

# EGA International Equity - *Investment Insight*

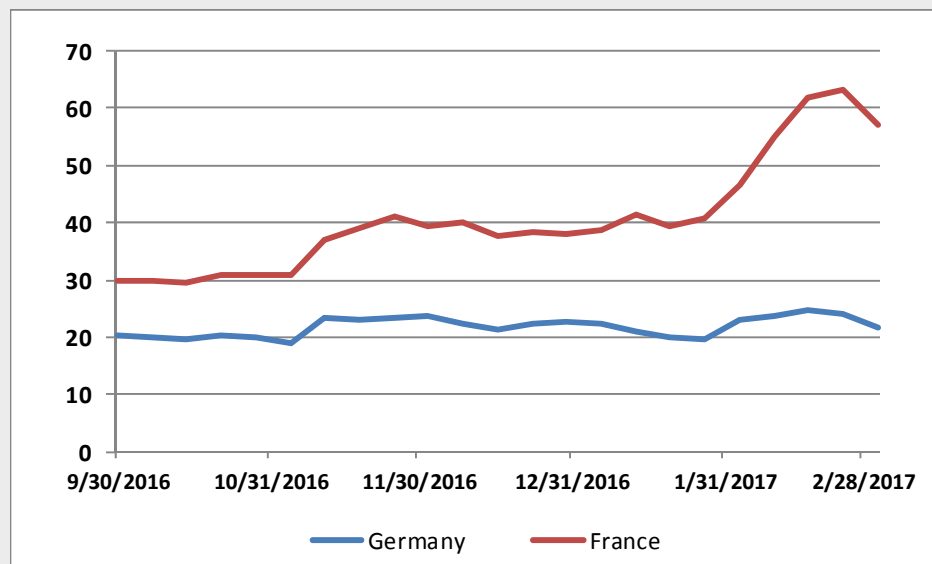
March 2017

## French Elections 2017—Key Risk for European Equities

While global economies are showing an upturn in economic growth and industrial production, giving a lift to global equities this year, many analysts of European equities remain concerned about the potential for a political surprise in the upcoming French elections to upset the rosy outlook. After the surprise results of the U.K. Brexit referendum and the U.S. Presidential election, the rising global tide of populist sentiment has raised questions about whether the anti-Europe, right wing candidacy of Marianne Le Pen and her Front National Party could present a negative political shock if elected. Marianne Le Pen and her National Front Party call for France to pull out of the Euro currency union and to hold a referendum on EU membership. This has raised fears that her election could lead to the ultimate break up of the European Union.

These fears have been reflected in the financial markets. Last fall, the prospect of Le Pen doing well in the election looked remote. But as the pro-EU early poll leader Francois Fillon has been caught up in a scandal about employing his family members in political jobs, his poll numbers have dropped and Le Pen's have risen. Nervousness at the prospect of a Le Pen victory has been reflected in the rising probability of French sovereign bond default as measured by the premiums bond investors pay to insure against that outcome.

Default Risk of Sovereign Debt - 5 Year CDS



Source: Factset

While U.S. equity markets have been on a tear this year, rising about 6% year-to-date, European markets have been more muted despite economic news that is just as good if not better than the U.S. We believe that one reason the European markets have lagged is the potential prospect of the National Front winning electoral victory in France.

Part of the concern derives from the peculiar format of the French election, which is divided into two rounds. In the first round on April 23 multiple candidates vie against each other and the two top vote getters advance to a second round run off. Right now Le Pen is leading the polls for the first round with about 27% support and appears likely to advance to the second round. The other likely candidate to advance appears to be Emmanuel Macron, a candidate of the center-left party En Marche! While Le Pen's lead in the first round looks worrying, in the second round to be held May 7, Macron appears to have a commanding lead against Le Pen, with the most recent polls placing him ahead of Le Pen by 30%.

We believe a Macron victory in the Presidential election would smooth most fears of investors in European equities. Not only would his election squelch fears about Le Pen, Macron's platform offers many positive economic reforms for France.

#### Key Dates:

April 23<sup>rd</sup> - 1st Presidential Election  
May 7<sup>th</sup> - 2<sup>nd</sup> Presidential Election  
June 11<sup>th</sup> - 1<sup>st</sup> Parliamentary Election  
June 18<sup>th</sup> - 2<sup>nd</sup> Parliamentary Election

#### Five Major Candidates:

(In order of polling as of March 20th)

1. **Marine Le Pen**  
*Front National*
2. **Emmanuel Macron**  
*En Marche!*
3. **Francois Fillon**  
*Republican*
4. **Benoit Hammon**  
*Socialist*
5. **Jean-Luc Melechon**  
*Rebellious France*

#### Key Players:

**Incumbent President:** Francois Hollande, *Socialist Party*, Not running in this election

- **Benoit Hammon** is running for *Socialist Party*; his platform is to introduce basic income, increase security/defense spending, introduce tax on robots if they replace ordinary employment, increase minimum wage, and mutualisation of European debt

#### Top 3 Players:

##### Marine Le Pen

##### Proposals:

- Reinstate a national currency and internal border controls
- Reform EU
- Lower taxes for lower incomes
- Maintain 35 hour work week
- Reintroduction of internal border controls
- Lower retirement age to 60
- Increase security / defense spending
- Lower Social Security contributions

##### Emmanuel Macron

##### Proposals:

- Increase European integration
- Lower Social Security contributions
- Reform 35 hour work week
- Increased security / defense spending
- Flexibility in the retirement age
- Recently announced alliance with Francois Bayrou

##### Francois Fillon

##### Proposals:

- Raise retirement age to 65
- Reduce immigration
- Reduce public spending by fund €100 bn in 5 years
- Increase VAT by 2%
- Lower income taxes and Social Security contributions
- End wealth tax and 35 hour work week
- More security / defense spending

Source: UBS

While the surprises of the Brexit referendum and U.S. Presidential election offer caution about ruling out the election of Le Pen in France despite the current large poll advantages for Macron, we would point out that the polls in Britain and the U.S. showed a much closer race than the French election at this point. Also even if Le Pen is elected President in France, she will be unlikely to force a referendum on EU membership unless her party also gains a majority in the Parliamentary elections in June. Right now the polls also show that the National Front is unlikely to prevail in the Parliamentary elections.

While many rightly worry that a victory by Le Pen and the National Front could imperil the unity of the European Union, and would likely usher in a wave of political uncertainty that would undoubtedly undermine European equities, we think the current prospect for this outcome is remote. European equities offer clear valuation advantages to U.S. Equities; we may have to wait until after the uncertainty of the French elections is resolved before the attractions of European equities are more fully realized.

- **The EGA International Equity Team**