

Global Weekly

The French go to the polls

Investment
Communication
21 April 2017

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The first round of the French presidential elections is in the weekend. Our base case is that Emmanuel Macron will win the presidency, but we have also looked at the consequences of a potential victory for François Fillon and the two populist eurosceptic candidates, Marine Le Pen and Jean-Luc Mélenchon. A victory of Fillon would probably be the best-case scenario for financial markets, as his plans are the most ambitious with regard to stimulating economic growth and also the most beneficial for government finances. That said, given the recent polls of the first and second round of voting, a victory for Macron is more likely. We think that in regard to economic reforms and consolidating government finances, his plans are also favourable, albeit less ambitious, than Fillon's. In the event of a Macron victory, we expect the 10-year French spread to fall back to around 50 basis points and the EUR/USD to rise to 1.10. We would see it as a significantly less market-friendly outcome if Le Pen or Mélenchon would win; the euro would drop sharply and we expect much higher government spreads of 225 basis points and 125 basis points respectively for Le Pen and Mélenchon.

Equity index performance in local currency

	Value	One week change (%) [*]	Year-to-date (%)
MSCI ACWI	447.4	0.6	6.0
S&P 500	2,355.8	1.2	5.2
AEX Index	511.7	-0.8	5.9
EuroStoxx 50	3,440.0	-0.2	4.5
DAX Index	12,027.3	-0.7	4.8
Nikkei 225	18,430.5	0.0	-3.6
Hang Seng Index	24,057.0	-0.8	9.3

^{*}Thursday close compared with Friday last week

Performance data as of Thursday, 20 April 2017

Source: Bloomberg

Equity market update

After the Easter holiday, equity markets started the week cautiously, with a backdrop of tension around North Korea. China and emerging Asian markets declined, and Japan and South Korea opened slightly higher. The US dollar weakened against both the euro and the Japanese yen, and European markets mostly opened the week lower. The French CAC40 Index pulled back from pre-Easter highs, amid uncertainty around the increasingly competitive French elections.

The first-quarter earnings season began in the US with a mildly positive start. There were some surprise earnings misses from IBM and Goldman Sachs, while Morgan Stanley results were significantly better than expected.

UK Prime Minister Theresa May surprised everyone with a successful push for a snap UK election on 8 June. Her goal is to cement her mandate and the Tories' lead in the polls. The UK FTSE Index corrected slightly, but the pound moved stronger against most major currencies, reflecting the market view that this may indeed strengthen May's negotiating hand. Fund managers continued a rotation of asset flows from the US to Europe, despite political worries. This is based on a growing consensus that Trump may be hard pressed to deliver on his largest campaign promises. In particular, the link between failure to repeal Obamacare and stalled efforts on tax cuts was hinted at in comments by the US Treasury Secretary. A different aspect of US strategy was also highlighted by Vice President Mike Pence's push for more bilateral trade with both South Korea and Indonesia this week. He is seeking to counter China's regional charm offensive in the wake of Trump's striking down the Trans Pacific Partnership trade pact.

Bond markets update

Core government bonds in the US, eurozone and Japan rose in the past two week to recent highs. The market fled to safety following a number of negative stories related to tensions in Korea, a new election being called in the UK and continued scepticism regarding the Trump administration's ability to deliver on tax reform promises. Markets were spooked when yields pierced through resistance levels, which was exacerbated following a sell-off by speculative investors who were short Treasuries.

In past writings, we indicated that the path to higher yields would be uneven and as last week's events unfolded we experienced our first setback. This however does not change our view. The South Asian conflict should stick to rhetoric and muscle flexing as the stakes for an all-out war are too high. Forward-looking economic data (such as consumer and producer confidence levels) remain resilient and the latest US core inflation numbers (albeit being somewhat below expectations) have hit the Federal Reserve's sweet spot. The first signs from corporate earnings look promising and should swing the pendulum in favour of equities soon.

Currency outlook

Sterling strengthened on May's announcement of elections in June. Even though the political uncertainty has increased, currency markets seemed to take the view that the "Brexit" would unlikely be much harder given the early elections.

Government bond yields

	Yield (%)	One week (bp)	One year (bp)
US Treasuries 2-year	1.195	-1.3	38.7
German Bunds 2-year	-0.813	5.6	-32.5
Japan 2-year	-0.225	0.5	3.7
US Treasuries 10-year	2.236	-0.2	37.5
German Bunds 10-year	0.234	4.9	-0.4
Japan 10-year	0.010	0.7	12.9

Spreads

	Spread (bp)	One week (bp)	One year (bp)
CDX NA IG	67.50	0.28	-5.39
iTraxx Euro 5-year	75.23	-1.39	7.21
JPM EMBI+	335.63	-3.27	-34.07

Performance data as of Friday, 21 April 2017

Source: Bloomberg

Reporting calendar

Barrick Gold Corp, Binckbank, Halliburton, Newmont Mining, Koninklijke Philips	24 Apr
3M Co, Arconic, Baker Hughes, Biogen, Caterpillar, CNOOC, Coca-Cola, Corbion, Du Pont (E.I.), De Nemours, McDonald's, Novartis, Randstad Holding, Valero Energy Corp	25 Apr
Amgen, Banco Santander, Baxter International, Boeing, Compagnie De Saint Gobain, Credit Suisse Group, Daimlerchrysler, Fiat Chrysler Automobiles, Glaxosmithkline, Iberdrola, Ingersoll-Rand, Koninklijke KPN, Peugeot, Procter & Gamble, Rockwell Automation, TechnipFMC, United Technologies, Vallourec, Yara International	26 Apr
Abbvie, Air Products & Chemicals, Amazon.com, Alphabet, Baidu, Banco Bilbao Vizcaya Argentia, BASF, Bayer, Bristol-Myers Squibb, Celgene, Deutsche Bank, Dow Chemical, Expedia, Ford Motor, Intel Corp, Johnson Controls, Krones, Kuka, Microsoft, Nokia, Simon Property Group, Starbucks, Total, Under Armour, United Parcel Service, Vinci	27 Apr
Chevron, Colgate-Palmolive, Cosco Shipping Energy, Denso, Exxon Mobil, General Motors, Linde, LyondellBasell, Sanofi	28 Apr

Furthermore, financial markets may also believe that there is now a minor probability for a Breain, i.e. Britain remaining in the EU. As speculative investors have been excessively short for a while, this sterling recovery has probably triggered the closing of some of the excessive speculative sterling short positions.

Published this week

Investment Strategy: The Momentum Continues

The positive factors that have supported equities since the fourth quarter of last year are expected to continue. This is in line with a belief that the expansion phase of the business cycle is not diminishing, and, instead, we are seeing one of the longest periods of uninterrupted US growth since the end of World War II.



Investment Strategy & Portfolio Expertise Group Economics

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