Weekly Digest

week ending **26 February 2017**

Globalisation vs. patriotism: is France next?

Political uncertainty abounds in the G7. Last year the US and UK caused a stir, now we are within eight weeks of France's surprising or becalming political waters. France is currently poised to follow the UK and US by voting for an unconventional outcome in the upcoming presidential election because neither of the leading candidates can be said to represent traditional, 'mainstream' parties. Indeed the current front runner is an independent, centrist politician, who threw his hat into the ring only three months ago. As a result, the vote in France is less about the traditional tension between left vs. right and more premised on protectionism vs. globalisation. Both the UK and US voted last year in a manner that can be construed as a step back from globalisation. The rhetoric surrounding both the votes was colourful, with President Trump's policies in particular causing ire due to their robustness and insularity. It is this popular isolationism, fuelled by the dissatisfaction of voters left behind by globalisation that favours Le Pen in contrast to the outward, more measured, approaches of the other front runners.

Polls published over the weekend put Marine Le Pen's National Front (FN) party ahead in the first round of voting. In the likely event that no party wins a majority in the first round, results show centrist independent candidate, Emmanuel Macron, ahead versus Le Pen in the race to become the next French leader. Mr Macron's bid was buoyed last week by the announcement that he would form an alliance with François Bayrou's Mouvement Démocrate (MoDem) centrist party. The situation is arguably more fluid than these polls suggest; a number of big names and established parties are struggling for traction but may yet hit their stride. The leader of Les Républicains, François Fillon, is currently under a cloud thanks largely to a looming judicial inquiry over allegations that he improperly paid family members using state funds but if these headlines fall away, and he has a strong showing in March's televised debate, it could swing the balance of power.

The margins in the two recent polls (conducted by Odoxa/Dentsu-Consulting and Figaro/LCI) suggest a Macron win by a margin of circa 60% versus 40% for Le Pen. These polls may flatter Macron at the moment, however, 2016 taught us that polls can swing substantially in the final build up to an election. Both front running candidates are notably very active and accomplished users of social media, and we know how powerful these outlets can be if harnessed properly, but they also provide ample opportunity for a political misstep. Another risk for Macron is that he is associated with deeply unpopular incumbent Socialist president François Hollande, whom he served for two years as economy minister.

Perhaps this particular vote should be more predictable because Le Pen's policies are very contentious and tend to divide opinion sharply, whereas Mr Macron deliberately occupies the centre ground to broaden his appeal. Political convention, however, tells us that centrist politics can fail to capture the imagination, and while Macron will hope to benefit from being the 'anyone but Le Pen' candidate in the second round, he may yet slip back into reach of the other mainstream candidates which could cannibalise the 'not Le Pen' vote.

If Le Pen were taken over the line by a silent supporter base, it would be a catastrophic blow for the European Union. Firstly Le Pen wants to take France (a founding member of the bloc) out of the Eurozone and will likely hold a referendum on leaving the EU. The second reason is that an erstwhile far right party could win a presidential election in Europe would rightly send shock waves through Brussels and call into question one of the key raisons d'être of the European project as a response to the political and military upheaval seen in the region in the 20th century (and indeed countless times in the centuries before). Ultimately the key question for France, geopolitics and the financial markets is who represents the greater risk? Is it an established, but extreme, right wing party with a seasoned leader, or a latecomer centrist candidate with no party and a relative lack of policies? The BBC reports one adroit French voter observing "You don't see many FN voters here. It's a vote that appears in the ballot boxes, but isn't openly expressed". Le Pen may yet secure another win for protectionism over globalisation.

Source: Bloomberg. Returns in US dollars unless otherwise stated.

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The **Marketplace**

- Polls show growing support for Macron & Le Pen
- Strong week for bonds amid Euro uncertainty
- Progress made on Greek debt negotiations
- US equities continue their ascent
- Gold prices rise for fourth consecutive week

Market **Focus**

Europe

- The latest polls ahead of the French Presidential election in April predicted that far-right candidate Marine Le Pen would win the first round of voting, with 27%, with independent candidate Emmanuel Macron gaining 25% and centre-right candidate Francois Fillon on 19%. Macron was then predicted to win the head-to-head second round vote versus Le Pen, by a 61:39 margin.
- Macron has recently benefitted from the support of centrist candidate Francois Bayrou and socialist lawmaker Christophe Caresche, the latter of who called Macron the “only solution to counter effectively Marine Le Pen in the second round of the Presidential election.”
- Euro government bonds rose 0.6% last week, whilst Continental European equities retreated 0.2%. Investors’ weaker appetite for risk seemed a result of re-pricing of political risks as well as speculation of the possibility of a Euro break up if Le Pen were to come to power.
- In Greece, yields on two-year government debt fell by 196 basis points to 7.7% after their government agreed in principle to adopt tax and pension reforms recommended by the IMF, who view the measures as necessary for Greece to achieve fiscal surplus targets by 2019. The concession makes it more likely that Greece will receive further bailout funding to help it avoid defaulting on debt maturing in July.
- Encouraging Purchasing Managers Index (PMI) numbers for the Euro Area in February showed the manufacturing and services indexes rising by 0.3 and 1.9 points to 55.5 and 55.6 respectively. This left the composite index at 56.0; its highest level since April 2011.

US

- Equities gained 0.7% over the week, with the Dow Jones Industrial Average index recording its eleventh consecutive day of new all-time highs on Friday.
- This was despite disappointing flash PMI figures for February, in which the services and manufacturing numbers both fell, by 1.7 and 0.7 points, to 53.9 and 54.3 respectively, although numbers above 50 still represent an expansion in economic activity.
- US Treasury prices, in coordination with rising European bond prices, rose 0.6% for the week, with yields on 10 year debt closing on Friday at 2.31%; their lowest level since November.
- The markets’ attention this week will focus on President Trump’s address to Congress on Tuesday (early Wednesday in the UK), where he may reveal more details regarding his plans for tax reforms and a potential border adjusted tax on imports into the US.

Commodities

- Gold continued to be a major beneficiary of heightened political uncertainty and perceived upside risks to inflation, rising 1.4% last week to USD 1,257.19 per ounce. Year-to-date gold has returned 9.0%, with prices having risen in all but one week so far in 2017.

James Klempster (CFA) & Oliver Bickley

Source: Bloomberg. Returns in US dollars unless otherwise stated.

Montpelier momentum

Weekly Digest week ending **26 February 2017**

Asset Class/Region	Currency	Currency returns			
		Week ending 24 February 2017	Month to date	YTD 2017	12 months
Developed Market Equities					
United States	USD	0.7%	4.0%	6.0%	24.6%
United Kingdom	GBP	-0.4%	2.9%	2.3%	28.8%
Continental Europe	EUR	-0.2%	2.3%	2.2%	19.4%
Japan	JPY	0.4%	1.9%	2.1%	23.4%
Asia Pacific (ex Japan)	USD	0.5%	3.8%	9.9%	28.3%
Australia	AUD	-0.7%	2.7%	1.9%	23.0%
Global	USD	0.3%	2.9%	5.4%	22.4%
Emerging Market Equities					
Emerging Europe	USD	-1.0%	0.1%	1.9%	34.3%
Emerging Asia	USD	0.7%	4.1%	10.2%	27.7%
Emerging Latin America	USD	-0.1%	4.3%	12.2%	51.4%
BRICs	USD	0.1%	4.1%	10.7%	40.6%
MENA countries	USD	-0.5%	0.9%	2.6%	20.7%
South Africa	USD	0.8%	4.1%	7.1%	33.0%
India	USD	2.0%	5.9%	11.5%	32.8%
Global emerging markets	USD	0.5%	3.8%	9.5%	31.1%
Bonds					
US Treasuries	USD	0.6%	0.8%	1.0%	-1.2%
US Treasuries (inflation protected)	USD	0.8%	0.8%	1.7%	4.2%
US Corporate (investment grade)	USD	0.8%	1.3%	1.6%	6.9%
US High Yield	USD	0.5%	1.3%	2.7%	23.9%
UK Gilts	GBP	1.2%	2.8%	0.9%	6.0%
UK Corporate (investment grade)	GBP	1.0%	2.3%	1.3%	11.2%
Euro Government Bonds	EUR	0.6%	0.9%	-1.1%	-0.5%
Euro Corporate (investment grade)	EUR	0.6%	1.3%	0.7%	4.7%
Euro High Yield	EUR	0.3%	1.0%	1.7%	13.8%
Japanese Government	JPY	0.4%	0.1%	-0.6%	-0.1%
Australian Government	AUD	0.5%	0.1%	0.7%	0.4%
Global Government Bonds	USD	0.6%	0.2%	1.1%	-2.2%
Global Bonds	USD	0.5%	0.2%	1.1%	-0.5%
Global Convertible Bonds	USD	-0.1%	0.8%	3.0%	8.2%
Emerging Market Bonds	USD	0.9%	2.1%	3.6%	11.5%

Source: Bloomberg

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Asset Class/Region	Currency	Currency returns			
		Week ending 24 February 2017	Month to date	YTD 2017	12 months
Property					
US Property Securities	USD	2.0%	3.6%	3.5%	16.7%
Australian Property Securities	AUD	-0.6%	3.0%	-2.0%	3.0%
Asia Property Securities	USD	2.1%	3.6%	9.3%	19.6%
Global Property Securities	USD	1.5%	3.6%	4.8%	15.7%
Currencies					
Euro	USD	-0.4%	-2.0%	0.5%	-4.0%
UK Pound Sterling	USD	0.2%	-0.8%	0.9%	-10.5%
Japanese Yen	USD	0.6%	0.7%	4.3%	0.0%
Australian Dollar	USD	0.2%	1.5%	6.7%	6.7%
South African Rand	USD	1.4%	4.6%	6.0%	20.8%
Swiss Franc	USD	-0.4%	-1.6%	1.2%	-1.8%
Chinese Yuan	USD	0.0%	0.0%	1.2%	-4.9%
Commodities & Alternatives					
Commodities	USD	-0.4%	0.1%	1.0%	22.7%
Agricultural Commodities	USD	-1.2%	-0.2%	2.9%	9.5%
Oil	USD	0.3%	0.5%	-1.5%	62.7%
Gold	USD	1.4%	3.8%	9.0%	2.3%
Hedge funds	USD	-0.1%	1.0%	1.6%	7.9%

Source: Bloomberg

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