



Macro

No room for complacency

Upcoming UK and French elections are far less predictable than you might think. The data suggests a wide range of plausible outcomes.

In 1805, the Scottish novelist and playwright Walter Scott won literary fame overnight. Scott's narrative poem, "The Lay of the Last Minstrel," tells the story of an old wandering bard and an ancient feud. Before the minstrel recites his lay, he hesitates:

"And scenes, long past, of joy and pain,
came wildering o'er his aged brain."

This is a little how we feel, as we weigh in once more on upcoming electoral events. Like the minstrel in the story, we may well be the last of a dying breed in remembering the lessons from Trump and Brexit. As we noted in our March 13th CIO View Special, introducing our European election watch, "polling can actually be quite useful, if used wisely." At the time, we argued that the widespread skepticism towards opinion polls ahead of the elections for the Dutch House of Representatives and the French presidential elections was overdone. However, blindly taking comfort from reassuring polling results can be equally dangerous. "Polls are only a snapshot and even the ones published just before an election are usually a few days old by the time you read about them. A lot can still change in those final days."

It pays to be especially cautious when different forecasting methods yield widely different results. This may "point to systematic biases. Until the vote takes place, however, you cannot know for sure which sources of data will prove reliable this time around. (...) The key is not getting into the business of trying to predict the direction of the suspected polling error. Instead, all you can say is that a broader range of outcomes is possible." This, alas, is exactly where we are a few days ahead of the general election in the United Kingdom (UK) and to a lesser extent in France.

The UK general election

Not so long ago, the outcome of the UK snap election looked like a foregone conclusion. Indeed, our base case remains the return of a government led by the Conservative Party (the Tories). The Labour Party has rapidly been gaining ground in the opinion polls, leaving the Conservatives only a few points ahead in some of the latest ones. As we noted in our March 13th Special, that might still be enough to ensure a Tory win: "Thanks to the UK's first-past-the-post electoral system, a plurality in the popular vote can translate into whopping majorities in the lower house (House of Commons)." Indeed, it is a fairly typical pattern for British election campaigns that the opposition party gains ground, only to go down in defeat in the end.

Stefan Kreuzkamp
Chief Investment Officer



Expectations in a nutshell

- Among the many concerns of global investors, worries about European politics appear to have rapidly receded in recent weeks.
- Ahead of parliamentary elections in the UK and France, fairly market-friendly outcomes remain our base case.
- However, we caution that uncertainty is very high. Politics remain in flux in both France and the UK. Meanwhile electoral systems may exaggerate last-minute trends.

Deutsche Bank does not intend to promote a particular outcome to the parliamentary elections in France and the United Kingdom due to take place in June. Readers should, of course, vote in the election as they personally see fit. All opinions and claims are based upon data on 6/6/17 and may not come to pass. This information is subject to change at any time, based upon economic, market and other considerations and should not be construed as a recommendation. Past performance is not indicative of future returns. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Deutsche Asset Management Investment GmbH



There are nevertheless plenty of reasons why we are cautious. The main ones are:

- In terms of economic fundamentals, this should be a close race. While the feared Brexit recession has not materialized, voters may already be feeling the pinch in their pocketbooks. Following the Brexit vote, the British pound fell sharply. As a result of this and the recovery in oil prices, inflation has accelerated. Wages have failed to keep pace. This would usually augur badly for the prospects of the government retaining, let alone increasing, its parliamentary majority.
- Prime Minister Theresa May has proven a surprisingly gaffe-prone campaigner. Her government was supposed to run as a steady pair of hands - "strong and stable" in uncertain times. Instead she was forced into a series of embarrassing u-turns, notably on plans to change the funding system for social care. The opposition labelled this a "dementia tax." Plans to do away with school lunches for the first three years of primary school earned her the nickname "lunch snatcher." Animal lovers were dismayed by the decision to drop the commitment of putting in place a complete ban on ivory trading. All of this has shifted attention away from policy areas such as immigration, government finances and corporate tax cuts, where Ms. May might have had a more popular story to tell.
- The policies of her Labour opponent Jeremy Corbyn may well be unaffordable, but have nevertheless proven to be crowd pleasers. Mr. Corbyn and his team may not have a full grasp of some of the finer details of their own policies. In terms of messaging, they seem to have done a surprisingly good job, however. For the Tories, time is running out in painting Mr. Corbyn as unsuitable for higher office – indeed, his personal poll numbers have steadily been improving.
- The British political system is in flux. At the start of the campaign, winning over supporters of the UK Independence Party did wonders for Conservative poll numbers. Labour's resurgence initially owed much to winning over support from smaller parties, such as the Greens and the Liberal Democrats, as well as many young voters. A critical question is whether these groups will actually show up to vote in the numbers pollsters are assuming. Another is whether Labour can continue to gain at the expense of the Tories, as some of the more recent polls suggest.

All this suggests plenty of uncertainty in terms of national vote shares. Indeed, it is worth keeping in mind that we have already seen a fairly big miss by the pollsters this year. Ahead of the French presidential election, Emmanuel Macron was expected to beat his far-right opponent Marine Le Pen by about 20% points. Instead, he ended up winning 66% to 34%, a whopping 32% margin. Keep in mind that British pollsters have had a far patchier track record than their colleagues across the channel (i.e. in France), particularly when it comes to calling winners. Which takes us to our biggest concern.

Deutsche Bank does not intend to promote a particular outcome to the parliamentary elections in France and the United Kingdom due to take place in June. Readers should, of course, vote in the election as they personally see fit. All opinions and claims are based upon data on 6/6/17 and may not come to pass. This information is subject to change at any time, based upon economic, market and other considerations and should not be construed as a recommendation. Past performance is not indicative of future returns. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Deutsche Asset Management Investment GmbH



The vagaries of first-past-the-post

Under the UK's first-past-the-post electoral system, a plurality of the vote in any given constituency determines who gets sent to Westminster. To win a majority, you need to win over voters in the right sort of places. Last time around, the Tories and the Scottish National Party (SNP) were the main beneficiaries of this electoral system, requiring fewer votes than Labour for each of their seats, and far fewer votes than most of the smaller parties. As constituency boundaries were left unchanged for 2017 snap elections, this would augur well for the Tories to retain their majority. Until 2015, however, the same boundaries had tended to favor Labour. In part due to tactical voting, it is very hard to predict how things will turn out this time around.

The degree of uncertainty can readily be seen by glancing at the wide range of results from various seat projection models. These generally try to supplement national polling data and the usually very limited constituency survey data with other potential pointers on local voting behavior (such as the demographics and location of each constituency, as well as past voting behavior, regional effects, and local attitudes).¹ All this is quite promising, but also fairly new in the UK. Figuring out which statistical tweaks to use will probably take a few more electoral cycles.

For what they are worth, most seat projection models still point to an increased Tory majority. However, a hung parliament, in which no single party has an absolute majority in the House of Commons, is increasingly being seen as a distinct possibility. And so, we end up where we started. There is plenty of uncertainty in the polls and in seat projections. As always, that uncertainty cuts both ways.

Our UK base case and the alternatives

Our base case remains a stable or increased Tory majority, strengthening Theresa May and facilitating a hard but orderly Brexit. As this is in line with market expectations, the financial-market impact is likely to be limited. The pound would probably strengthen.

However, Tory losses of the sort implied by some of the recent projections could fatally undermine the position of Ms. May as prime minister and party leader. Tory infighting could then easily result in a hard Brexit candidate taking over, increasing the risk of a Brexit with no alternative arrangement in place. In such a scenario, the immediate market turbulences might prove limited even for UK financial markets and as short-lived as after the Brexit vote. In the longer term, it might well prove a drag on sentiment towards both Britain and Europe in general.

And if Labour were somehow to emerge sufficiently strengthened to form a government, for example in coalition with the SNP and the Liberal Democrats? From a market perspective, that might sound appealing in theory. For one thing, a soft Brexit, including access to the European single market in return for concessions on the free

Deutsche Bank does not intend to promote a particular outcome to the parliamentary elections in France and the United Kingdom due to take place in June. Readers should, of course, vote in the election as they personally see fit. All opinions and claims are based upon data on 6/6/17 and may not come to pass. This information is subject to change at any time, based upon economic, market and other considerations and should not be construed as a recommendation. Past performance is not indicative of future returns. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Deutsche Asset Management Investment GmbH

¹For an introduction to the methodologies used, see Chris Hanretty, Benjamin Lauderdale and Nick Vivyan (2016), "Comparing Strategies for Estimating Constituency Opinion from National Survey Samples", Political Science Research and Methods, available online at <https://www.cambridge.org/core/journals/political-science-research-and-methods/article/comparing-strategies-for-estimating-constituency-opinion-from-national-survey-samples/60701055350642BFA9BD5FF6EE469BC2>



movement of EU nationals might be back on the table. It would be very tricky, however, for such a government to operate in practice. Apart from the difficulties in managing the coalition government, Labour itself remains split on many issues, while Mr. Corbyn and his allies lack government experience. Last but not least, such an outcome might reverberate across the channel, strengthening far-left opponents of Emmanuel Macron.

A sneak French preview

Based on the campaign for the French parliamentary elections so far, we remain pretty confident in the prospects for meaningful market-friendly reforms. Both polling and recent French political history suggest that, as the newly elected president, Macron will secure sufficient support for his movement "République en Marche" to enact his agenda.

However, we would conclude with a few words of caution. The French electoral system, with its two rounds, makes it even trickier to translate national vote projections into seats in the National Assembly. If no candidate wins an absolute majority in the first round, all candidates gaining at least 12.5% proceed to the run-off. Traditionally, this has tended to mean two candidates. This year, there is a risk of plenty of three-way contests. Based on the 2015 regional elections, this might happen in as many as 150 out of the 539 constituencies on mainland France.² First-round results of the presidential elections suggested a similar picture. By contrast, recent predictions of a hefty majority for Macron's movement appear to be mainly driven by its strength in recent polling. So, relatively small polling errors or last-minute scandals ahead of the first round on June 11th could produce markedly different results. Moreover, past parliamentary elections suggest that the local profile of candidates appears to have a significant impact on results.³ This could potentially hurt the prospects of recently recruited candidates of the République en Marche. Turn-out could also prove a challenge, especially in the second round.

Conclusion

In short, do not discount the potential for surprises from the French elections just yet either. Election fatigue among investors notwithstanding, both the UK and the French parliamentary elections should certainly be worth watching. As Walter Scott's last minstrel might put it come election eve:

"The present scene, the future lot,
His toils, his wants, were all forgot."

Deutsche Bank does not intend to promote a particular outcome to the parliamentary elections in France and the United Kingdom due to take place in June. Readers should, of course, vote in the election as they personally see fit. All opinions and claims are based upon data on 6/6/17 and may not come to pass. This information is subject to change at any time, based upon economic, market and other considerations and should not be construed as a recommendation. Past performance is not indicative of future returns. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Deutsche Asset Management Investment GmbH

²Study by OpinionWay and la Lettre de l'opinion (Septembre 16th, 2016), "Législatives 2017 : vers une recombinaison inédite ?", Objectif 577 – L'Observatoire des législatives 2017

³Sylvain Brouard and Éric Kerrouche (2013), "L'effet candidat lors des élections parlementaires - L'exemple des élections législatives" Revue française de science politique. Vol. 63, pp. 1113-1136



Glossary

Brexit

Brexit is a combination of the words "Britain" and "Exit" and describes the possible exit of the United Kingdom of the European Union.

European Union (EU)

The European Union (EU) is a political and economic union of 28 member states located primarily in Europe.

Inflation

Inflation is the rate at which the general level of prices for goods and services is rising and, subsequently, purchasing power is falling.

Pound sterling (GBP)

The pound sterling (GBP), or simply the pound, is the official currency of the United Kingdom and its territories.

Deutsche Bank does not intend to promote a particular outcome to the parliamentary elections in France and the United Kingdom due to take place in June. Readers should, of course, vote in the election as they personally see fit. All opinions and claims are based upon data on 6/6/17 and may not come to pass. This information is subject to change at any time, based upon economic, market and other considerations and should not be construed as a recommendation. Past performance is not indicative of future returns. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Deutsche Asset Management Investment GmbH



Risk warning

Investments are subject to investment risk, including market fluctuations, regulatory change, possible delays in repayment and loss of income and principal invested. The value of investments can fall as well as rise and you might not get back the amount originally invested at any point in time.

Investments in Foreign Countries – Such investments may be in countries that prove to be politically or economically unstable. Furthermore, in the case of investments in foreign securities or other assets, any fluctuations in currency exchange rates will affect the value of the investments and any restrictions imposed to prevent capital flight may make it difficult or impossible to exchange or repatriate foreign currency. Foreign Exchange/Currency – Such transactions involve multiple risks, including currency risk and settlement risk. Economic or financial instability, lack of timely or reliable financial information or unfavorable political or legal developments may substantially and permanently alter the conditions, terms, marketability or price of a foreign currency. Profits and losses in transactions in foreign exchange will also be affected by fluctuations in currency where there is a need to convert the product's denomination(s) to another currency. Time zone differences may cause several hours to elapse between a payment being made in one currency and an offsetting payment in another currency. Relevant movements in currencies during the settlement period may seriously erode potential profits or significantly increase any losses.

High Yield Fixed Income Securities – Investing in high yield bonds, which tend to be more volatile than investment grade fixed income securities, is speculative. These bonds are affected by interest rate changes and the creditworthiness of the issuers, and investing in high yield bonds poses additional credit risk, as well as greater risk of default.

Hedge Funds – An investment in hedge funds is speculative and involves a high degree of risk, and is suitable only for "Qualified Purchasers" as defined by the US Investment Company Act of 1940 and "Accredited Investors" as defined in Regulation D of the 1933 Securities Act. No assurance can be given that a hedge fund's investment objective will be achieved, or that investors will receive a return of all or part of their investment. Commodities – The risk of loss in trading commodities can be substantial. The price of commodities (e.g., raw industrial materials such as gold, copper and aluminium) may be subject to substantial fluctuations over short periods of time and may be affected by unpredicted international monetary and political policies. Additionally, valuations of commodities may be susceptible to such adverse global economic, political or regulatory developments. Prospective investors must independently assess the appropriateness of an investment in commodities in light of their own financial condition and objectives. Not all affiliates or subsidiaries of Deutsche Bank Group offer commodities or commodities-related products and services.

Deutsche Bank does not intend to promote a particular outcome to the parliamentary elections in France and the United Kingdom due to take place in June. Readers should, of course, vote in the election as they personally see fit. All opinions and claims are based upon data on 6/6/17 and may not come to pass. This information is subject to change at any time, based upon economic, market and other considerations and should not be construed as a recommendation. Past performance is not indicative of future returns. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Deutsche Asset Management Investment GmbH



Investment in private equity funds is speculative and involves significant risks including illiquidity, heightened potential for loss and lack of transparency. The environment for private equity investments is increasingly volatile and competitive, and an investor should only invest in the fund if the investor can withstand a total loss. In light of the fact that there are restrictions on withdrawals, transfers and redemptions, and the Funds are not registered under the securities laws of any jurisdictions, an investment in the funds will be illiquid. Investors should be prepared to bear the financial risks of their investments for an indefinite period of time.

Investment in real estate may be or become nonperforming after acquisition for a wide variety of reasons. Nonperforming real estate investment may require substantial workout negotiations and/ or restructuring. Environmental liabilities may pose a risk such that the owner or operator of real property may become liable for the costs of removal or remediation of certain hazardous substances released on, about, under, or in its property. Additionally, to the extent real estate investments are made in foreign countries, such countries may prove to be politically or economically unstable. Finally, exposure to fluctuations in currency exchange rates may affect the value of a real estate investment.

Structured solutions are not suitable for all investors due to potential illiquidity, optionality, time to redemption, and the payoff profile of the strategy. We or our affiliates or persons associated with us or such affiliates may: maintain a long or short position in securities referred to herein, or in related futures or options, purchase or sell, make a market in, or engage in any other transaction involving such securities, and earn brokerage or other compensation. Calculations of returns on the instruments may be linked to a referenced index or interest rate. In such cases, the investments may not be suitable for persons unfamiliar with such index or interest rates, or unwilling or unable to bear the risks associated with the transaction. Products denominated in a currency, other than the investor's home currency, will be subject to changes in exchange rates, which may have an adverse effect on the value, price or income return of the products. These products may not be readily realizable investments and are not traded on any regulated market.

Hong Kong

The contents of this document have not been reviewed by any regulatory authority in Hong Kong. You are advised to exercise caution in relation to the investments contained herein. If you are in any doubt about any of the contents of this document, you should obtain independent professional advice. This document has not been approved by the Securities and Futures Commission in Hong Kong nor has a copy of this document been registered by the Registrar of Companies in Hong Kong and, accordingly, (a) the investments (except for investments which are a "structured product" as defined in the Securities and Futures Ordinance (Cap. 571 of the Laws of Hong Kong) (the "SFO")) may not be offered or sold in Hong Kong by means of this document or any other document other than to "professional investors" within the meaning of the SFO and any rules made thereunder, or in other circumstances which do not result in the document being

Deutsche Bank does not intend to promote a particular outcome to the parliamentary elections in France and the United Kingdom due to take place in June. Readers should, of course, vote in the election as they personally see fit. All opinions and claims are based upon data on 6/6/17 and may not come to pass. This information is subject to change at any time, based upon economic, market and other considerations and should not be construed as a recommendation. Past performance is not indicative of future returns. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Deutsche Asset Management Investment GmbH



a “prospectus” as defined in the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32 of the Laws of Hong Kong) (“CO”) or which do not constitute an offer to the public within the meaning of the CO and (b) no person shall issue or possess for the purposes of issue, whether in Hong Kong or elsewhere, any advertisement, invitation or document relating to the investments which is directed at, or the contents of which are likely to be accessed or read by, the public in Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to the investments which are or are intended to be disposed of only to persons outside Hong Kong or only to “professional investors” within the meaning of the SFO and any rules made thereunder.

Singapore

Singapore Interests in the funds mentioned herein are not allowed to be made to the public or any members of the public in Singapore other than (i) to an institutional investor under Section 274 or 304 of the Securities and Futures Act (Cap 289) (“SFA”), as the case may be, (ii) to a relevant person (which includes an Accredited Investor) pursuant to Section 275 or 305 and in accordance with other conditions specified in Section 275 or 305 respectively of the SFA, as the case may be, or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA.

Important Information

Deutsche Asset Management is the brand name of the Asset Management division of the Deutsche Bank Group. The respective legal entities offering products or services under the Deutsche Asset Management brand are specified in the respective contracts, sales materials and other product information documents. Deutsche Asset Management, through Deutsche Bank AG, its affiliated companies and its officers and employees (collectively “Deutsche Bank”) are communicating this document in good faith and on the following basis.

This document has been prepared without consideration of the investment needs, objectives or financial circumstances of any investor. Before making an investment decision, investors need to consider, with or without the assistance of an investment adviser, whether the investments and strategies described or provided by Deutsche Bank, are appropriate, in light of their particular investment needs, objectives and financial circumstances. Furthermore, this document is for information/discussion purposes only and does not constitute an offer, recommendation or solicitation to conclude a transaction and should not be treated as giving investment advice. Deutsche Bank does not give tax or legal advice. Investors should seek advice from their own tax experts and lawyers, in considering investments and strategies suggested by Deutsche Bank. Investments with Deutsche Bank are not guaranteed, unless specified.

Investments are subject to various risks, including market fluctuations, regulatory change, possible delays in repayment and

Deutsche Bank does not intend to promote a particular outcome to the parliamentary elections in France and the United Kingdom due to take place in June. Readers should, of course, vote in the election as they personally see fit. All opinions and claims are based upon data on 6/6/17 and may not come to pass. This information is subject to change at any time, based upon economic, market and other considerations and should not be construed as a recommendation. Past performance is not indicative of future returns. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Deutsche Asset Management Investment GmbH



loss of income and principal invested. The value of investments can fall as well as rise and you might not get back the amount originally invested at any point in time. Furthermore, substantial fluctuations of the value of the investment are possible even over short periods of time. The terms of any investment will be exclusively subject to the detailed provisions, including risk considerations, contained in the offering documents. When making an investment decision, you should rely on the final documentation relating to the transaction and not the summary contained herein. Past performance is no guarantee of current or future performance. Nothing contained herein shall constitute any representation or warranty as to future performance. Although the information herein has been obtained from sources believed to be reliable, we do not guarantee its accuracy, completeness or fairness. Opinions and estimates may be changed without notice and involve a number of assumptions which may not prove valid. We or our affiliates or persons associated with us or such affiliates ("Associated Persons") may (i) maintain a long or short position in securities referred to herein, or in related futures or options, and (ii) purchase or sell, make a market in, or engage in any other transaction involving such securities, and earn brokerage or other compensation.

The document was not produced, reviewed or edited by any research department within Deutsche Bank and is not investment research. Therefore, laws and regulations relating to investment research do not apply to it. Any opinions expressed herein may differ from the opinions expressed by other Deutsche Bank departments including research departments. This document may contain forward looking statements. Forward looking statements include, but are not limited to assumptions, estimates, projections, opinions, models and hypothetical performance analysis. The forward looking statements expressed constitute the author's judgment as of the date of this material. Forward looking statements involve significant elements of subjective judgments and analyses and changes thereto and/or consideration of different or additional factors could have a material impact on the results indicated. Therefore, actual results may vary, perhaps materially, from the results contained herein. No representation or warranty is made by Deutsche Bank as to the reasonableness or completeness of such forward looking statements or to any other financial information contained herein.

This document may not be reproduced or circulated without our written authority. The manner of circulation and distribution of this document may be restricted by law or regulation in certain countries, including the United States. This document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, including the United States, where such distribution, publication, availability or use would be contrary to law or regulation or which would subject Deutsche Bank to any registration or licensing requirement within such jurisdiction not currently met within such jurisdiction. Persons into whose possession this document may come are required to inform themselves of, and to observe, such restrictions. Unless notified to the contrary in a particular case, investment instruments are not insured by the Federal Deposit Insurance Corporation ("FDIC")

Deutsche Bank does not intend to promote a particular outcome to the parliamentary elections in France and the United Kingdom due to take place in June. Readers should, of course, vote in the election as they personally see fit. All opinions and claims are based upon data on 6/6/17 and may not come to pass. This information is subject to change at any time, based upon economic, market and other considerations and should not be construed as a recommendation. Past performance is not indicative of future returns. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Deutsche Asset Management Investment GmbH



or any other governmental entity, and are not guaranteed by or obligations of Deutsche Bank AG or its affiliates.

© 2017 Deutsche Asset Management Investment GmbH
Publisher: Deutsche Asset Management Investment GmbH,
Mainzer Landstraße 11-17, 60329 Frankfurt am Main, Germany

Deutsche Bank does not intend to promote a particular outcome to the parliamentary elections in France and the United Kingdom due to take place in June. Readers should, of course, vote in the election as they personally see fit. All opinions and claims are based upon data on 6/6/17 and may not come to pass. This information is subject to change at any time, based upon economic, market and other considerations and should not be construed as a recommendation. Past performance is not indicative of future returns. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Deutsche Asset Management Investment GmbH