## Investment Insights

# Macron Triumphs in French Election

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## Highlights

- Macron won the French presidential election by a wider-than-expected margin, removing a major tail risk for markets.
- The Macron win paves the way for the Fed to hike rates in June and the European Central Bank to signal a "taper" of policy accommodation later this year.
- Bessemer mandates are looking to add European exposure opportunistically in the coming weeks and months but maintain a core overweight positioning to the U.S.

Emmanuel Macron won the French presidential election on Sunday, May 7, by a wider-than-expected 30-point margin. As we discussed in the recent *Investment Insights*, "The French Elections, Explained," Macron's victory is perhaps less important than Le Pen's loss. A Le Pen victory would have set France on a path to leave the European Union (EU), calling into question the future of the region. With this scenario avoided, we expect European markets now to focus more on economic growth, valuations, and industry dynamics. The immediate market reaction so far Monday has been mixed, with equities and the currency slightly weaker as some short-term investors take profits on positive European positions.

## Implications for Monetary Policy and the Euro-U.S. Dollar Relationship

Consistent with what we have discussed in prior pieces, Macron's victory could, at the margin, allow the European Central Bank (ECB) to gradually begin moving toward a path of monetary policy normalization at some point over the summer. To be clear, this initial step would likely involve communicating to the markets when and how it will begin to taper its asset purchase program (assuming economic data continue to trend positively, we believe such communication could occur as early as June). For context, the ECB is currently buying €60 billion of bonds per month, which is designed to ease credit conditions and support the growth of the European economy. June could see the ECB start to hint at tapering, followed by a more detailed tapering plan in the fall and actual implementation in 2018.

The French election outcome also paves the way for a June rate hike by the Federal Reserve, which is widely expected by most market participants. The market-implied probability of a rate hike was north of 80% prior to the election, and with the tail risk of a Le Pen victory vanquished, there are few hurdles between now and the June meeting. Barring a sudden deterioration in U.S. economic data or a dramatic increase in market volatility between now and then, we also expect the Fed to hike rates in June. Rate hikes, at the margin, will help lift U.S. government bond yields. Importantly as well, a more constructive European environment should also help lift core European bond yields (notably German bond yields). If bonds appear more attractive at home, European investors are relatively less likely to buy U.S. bonds. This shift in demand should also lift U.S. yields.

Implications for the euro-U.S. dollar exchange rate are less clear-cut. The removal of the Le Pen risk, in our view, is positive for the euro, in part via ECB policy expectations and in part because foreign investors may now be more likely to want to buy French and other European assets (buying euros in the process).

That said, to the degree the better European backdrop gives the U.S. Fed confidence to hike rates further, that should provide a measure of support for the dollar as well. In the end, we expect EUR/USD to be supported but settle into a range near current levels.

## Populism Encounters a Political Setback but Unlikely to Fade Completely

Even though the populist candidate, Le Pen, did not prevail in this presidential election, the rise and power of populism will remain a key theme in the years to come in France, as well as in the rest of Western Europe and the U.S. The message of populism speaks to the growing number of citizens who have no confidence in the national government and think their future is worse than their current situation. According to a Gallup poll conducted in 2016, 70% of French citizens have no confidence in the national government (Exhibit 1). This share is a noteworthy increase compared to the same data point in 2012 (55%). The share of individuals who believe their future life is worse off has also increased from 49% in 2012 to 64% in 2016. Those who feel both of these sentiments amounts to 43% of surveyed individuals, placing France third in terms of greatest share of the population having such negative feelings within the EU. The comparable percentages in the U.S. and U.K. are 26% and 32%, respectively. Since Macron represents the status quo to a large degree, those who feel discouraged and disaffected will likely continue to feel that way until their voices are heard.

Indeed, Macron will likely face a notable contingent of the French parliament representing populist interests, which at the margin will impact whatever policy program he wants to pursue.

### Exhibit 1: Discouraged and Disaffected Citizens in the EU and U.S. in 2016

| | No confidence in national government (disaffected) | Future life poorly viewed relative to current life (discouraged) | Disaffected and discouraged |
|---|---|---|---|
| Greece | 81% | 67% | 54% |
| Italy | 75 | 62 | 46 |
| France | 70 | 64 | 43 |
| Spain | 69 | 52 | 34 |
| Belgium | 57 | 62 | 34 |
| U.K. | 56 | 57 | 32 |
| Austria | 55 | 56 | 31 |
| Netherlands | 42 | 67 | 28 |
| Czech Republic | 45 | 60 | 27 |
| Germany | 43 | 60 | 27 |
| U.S. | 69 | 38 | 26 |
| Portugal | 57 | 44 | 25 |
| Luxembourg | 30 | 67 | 22 |

As of 2016. Data is from the Gallup World Poll. Results are based on telephone and face-to-face interviews with at least 1,000 adults, aged 15 and older, in each sampled country.

Source: Gallup

## Upcoming Political Events in Focus

France's presidential election has dominated the headlines over the past several months and was a key known risk factor for Europe, in our view. However, other important European elections remain on the horizon, including German state elections, German parliamentary elections, and the Italian presidential election. German Prime Minister Merkel is running for a fourth term as chancellor, but the country's anti-EU party, Alternative for Germany (AfD), has been on the rise. While we expect Prime Minister Merkel to be re-elected, we expect the populism movement to continue posing risks to the status quo in the years to come. In Italy, there will be a general election by May 2018. The country's populist Five Star Movement has also been on the rise, and the current mayors of Rome and Turin are members of this political party. Within France, parliamentary elections are scheduled for June 11 and June 18 (Exhibit 2).

## Bessemer Exposure to European Equities

Bessemer mandates have held significant underweight exposure to European equities for approximately the past 18 months. One of the factors we have considered is political risk, and the French election has been the harbinger in this regard. With this event having concluded with a benign outcome, we are looking to add exposure to Europe at the margin and opportunistically over the weeks and months ahead, with an eye to more attractive valuations and the recent pick-up in economic momentum. The equity mandates, however, maintain core overweight exposure to the U.S., where we see a more compelling long-term story with regard to growth potential, as well as defensive characteristics should markets become more volatile.

### Exhibit 2: Upcoming European Elections

| Event | Date(s) in 2017 |
|---|---|
| German regional election | May 14 |
| Snap U.K. general election | June 8 |
| French legislative election | June 11 and 18 |
| German federal elections | August – October |
| Italian general elections | TBD |

Source: Bloomberg

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