7.7% y/y and actually improved to 8.9% as of the January 2 week (*Fig. 9*). It's highly unusual that estimates rise over the course of a quarter, having happened less than 20% of the time since we began tracking this data in 1994.

We expect the typical earnings surprise "hook"—i.e., the sudden uptick in the charted estimates data once actual results are tacked on—to peg Q4-2025's final y/y growth at a double-digit percentage rate for a fifth straight quarter. That would also mark the S&P 500's tenth straight quarter of positive y/y earnings gains, the longest such stretch since the 12 quarters ended Q2-2019.

Positive y/y earnings growth is forecasted for nine of the 11 S&P 500 sectors, Joe reports, and positive y/y revenues growth for ten (all but Energy). Here are more of his takeaways from the latest consensus estimates data:

(1) *Broad sector revenue growth expected again in Q4.* Ten S&P 500 sectors' revenues should grow y/y in Q4, down slightly from all 11 rising during Q3 (*Fig. 10*). That's still near the highest count since Q3-2022. No revenues recession in sight!

Information Technology has been leading all sectors in revenues growth since Q1-2024; its Q4-2025 revenues should rise 18.1% y/y, a double-digit rate for a seventh straight quarter. Also notable: Materials' expected 3.6% y/y revenue gain would be its third straight after nine declines in a row. Only Energy's revenues are forecast to drop in Q4, albeit just 2.4% y/y.

Here are the sectors' proforma y/y revenues growth forecasts for Q4-2025: Information Technology (18.1%), Health Care (8.9), Communication Services (8.6), S&P 500 ex-Energy (8.1), S&P 500 (7.3), Real Estate (6.8), Financials (6.4), Industrials (6.2), Utilities (6.1), Consumer Discretionary (4.4), Consumer Staples (4.1), Materials (3.6), and Energy (-2.4).

(2) *Earnings growth less broad for the 11 sectors.* Information Technology is the only S&P 500 sector expected to grow earnings faster than the index in Q4-2025. However, the analysts expect nine sectors to post a y/y earnings gain. We think all 11 sectors could post positive y/y earnings growth following their earnings surprise hooks. That hasn't happened since Q2- and Q3-2021, when the US economy was reopening after Covid lockdowns.

Among the lagging sectors, Consumer Discretionary's earnings is expected to fall y/y in Q4 for the first time in 12 quarters; Industrials' is expected to fall y/y for the first time in five quarters; and Energy's is expected to rise for the first time in six quarters and only the second time in 11 quarters.

Among the nine sectors expected to post earnings growth in Q4, only Information Technology is expected to grow faster than the S&P 500 and at a double-digit percentage rate to boot.

Here's how the S&P 500 sectors' consensus earnings growth rates stack up for Q4-2025: Information Technology (26.5%), S&P 500 ex-Energy (9.2), S&P 500 (8.9), Materials (8.2), Financials (6.7), Communication Services (7.3), Utilities (3.8), Energy (1.7), Consumer Staples (1.6), Real Estate (0.8), Health Care (0.7), Industrials (-1.7), and Consumer Discretionary (-2.8).

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