



CIO Flash

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## What it all means for France and beyond

**Macron looks on track to win. Governing will be harder. How France got here has broader implications for the rest of Europe. We are upgrading European equities.**

### Macron did it, now what can he do?

Sometimes, everything goes pretty much as expected in politics. That is pretty much what happened at the French presidential elections. From the get-go, Emmanuel Macron was the sort of candidate you might have expected to do well in the first round. In the old days, it would probably have taken him several more runs and maybe another 20 years to win the presidency.

Instead he now looks all set to win in two weeks' time. In addition to his obvious talent as a campaigner, two other factors explain this. Both have broader significance.

First, Macron's victory highlights how exhausted the two traditional parties of the left and the right are. In France, both lacked credibility and ideas at the start of the campaign. Add accusations of corruption in the case of François Fillon, and it is easy to explain how his attempt to run on an ideas platform only led him to a disappointing third place finish just short of 20%. Benoît Hamon, the official Socialist candidate came in 5th, with only about 6% of the vote.

Second, voters may flirt with radical ideas from both left and right. Marine Le Pen did secure 21% after all, while Jean-Luc Mélenchon managed to almost make it among the top three. However, French voters do not appear ready to hand power to the populists just yet.

We would expect traditional politicians from all sides of the ideological spectrum to rally around Macron in the next two weeks. That should most certainly allow him to win the presidency, and leave his centrist political movement En Marche! well positioned for the June parliamentary elections.

But, for such a new group, winning even a few dozen seats would be quite an achievement. Given the vagaries of the French electoral system, En Marche! will have to cut deals ahead of the vote. With the traditional parties in disarray, this will take a lot of political skill. So will governing with what is likely to be a splintered and divided parliament, requiring coalitions of one sort or the other. Macron has shown himself a talented campaigner. The hard part starts right about now: proving that he can actually deliver on his promises to make France more innovative, leaner and competitive again.

### Markets relieved; we upgrade European equities

From a market perspective this certainly looks like a favorable outcome. We are already seeing increased investors' risk appetite

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on Monday morning. More specifically we see the following asset class implications:

- **Equities:** The European political landscape has deterred many international investors from shifting funds to this region in the past few months. With what we regarded the biggest political tail risk now almost off the table, we believe that flows into European equities will increase. Fundamentals have been improving for some time now, with Eurozone purchasing manager indices (PMIs) at seven-year highs. Continuous positive earnings revisions in 2017 are being supported by companies across various sectors commenting positively on their outlook. We expect double digit earnings growth in 2017. This leads us to upgrade Europe to Overweight. We will soon publish a more detailed report on European equities. On a sector basis we upgrade financials to Overweight and reduce telecoms to Underweight as of today.
- **Fixed Income:** We have entered the election with a risk bias, being overweight periphery bonds, euro investment grade as well as emerging-market bonds. Given the outcome we keep this positioning, as well as being underweight duration. We still expect 10-year sovereign rates to increase on a 12-month horizon. We expect further spread tightening of periphery and French sovereigns after a successful second round.
- **Currencies:** EUR/USD initially gained almost 2% compared to Friday close. We expect further support for the euro while seeing few drivers for the U.S. dollar in the short term. Next to positive Eurozone news there is scope for negative headline news from the U.S as the continuing resolution, on which the U.S. budget is running, expires by the end of the week. Strategically, however, we stick to our parity call for the time being.

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## Glossary

### Eurozone

The Eurozone is formed of 19 European Union member states that have adopted the euro as their common currency and sole legal tender.

### Investment Grade (IG)

An investment-grade (IG) rating by a rating agency such as Standard & Poor's indicates that a bond has a relatively low risk of default.

### Periphery countries (sometimes referred to as just the periphery)

Periphery countries are less developed than the core countries of a specific region. In the Eurozone, the euro periphery consists of the economically weaker countries such as Greece, Portugal, Italy, Spain and Ireland.

### Purchasing Managers Index (PMI)

The Purchasing Managers Index (PMI) is an indicator of the economic health of the manufacturing sector in a specific country or region.

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