Emmanuel Macron has been elected President of France: what is the outlook for the markets?

Nuno Teixeira
Head of Institutional and Retail Solutions
Investment & Clients Solutions division

The second round of the French presidential elections has led to victory for Emmanuel Macron, who achieved more than 66% of votes. This result marks a clear watershed with traditional French politics over the past 50 years, as it is the first time that none of the mainstream parties have had a candidate in the second round of voting.

The En Marche *(On the Move) candidate has a reformist and progressive positioning, and unlike the scenario that could have emerged in the event of the election of an anti-establishment candidate in favor of taking France out of the euro, this outcome should not have a major economic and financial impact on the euro area in the short term. However, it could point to major economic initiatives between France and Germany that would give this area fresh impetus. The result also enables investors to focus on economic and financial fundamentals again, which have steadily been improving since the ECB announced its bond purchase program in March 2015.*

What is the immediate impact on the markets?

The clear and unquestionable victory for Emmanuel Macron, combined with a future pro-European parliamentary majority in favor of liberal reforms, could give the French economy fresh impetus. The question of who the next (acting or definitive) prime minister will be admittedly still lies wide open, as does the matter of the extent of the new President's majority, but we do not think that the answers to these two questions will be decisive for future trends on the European equity markets. While it is difficult to draw real projections, an OpinionWay poll from May 4 already suggested that *En Marche* could achieve between 249 and 286 seats in the French parliament and just about reach the 290-seat mark required to give the party an absolute majority, with the help of French overseas areas and votes from French nationals living abroad. We will see what happens in June, but it is vital to be able to rely on reformist ambitions in France, regardless of the future government composition following the general election.

The result of the second round of voting in the presidential election was higher than the polls had projected for Emmanuel Macron over the past two weeks, but a clear victory for the *En Marche* candidate had been broadly expected by investors since the first round of voting, as reflected by the rally of almost 8% on the CAC 40 and the narrowing of the 10-year Bund/OAT spread from 69bps to 43bps. The euro area as a whole was buoyed by this wave of optimism, as the EuroStoxx 50 had also gained more than 7% over the period and the spread on peripheral debt (Italy, Spain, Portugal) to the Bund also narrowed. The prospects of a victory for a reformist candidate in France also eliminated a major source of uncertainty on the financial markets in the euro area, which had been behind the valuation discount to the US market. The discount had admittedly partly reduced since the result of the Italian referendum in early December 2016, from around 25% to 15%, but it still remains higher than the historical level, and is even more significant when we consider that the upside for margins and earnings for European corporates is much higher than for their US counterparts. We note that the markets in the euro area are now trading at a reasonable 15x projected 2017 earnings (7% below the average for 2001-2006) and that European equity funds have seen net redemptions of close to $90bn since January 2016.

The election of Emmanuel Macron was broadly expected and had only a limited impact on the European markets on Monday morning, which is a public holiday in France, but not in most other European countries. Investors opted to take profits after two weeks of strong rallies: three hours after market opening, we saw a drop of 0.45% on the EuroStoxx 50, and a greater decline on the CAC 40 (-0.9%). Banking stocks in the euro area that had surged more than 11% compared to their levels ahead of the first round of voting for the French presidential, also consolidated (-0.8%). Meanwhile, the 10-year OAT/Bund spread, a real litmus test for France's risk premium, stabilized at around 42.5bps, compared to a high of 79bps on February 21, but largely at a similar level to last Friday. The euro dipped around 0.6% to the dollar to around 109.32.

What is the macro-economic impact?

We do not yet know who will achieve the parliamentary majority, but from a fundamental standpoint, we can see that the *En Marche* and *Les Républicains* economic programs are fairly similar, even if we base our analysis on François Fillon's program.

Setting aside the scenario of an absolute majority for Emmanuel Macron's *En Marche*, the other most credible scenarios would be a relatively strong majority for *En Marche*, an *En Marche*/*Les Républicains* coalition or a relative or even absolute majority for *Les Républicains.* In this last example, Emmanuel Macron would be forced to put up with a "cohabitation" with an opposition party, and implement an economic program that would probably be watered down compared to François Fillon's program. Looking at the key program points in common, Macron's program shares with the political right an aim to cut back tax pressure (cutting corporation tax from 33% to 25%), an intention to cut back on inefficient public spending, a target to make the labor market more flexible and the objective to reform social security systems. However, the *Les Républicains* program would be more "aggressive" on budget cuts, but also on reducing social security contributions.

If the right wing's program were applied as it stands, it would imply a substantial cut in public spending (around €20bn per year, or close to one point of GDP), which could drag down growth in the short term, while the impact would be smaller in Macron's program (€12bn per year). Looking at companies, the cut in corporation tax and (on the right) the planned reduction in employer social security contributions would have a major impact on corporate earnings, of around 20% for the LR program and 10% for EM. It is therefore reasonable to expect positive earnings upgrades for French corporates, which should drive French stocks.

Overall, Macron's economic program looks set to meet with a better welcome from French public opinion than the right's program (based on Fillon's program of course), as it does not seem to take changes in the country's social model as far. The elimination of 500,000 public sector jobs proposed by Fillon during the five-year presidential term is no longer on the cards as it is too difficult to implement. Meanwhile, for Macron, the aim is to move towards a model resembling the Northern European approach, as aligning on these countries' best practices could help France gain between 0.5% and 1% in GDP growth per year (see OECD report "*Raising Potential Growth After Crisis",* 2011).

Heading towards a clear reduction in political risk in Europe

One of the remaining challenges for the weeks ahead is whether the new President-elect will achieve a majority in the forthcoming general election or if the parliamentary majority resulting from the election will require a "cohabitation" with an opposition party. Since the French President's term was cut from seven to five years in 2000, the French population has always afforded the incoming President a parliamentary majority. However, we are witnessing an unprecedented situation with Emmanuel Macron, as he did not build alliances with other parties. This situation will not make the task at hand any easier as outgoing members of parliament from the mainstream parties (socialists and republicans) will continue to enjoy the advantage of familiarity when up against new faces from *En Marche*. The presidential election has shaken up the traditional mainstream right-left party system, but we can still expect a certain degree of resistance to the anti-establishment stance at the general election, and this may lead to three or even four candidates qualifying for the second round of voting in many areas.

However, French political risk seems clearly to be easing and investors are now set to look at other countries, where political risks also seem to be lessening:

- In Germany, whether Angela Merkel (CDU) or Martin Schulz (SPD) wins the elections in September, there is little room for a populist scenario in view of the relatively limited popularity of anti-European party AfD in the polls;
- In Italy, the political situation admittedly remains problematic, as the Five-star movement still leads in the polls, while the Democratic Party was recently hit by the recent split with its left wing. However, the most likely scenario is that there will be no elections before February 2018 (in view of President Mattarella's insistence on the need for electoral reform before any election and the relatively weak position of the Democratic Party in power). So there is therefore a very slim chance that Italian political risk will intensify in the months ahead;
- In Greece, the agreement between the Syriza government and the IMF/European Commission/ECB Troika on May 2 led to a pledge to reduce debt in exchange for structural reforms and reduces the risk that Greece will make the headlines over the months ahead. We note that Macron stated that he was willing to fight "for the restructuring of Greek debt", i.e. debt held by supra-national bodies (private debt was already restructured): if this move were confirmed, it would be a strong signal from Germany that it wants to seek out solutions for the future of the euro area, marking the solidarity of the Franco-German partnership.

Investment strategy for 2017

In our diversified portfolios' asset allocation, we had maintained an overweight equity stance over the past two weeks (+5% for a benchmark of 50% equities/50% FI), with a particularly offensive slant on the euro area markets (+8% vs. a neutral position of 10%), including tactical positions offering specific exposure to the growth recovery cycle in this area (small caps, financials, Italian market), although we did not have a specific slant on French equities.

Our pro-cyclical tactical position on European equities is due to the fact that activity has held up at an encouraging pace in Europe (+0.5% for GDP, as in the last quarter of 2016) while economic survey data (PMI and European Commission) now stand well above their long-term averages. We are convinced that the gap between soft data, which are at a high unseen since 2011 (particularly PMI type surveys) and hard data, which is still tentative (industrial production, retail sales, etc.) will close up via an upgrade to economic growth figures.

Our confidence is also due to a very favorable trend seen on earnings per share, which posted their strongest round in Europe in 15 years, reflecting the synchronized upturn in the world growth cycle, with European corporates more exposed to this trend than their US counterparts. So we can expect growth of around 15% in EPS in the euro area this year.

So to conclude, the rally of more than 12% on the euro area markets since the start of the year, and of 22% since the election of Donald Trump in the US, can admittedly prompt us to reduce the extent of our plays and take some profits over the days ahead, but the fact remains that fundamental economic data in the euro area are sound and the risk premium on the equity market in the area is very attractive as compared to the bond market, with dividend yield of 6.6%, which is 6.2% better than the yield on the 10-year Bund. In view of these factors, we think that upside on these markets out to the end of the year remains significant, as the sovereign debt markets are much more expensive than the equity markets at this stage. Asset allocation strategies should therefore continue to overweight European equities.

Text completed on May 8 2017.

Natixis Asset Management
Limited liability company - Share capital €50,434,604.76
Regulated by AMF under no. GP 90-009 RCS Paris n°329 450 738
Registered Office: 21 quai d'Austerlitz – 75634 Paris Cedex 13 - Tel. +33 1 78 40 80 00
This document is intended for professional clients only. It may not be used for any purpose other than that for which it was intended and may not be reproduced, disseminated or disclosed to third parties, whether in part or in whole, without prior written consent from Natixis Asset Management. No information contained in this document may be interpreted as being contractual in any way. This document has been produced purely for informational purposes. It consists of a presentation created and prepared by Natixis Asset Management based on sources it considers to be reliable.
Natixis Asset Management reserves the right to modify the information presented in this document at any time without notice, and in particular anything relating to the description of the investment process, which under no circumstances constitutes a commitment from Natixis Asset Management. Natixis Asset Management will not be held liable for any decision taken or not taken on the basis of the information in this document, nor for any use that a third party might make of the information.
Figures mentioned refer to previous years. Past performance does not guarantee future results.
The analyses and opinions referenced herein represent the subjective views of the author(s) as referenced, are as of the date shown and are subject to change. There can be no assurance that developments will transpire as may be forecasted in this material.

• **In the EU (ex UK)**: This material is provided by NGAM S.A. or one of its branch offices listed below. NGAM S.A. is a Luxembourg management company that is authorized by the Commission de Surveillance du Secteur Financier and is incorporated under Luxembourg laws and registered under n. B 115843. Registered office of NGAM S.A.: 2, rue Jean Monnet, L-2180 Luxembourg, Grand Duchy of Luxembourg. France: NGAM Distribution (n.509 471 173 RCS Paris). Registered office: 21 quai d'Austerlitz, 75013 Paris. Italy: NGAM S.A., Succursale Italiana (Bank of Italy Register of Italian Asset Management Companies no 23458.3). Registered office: Via Larga, 2 - 20122, Milan, Italy. Germany: NGAM S.A., Zweigniederlassung Deutschland (Registration number: HRB 88541). Registered office: Im Trutz Frankfurt 55, Westend Carrée, 7. Floor, Frankfurt am Main 60322, Germany. Netherlands: NGAM, Nederlands filiaal (Registration number 50774670). Registered office: World Trade Center Amsterdam, Strawinskylaan 1259, D-Tower, Floor 12, 1077 XX Amsterdam, the Netherlands. Sweden: NGAM, Nordics Filial (Registration number 516405-9601 - Swedish Companies Registration Office). Registered office: Kungsgatan 48 5tr, Stockholm 111 35, Sweden. Spain: NGAM, Sucursal en España. Registered office: Torre Colon II - Plaza Colon, 2 - 28046 Madrid, Spain. • **In Switzerland**: Provided by NGAM, Switzerland Sàrl, Rue du Vieux Collège 10, 1204 Geneva, Switzerland or its representative office in Zurich, Schweizergasse 6, 8001 Zürich. • **In the UK**: Approved for use by NGAM UK Limited, authorized and regulated by the Financial Conduct Authority (register no. 190258). Registered Office: NGAM UK Limited, One Carter Lane, London, EC4V 5ER. • **In the DIFC**: Distributed in and from the DIFC financial district to Professional Clients only by NGAM Middle East, a branch of NGAM UK Limited, which is regulated by the DFSA. Related financial products or services are only available to persons who have sufficient financial experience and understanding to participate in financial markets within the DIFC, and qualify as Professional Clients as defined by the DFSA. Registered office: Office 603 - Level 6, Currency House Tower 2, PO Box 118257, DIFC, Dubai, United Arab Emirates.• **In Singapore**: Provided by NGAM Singapore (name registration no. 53102724D), a division of Natixis Asset Management Asia Limited (company registration no. 199801044D). Registered address of NGAM Singapore: 10 Collyer Quay, #14-07/08 Ocean Financial Centre, Singapore 049315. • **In Taiwan**: This material is provided by NGAM Securities Investment Consulting Co., Ltd., a Securities Investment Consulting Enterprise regulated by the Financial Supervisory Commission of the R.O.C. Registered address: 16F-1, No. 76, Section 2, Tun Hwa South Road, Taipei, Taiwan, Da-An District, 106 (Ruentex Financial Building I), R.O.C., license number 2012 FSC SICE No. 039, Tel. +886 2 2784 5777. • **In Japan**: Provided by Natixis Asset Management Japan Co., Registration No.: Director-General of the Kanto Local Financial Bureau (kinsho) No. 425. Content of Business: The Company conducts discretionary asset management business and investment advisory and agency business as a Financial Instruments Business Operator. Registered address: 2-2-3 Uchisaiwaicho, Chiyoda-ku, Tokyo. • **In Hong Kong**: This document is issued by NGAM Hong Kong Limited and is provided solely for general information only and does not constitute a solicitation to buy or an offer to sell any financial products or services. • **In Australia:** This document is issued by NGAM Australia Pty Limited (NGAM Aust) (ABN 60 088 786 289) (AFSL No. 246830) and is intended for the general information of financial advisers and wholesale clients only. • **In New Zealand:** This document is intended for the general information of New Zealand wholesale investors only and does not constitute financial advice. This is not a regulated offer for the purposes of the Financial Markets Conduct Act 2013 (FMCA) and is only available to New Zealand investors who have certified that they meet the requirements in the FMCA for wholesale investors. NGAM Australia Pty Limited is not a registered financial service provider in New Zealand. • **In Latin America:** This material is provided by NGAM S.A. • **In Mexico:** This material is provided by NGAM Mexico, S. de R.L. de C.V., which is not a regulated financial entity with the Comisión Nacional Bancaria y de Valores or any other Mexican authority. This material should not be considered an offer of securities or investment advice or any regulated financial activity. Any products, services or investments referred to herein are rendered exclusively outside of Mexico. • **In Uruguay:** This material is provided by NGAM Uruguay S.A., a duly registered investment advisor, authorised and supervised by the Central Bank of Uruguay. Registered office: WTC – Luis Alberto de Herrera 1248, Torre 3, Piso 4, Oficina 474, Montevideo, Uruguay, CP 11300. • **In Colombia:** This material is provided by NGAM S.A. Oficina de Representación (Colombia) to professional clients for informational purposes only as permitted under Decree 2555 of 2010. Any products, services or investments referred to herein are rendered exclusively outside of Colombia. The above referenced entities are business development units of Natixis Global Asset Management, S.A., the holding company of a diverse line-up of specialised investment management and distribution entities worldwide. The investment management subsidiaries of Natixis Global Asset Management conduct any regulated activities only in and from the jurisdictions in which they are licensed or authorised. Their services and the products they manage are not available to all investors in all jurisdictions. • **In Canada:** NGAM Distribution, L.P. ("NGAM Distribution"), with its principal office located in Boston, MA, is not registered in Canada and any dealings with prospective clients or clients in Canada are in reliance upon an exemption from the dealer registration requirement in National Instrument 31 – 103 Registration Requirements, Exemptions and Ongoing Registrant Obligations. There may be difficulty enforcing legal rights against NGAM Distribution because it is resident outside of Canada and all or substantially all of its assets may be situated outside of Canada. The agent for service of process in Alberta is Borden Ladner Gervais LLP (Jonathan Doll), located at Centennial Place, East Tower, 1900, 520 – 3rd Avenue SW, Calgary, Alberta T2P 0R3. The agent for service of process in British Columbia is Borden Ladner Gervais LLP (Jason Brooks), located at 1200 Waterfront Centre, 200 Burrard Street, P.O. Box 48600, Vancouver, BC V7X 1T2. The agent for service of process in Ontario is Borden Ladner Gervais LLP (John E. Hall), located at Scotia Plaza, 40 King St. W, Toronto, ON M5H 3Y4. The agent for service of process in Quebec is Borden Ladner Gervais LLP (Christian Faribault), located at 1000 de La Gauchetiere St. W, Suite 900, Montreal, QC H3B 5H4. • **In the United States**: Provided by NGAM Distribution L.P. 399 Boylston St. Boston, MA 02116. Natixis Global Asset Management consists of Natixis Global Asset Management, S.A., NGAM Distribution, L.P., NGAM Advisors, L.P., NGAM S.A., and NGAM S.A.'s business development units across the globe, each of which is an affiliate of Natixis Global Asset Management, S.A. The affiliated investment managers and distribution companies are each an affiliate of Natixis Global Asset Management, S.A. This material should not be considered a solicitation to buy or an offer to sell any product or service to any person in any jurisdiction where such activity would be unlawful. **Investors should consider the investment objectives, risks and expenses of any investment carefully before investing.** The above referenced entities are business development units of Natixis Global Asset Management, the holding company of a diverse line-up of specialized investment management and distribution entities worldwide. Although Natixis Global Asset Management believes the information provided in this material to be reliable, it does not guarantee the accuracy, adequacy or completeness of such information.