



Global Weekly

Vive la France!

**Investment
Communication
28 April 2017**

Investors applauded the outcome of the first round of presidential elections in France. Equity markets moved higher this week, while the spread between 10-year French and German government bond yields narrowed.

There is good news and bad news following the market-friendly outcome of the first round of the French presidential elections. The good news is that the nightmare scenario for markets – a run-off between Marine Le Pen and Jean-Luc Mélenchon – has been avoided, with the Frexit tail risk diminishing further. Financial markets responded by pricing out the Frexit risk premium, leading to a rise in the euro and higher French government bonds. Emmanuel Macron will very likely win the second round and he has a positive economic agenda. The bad news is that he will face serious obstacles in implementing that agenda. Even presidents with the best intentions have struggled to pass reforms in France. They have been blocked by vested interests, street protests and strikes in the past. Macron will likely also face the obstacle of not having a parliamentary majority. Under France's semi-presidential political system, if a president's party is different to that of the majority of members in parliament,

Equity index performance in local currency

	Value	One week change (%) [*]	Year-to-date (%)
MSCI ACWI	455.9	2.1	8.1
S&P 500	2,388.8	1.7	6.7
AEX Index	521.9	1.9	8.0
EuroStoxx 50	3,563.3	3.6	8.3
DAX Index	12,443.8	3.3	8.4
Nikkei 225	19,251.9	3.4	0.7
Hang Seng Index	24,698.5	2.7	12.3

^{*}Thursday close compared with Friday last week

Performance data as of Thursday, 27 April 2017

Source: Bloomberg

the government is divided – this is called 'cohabitation'. When this happens, the president can become a marginal figure in national politics.

The European Central Bank (ECB) kept its forward guidance and broad assessment unchanged at its press conference on Thursday. However, the central bank sounded more positive on the economy and said that although risks to growth were still

tilted to the downside, they were becoming more balanced. This opens the door for a significant change in its communication in June, which could mark the first step in the ECB's gradual path towards the exit from its stimulus measures. We expect the forward guidance to become more neutral in June. We think that the central bank will start the exit from its unconventional monetary policy in early 2018, which means that we should see a change in communication during the course of this year. Although underlying inflationary pressures will likely remain weak, the ongoing economic recovery may give the ECB more confidence that these pressures will build in the future. More importantly, the ECB will find it increasingly difficult to execute its programme without larger and larger deviations from its capital key. Following a change of the forward guidance in June, the ECB looks likely to set out its plan for tapering in September of this year. We think the ECB will start to reduce the pace of its monthly asset purchases (from EUR 60 billion per month currently) in January of next year, in steps of EUR 10 billion a month. That would lead to an end of the asset purchase programme by June 2018. The central bank is seen subsequently following with a 10 basis points increase in its deposit rate later that year.

Equity markets update

This week, equity markets were dominated by the outcome of the first round of the French elections. With Macron and Le Pen moving to the second round, the outcome was clearly favourable and market-friendly. As a consequence, global equity markets got a strong boost. Not surprisingly, the upward market move was most pronounced in Europe, specifically in France. These positive developments were a confirmation of our preference for European over US stocks, which was partly based on expectations of a market-friendly outcome of the French elections.

Meanwhile, the earnings season is gradually gaining steam. So far, results are encouraging and coming in somewhat ahead of expectations. Positive earnings trends are an important pillar of our overweight equity position.

With regard to the US, equity markets were awaiting a statement on promised tax reforms, as President Donald Trump had hinted at a 'big announcement' about this topic. Since the US elections, tax reforms have been well flagged and in part already baked into markets. This week's tax announcement was limited to the introduction of a framework, with further details expected later in the year. Hence, we believe the short-term market impact might be relatively modest.

On balance, the fundamental perspective for equity markets continues to be supportive, with positive incoming macro data and encouraging earnings developments. In addition,

Reporting calendar

Anadarko Petroleum, Pfizer, Devon Energy Corporation, Merck, Becton Dickinson & Co, Apple, BP, Gilead Sciences, Altria Group, Kraft Foods, ConocoPhillips, Kon. DSM, TKH Group, Geberit	02 May
Fresenius, Solvay, BNP Paribas, Sprint Nextel, Estée Lauder, Swisscom, Sainsbury, Time Warner, Holcim, Telecom Italia, Volkswagen, Southern	03 May
HSBC, BMW, CBS, Infineon, Air France-KLM, Royal Dutch Shell, Inbev, Dominion Resources, Veolia, Société Générale, Freenet, Siemens, Avon Products, Motorola, Occidental Petroleum Corp, Kellogg, Apache, Repsol, Statoil, Viacom, Adidas	04 May
Vestas wind, Belgacom, Intesa Sanpaolo	05 May

political risks in Europe are decreasing. We therefore believe our overweight stance towards equities remains justified.

Bond markets update

US Treasury yields dropped nearly 45 basis points (bp) within four weeks to their lowest level this month. They rose again when rumours concerning a 'massive' tax cut plan by the US administration re-emerged. Given that market participants expect that the Trump administration will face several administrative challenges, the impact on 10-year US Treasury yields was rather muted. We expect Treasury yields to move sideways for the time being, as the probability of another rate hike in early May is low.

Risks in Europe clearly eased after the first round of the French elections. The spread between 10-year French and German government bond yields fell by nearly 20 bp to around 50 bp, which market participants already expected. Fundamental risks still linger in France and it seems unlikely that presidential candidate Emmanuel Macron will be able to tackle major obstacles to employment growth. We therefore expect spreads to trade around current levels for the remainder of the year. Spreads on peripheral government bonds also decreased. However, rating agency Fitch downgraded Italy from BBB+ to BBB (stable outlook) on grounds of fiscal slippage and political risks. As a result, peripheral spreads did not tighten as much as we had expected. We expect that Italy will once again become the eurozone's biggest concern.

Currencies outlook

Volatility expectations in currency markets have declined substantially after the first round of the French elections. Demand in the option market for a hedge against euro weakness also declined substantially, as the risk of Frexit decreased. The US dollar received some support after US President Donald Trump announced tax reforms, although the lack of clarity and

details capped the upside in the dollar. We expect the US dollar to remain firm, given that markets are only pricing in a 70% chance that the Fed will raise interest rates by 25 basis points in June. Meanwhile, the British pound continued to edge higher, as overcrowded speculative short positions were unwound.

Asset allocation

Our asset allocation consists of an overweight in equities, an underweight in bonds and an overweight in cash. Within alternatives, real estate is overweight, a neutral stance is taken to hedge funds and there is no allocation to commodities.

Investment Strategy & Portfolio Expertise Group Economics

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