

French election: markets complacent for Macron victory, but game is not yet won



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- **First round voting aligned to expectations:** most commentators and pollsters had anticipated a showdown between Macron and Le Pen in the second round of the French Presidential elections. While the general picture has been confirmed, the difference is in the detail, with Mélenchon outperforming forecasts and Pécresse coming in below expectations. The turnout was low compared to the average, largely due to abstention by younger voters.
- **Second round race tighter than in the past:** early polls are projecting a Macron victory but only marginally at 51-54.5% of votes in the second round. The outcome will be determined by the TV debate on 20 April and on the two candidates' ability to poach votes from those who were knocked out in the first round. Pundits estimate a Le Pen victory at 30%, which is not negligible and is likely to trigger some volatility in the coming weeks.
- **French economy in better shape than Eurozone:** the election has caused very little reaction on markets so far, as the result was already largely priced in. The Eurozone economy is still in worse shape compared to the US, but this is not due to the election, as much as the ongoing conflict in Ukraine. Le Pen's stance on international and foreign affairs represents another risk factor for investors in this regard.
- **Investment implications:** we remain cautious about European equities, favouring high-quality US names and the value sector. Now is not the time to add more risk to portfolios, but to play rotations within markets and to implement some short-term hedging against volatility. Markets seem complacent about a Macron victory, even though the probability of a non-market friendly victory by Le Pen is not negligible, and hedges should be considered. We remain cautious on the Euro. Ultimately the first-round result should also be seen as a potential risk for peripheral debt.

The first round of the Presidential elections in France took place on Sunday 10 April and the result confirmed the general picture that commentators had anticipated in the weeks leading up to the vote. Incumbent President Emmanuel Macron will face off against National Rally leader Marine Le Pen in the second round, scheduled for 24 April. Both candidates improved in absolute as well as in percentage terms compared to the first round in the 2017 elections. Macron was able to garner an extra 3% of votes, bringing his tally up to 27.84% (representing north of one million additional votes). Le Pen's share increased from 21.3% in 2017 to 23.1%. Far-left candidate Jean-Luc Mélenchon, who came third, similarly improved from 19.58% five years ago to 22%, with a slight increase in the absolute number of votes. Although pollsters are still betting on a Macron victory, the second round is another campaign altogether. One thing is for certain: the outlook is very different compared to five years ago, when President Macron won the Presidency with 66% of votes cast in his favour.

What are the key takeaways from the first round of voting?

Sunday's results saw a large drop-off between the first three candidates and the rest of the field. **The most notable event was the shattering of the Republican Party which has almost disappeared from the French political scene.** Conservative candidate Valérie Pécresse closed the first round at 4.8%, compared to François Fillon's 20% five years ago. This is a historic result, one that we have not seen since the Second World War. Moreover, the participation rate at 73.7% was well below the average (79.6%) and was largely attributed to massive abstentions by younger voters (that is the under 35s). Our central scenario remains a Macron victory in the second round, although we remain watchful about the shifting political landscape within the broader geopolitical context. In particular, there are four key takeaways from this first round of voting:

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- **Historical trends were prolonged:** the Covid pandemic has accelerated trends which were already in place in France and in the rest of the world. While the election result was similar to that in 2017, it bears a greater weight today. The pandemic has catalysed a complete reorganisation of the French political landscape.
- **Macron is on track to be re-elected for another term:** a number of candidates who were knocked out of the running on Sunday have already called upon their supporters to vote for the incumbent President. However, the second round is likely to be tighter this time than it was in 2017 and markets have started to factor this in.
- **Market volatility will be determined by early polls:** as polls start to come in over the next two weeks, reflecting the tighter margin between Macron and Le Pen, markets will be more volatile, calling for heightened attention and strategic hedging.
- **The second round will be decided by the campaign strategies:** key to the final result will be the portion of the electorate who voted for candidates other than Le Pen and Macron. It is likely that there will be some inflection in the latter’s favour.

The televised debate scheduled for 20 April (at 9pm CET) will also be crucial in determining the winner. In 2017, it was estimated that the debate gave Macron an additional 5 points in second round voting, while it was a disaster for Le Pen. Mrs Le Pen must therefore be better prepared this time, especially concerning her stance on Putin and France’s position towards Russia.

How did markets react to the elections?

The first-round result had hardly any impact on markets. The French sovereign spread tightened slightly, while the CAC 40 remained almost flat. Overall, the market’s reaction has been contained, as the first-round result was already priced in. The polls correctly predicted the general picture but failed to see the ‘details’: Mélenchon performed much better than anticipated, whereas Pécresse was well below expectations. Although a Macron win remains the most probable outcome, investors are concerned about Le Pen’s stance on certain key issues: “Frexit” is no longer on her agenda, but other issues remain and investors as well as governments will want to know her position regarding Europe. In the past Le Pen has advocated for a referendum to amend the constitution and reverse the primacy of European law over French law. She has argued against the free movement of goods and people across the Union (a breach of the single market) and does not want to comply with European treaties. Her election would be a shock for European integration, stifling progress on energy policies, defence and fiscal integration. It would govern market volatility and therefore commands a premium.

On international issues, particularly on the war front, Macron’s position has been clear. He will use his adversary’s previous stance to his advantage. Two angles should be considered in this regard. This first is the European issue highlighted above. Le Pen has always been highly Euro-sceptical and, even if she does not win a majority in parliament, the French Constitution gives the President vast powers. The second issue pertains to foreign affairs.

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What can we expect from the second round and how does it differ today from 2017?

The perception has changed since the last election. **The second round is another campaign altogether, one that will be determined by the abstention rate and how voters (particularly Mélenchon supporters) will reposition themselves.** Most major candidates, that is Pécresse (right), Jadot (green) and Hidalgo (socialist), immediately announced their support for Macron on Sunday. On the other hand, Mélenchon called on his supporters not to vote for Le Pen, which is a subtle but important difference. Macron has promised a “new approach” and now he must clarify his programme. Daily polls will measure his ability to bring together voters from the left and right. We expect Macron will win this election, as early polls are projecting his victory with 51-54.5% share of the votes, but we could go through a period of market volatility over the next two weeks depending on the result of the polls. The probability of a Le Pen victory is currently estimated at around 30% which is not negligible and could justify some hedging strategies in the short term.

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What are the prospects for the European economy?

Prior to the war in Ukraine we were constructive regarding the Eurozone’s (EZ) post-pandemic recovery and particularly in France, thanks to its strong labour market. The conflict has triggered a big confidence shock in Europe. Business confidence has collapsed and household confidence has likewise dropped significantly. Some large economies such as Germany and Italy are heading towards recession this year. The French economy should do better in comparison, although it will be impacted by the others. As the economic situation recovers from Covid, **the French economy should continue to benefit from the lagging impact of the 2014-2019 structural reforms and supply-side policies.** However, the current economic and political conditions (high inflation, social tensions and the fact that anti-Covid measures may have led some citizens to believe that fiscal resources are unlimited) suggest future policies will be nowhere near as aggressive as those conducted in the pre-Covid years.

What are the investment consequences?

It is still too early to have strong views, and the war in Ukraine remains a determining factor for markets. The prospect of a European recession is another key issue in terms of consequences. **Our tactical view is that US equities are in better shape than European ones.** This has nothing to do with the French election, but with the broader macroeconomic and geopolitical situation, as Europe has been hardest hit by the conflict in Ukraine. Generally we expect the election to trigger some short-lived volatility and perhaps a reaction for the sovereign spread. EZ equities have underperformed since the start of the year, especially compared to the US value segment and high-quality names; while we can foresee a market profit recession in the EZ, this is not the case for the US. **Now is not the time to add risk to portfolios from a directional perspective, but rather to play rotations within markets and across areas.**

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Definitions

- **Beta:** Beta is a risk measure related to market volatility, with 1 being equal to market volatility and less than 1 being less volatile than the market.
- **Drawdown:** The peak-to-trough decline during a specific record period of an investment, fund or commodity, usually quoted as the percentage between the peak and the trough.
- **Quality investing:** It aims at capturing the performance of quality growth stocks by identifying stocks with high return on equity (ROE), stable year-over-year earnings growth, and low financial leverage.
- **Value style:** It refers to purchasing stocks at relatively low prices, as indicated by low price-to-earnings, price-to-book, and price-to-sales ratios, and high dividend yields. Sectors with dominance of value style: energy, financials, telecom, utilities, real estate.

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