



May 8th 2017

A “French new deal”? *En Marche* gets running

Dear investors,

As we expected, Emmanuel Macron was elected last night as the new President of France. Further to this important outcome, we wanted to share a few thoughts.

The *En Marche* leader won the election with over **66.1% of the votes**, whilst the 2nd round of the election had a turnout of circa 75.1% (the lowest since 1969). **Emmanuel Macron still gathered more than 20.7M votes, turning him into one of the better elected presidents of recent times** (Hollande won with 18M voters in 2012, Sarkozy with 19M in 2007). At 39, Emmanuel Macron will be the youngest among G8 leaders. The former Rothschild investment banker and French Finance Minister will be sworn in later this week: while he held office in a Socialist government, **he is in our opinion certainly not the “heir of Francois Hollande” and should be viewed as a reformist social democrat.**

This unequivocal victory is likely to give President Macron the necessary momentum to tackle the “**third round**” i.e. the parliamentary elections, scheduled on June 11th and 18th. **The key now is that he gets a workable majority in Parliament to carry out the long overdue reforms that he is promoting. This looks as daunting a challenge as winning the presidential election was looking a year ago** (reminder: Emmanuel Macron odds of becoming the next President were 11/1 only a year ago).

A lack of majority in those elections would limit the ability of President Macron to implement his reforms, especially in the labour market. Winning the majority is far from being a certain outcome:

- Emmanuel Macron created his political movement just a year ago, with the ambition to break the traditional left/right divide in the French political landscape. His party has hardly any local presence, which is usually important in parliamentary elections. **The French society is divided: Emmanuel Macron gathered 90% of the votes in Paris** while rural areas and north of France was more in favour of Le Pen.
- The 1st round has shown a clear fragmentation of the French electoral base, which will undermine anyone’s capacity to build a majority. As we mentioned in our previous letter, it only takes 12.5% to qualify for the second round of the Parliamentary elections¹.

President Macron’s choice for a PM will be a key move in that respect, to start enlarging his electoral base. The official PM nomination should take place once Mr Macron formally takes over as President next Sunday. We would not be surprised that the new Prime Minister is a relatively unknown in the French political landscape, possibly a woman.

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¹ The second round holds unless a candidate gets an absolute majority in the first round, with the votes also representing at least 25% of registered voters



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Importantly, **the far-right populist candidate Marine Le Pen** was contained to 33.9% of the votes (circa 10.6M), which brings the following comments:

- **Le Pen did not succeed in portraying the presidential election as a European referendum**, or if she did, the French voted massively in favour of a stronger European Union.
- **The “Front Republicain” (opposition of all parties to the far right) has therefore materialised again**, as Mrs Le Pen failed to attract much more than her (growing) first round base: Le Pen won less than 3M additional votes between 1st and 2nd round. With 1st round candidate Dupont-Aignan joining Le Pen (tentatively bringing his 1st round 1.7m votes), this means that transfers of votes from Melenchon (7.1m votes in the first round) and Fillon (7.2m votes in the first round) have remained relatively muted (below 10%). This could partly be explained by her weak campaign in between the two rounds (including a “street fighting” style debate which brought back to mind the image of the old style Front National).
- **Le Pen did not come second yesterday’s vote, but third**, as non-voters (12M, i.e. 24.9%) and blank voters (4M) accounted for much more than her 10.6M votes.

Looking forward, **this election result is obviously supportive for France, but also for Europe**. On the one hand, in France, the flurry of challenges and questions - notably linked to the fragmentation of the political sphere, and the growing divide within the French population- are now left to the medium / long term. On the other hand, whilst valuations are high and spreads are tight, **President Macron’s election should rejuvenate the European project** and therefore open for a rather benign political environment for the next couple of years, **making it a great place for investing in Europe in the foreseeable future**. At the “border of Europe”, the election of “super-European” Macron will bring back questions on Brexit and we struggle to see his election a positive case for the UK, swamped with the negotiations with Europe without a great bargaining power. **A stronger Europe is probably not great news for Great Britain.**

Finally, we believe that valuations in the credit and equity markets are expensive. Overall, market positioning remains long with most European credits trading at all time highs (or highs) across European AT1s, High Yield and Investment Grade. **As previously said, we see very little premium for a negative outcome in the French parliamentary elections, not to mention other known unknowns outside France, such as events in Syria or North Korea.** We therefore maintain our focus on fundamentals and idiosyncratic risk, looking at both downside protection and upside potential.

We would be happy to discuss further if you would like to. With our very best regards,

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