

Investment viewpoint

Could France get its own Trudeau?

Asset Management

April 2017

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! 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?

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).



Salman Ahmed
Chief Investment Strategist
Lombard Odier Investment Managers

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.

Salman Ahmed

Chief Investment Strategist

Lombard Odier Investment Managers

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.

IMPORTANT INFORMATION

For professional investor use only. This material does not constitute an offer or solicitation in any jurisdiction where or to any person to whom it would be unauthorised or unlawful to do so.

Prospective investors should inform themselves as to any applicable legal requirements and taxation and exchange control regulations in the countries of their citizenship, residence or domicile which might be relevant. 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. Views and opinions expressed are for informational purposes only and do not constitute a recommendation by LOIM to buy, sell or hold any security.

Views and opinions are current as of the date of this presentation and may be subject to change, they should not be construed as investment advice. No part of this material may be (i) copied, photocopied or duplicated in any form, by any means, or (ii) distributed to any person that is not an employee, officer, director, or authorised agent of the recipient, without Lombard Odier Asset Management (Europe) Limited prior consent. In the United Kingdom, this material is a financial promotion and has been approved by Lombard Odier Asset Management (Europe) Limited which is authorised and regulated by the Financial Conduct Authority. Past performance does not guarantee future results.

Fixed Income securities are subject to the risks associated with debt securities including economic conditions, government regulations, market sentiment, and local and international political events. In addition, the market value of fixed income securities will fluctuate in response to changes in interest rates, currency values, and the creditworthiness of the issuer. If an issuer's financial condition worsens, the credit quality of the issuer may deteriorate making it difficult for an investor to sell such investments.

A significant level of investment in debt securities or risky securities implies that the risk of, or actual, default may have a material impact on performance. The likelihood of this depends on the creditworthiness of the issuers.

Emerging markets securities may be less liquid and more volatile and are subject to a number of additional risks including, but not limited to, currency fluctuations and political instability.

High yield, lower rated securities involve greater price volatility and present greater credit risks than higher rated fixed income securities.

©2017 LOIM. All rights reserved.