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Investment viewpoint

Could France get its own Trudeau?

Asset Management

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Results of the first round of the French presidential election see Emmanuel Macron and Marine Le Pen making it to the final, gaining 23.9% and 21.4% of the vote respectively.[1] For the first time in six decades, both mainstream parties were eliminated in the first round, highlighting a sentiment of change that is sweeping across the political landscape of advanced economies. Could Macron – a centrist political newcomer – be to France what Trudeau is to Canada?

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Sunday's result is consistent with recent polls and our base case expectations. Crucially for investors, the presence of centrist candidate Macron in the second and final round significantly increases the probability of a pro-EU French president; based on the polls we assign an 80% to 85% probability to Macron winning, and the backing of François Fillon and Benoît Hamon would further strengthen his case.

As we discussed in detail in our latest Global Perspectives piece **(President Le Pen: picturing the tail risk)**, the spectre of a Le Pen win would represent a very strong negative for French and European assets – one that we believe could well trigger a negative reaction globally given its implications for the future of EU/Eurozone. Sunday's result should help to assuage concerns that France will get a far-right president, given that current polls suggest Macron will comfortably beat Le Pen in the second round. That said, the possibility of a Macron scandal and/or terrorist attack remain as key "known unknowns," and polls have proven unreliable in the past.

After the second round of the presidential election, eyes are likely to turn to the parliamentary elections in June, where neither of the candidates is likely to achieve a majority, thus leading to a period of "co-habitation."

We expect Sunday's result to be positive for the Euro, as is already being reflected in price action. However, we expect the upside to be contained to around 2% to 3% on a trade-weighted index basis as Euro pricing never strongly reflected a Le Pen victory.

However, we expect French sovereign bond spreads vs. bunds to narrow substantially relative to current levels. We also expect substantial upside to European equities as attention turns towards the healthy economic recovery currently taking place in the region (see **President Le Pen: picturing the tail risk**). Moreover, the significant valuation gap relative to US Equities make European stocks attractive, in our view, especially as the quality of the US economic recovery weakens and realisation grows that the US legislative system is likely to be a major hindrance to Trump's fiscal bazooka (in terms of size, scope and timing).

[1] At time of going to print, 97% of votes had been counted.

Beyond Europe, we maintain our positive view on emerging market assets and we are now more strongly favouring local currency debt and equities relative to hard currency debt. We believe the synchronised trends of recovering economic growth and still-subdued inflation continue to be important support factors for emerging markets.[2]

To end with a note of caution: although it appears for now that Europe may have dodged a hurricane of populism, and while it may be tempting to hail a new era in French politics with the prospect of a Macron victory, investors should not forget that more than 40% of voters chose a far-left or far-right candidate in Sunday's election. The weakness of the design of the EU when it comes to dealing with shocks, coupled with the need for reform will continue to remain important factors going forward, in our view. Any complacency among EU institutions over dealing with major issues confronting Europe will be premature as volatile Italian politics come into focus in coming months (elections are due by May 2018). We will be keeping a keen eye on all developments.

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[2] Any reference to a specific company or security does not constitute a recommendation to buy, sell, hold or directly invest in the company or securities. It should not be assumed that the recommendations made in the future will be profitable or will equal the performance of the securities discussed in this document.