Macron’s Victory Is Positive for Europe, but Euroskeptic Risks Remain

PERSPECTIVE FROM TEMPLETON GLOBAL MACRO AND TEMPLETON GLOBAL EQUITY GROUP

Recent political events have underscored the influence certain outcomes can have on potential impacts to a country’s economy and markets. The French presidential election is no exception, with both candidates offering different platforms for France as a member of the European Union. Our investment teams evaluate the opportunities and risks associated with this significant election and consider them in regard to their own theses and themes about their portfolios. Here we share insights from Templeton Global Macro and Templeton Global Equity Group to offer perspectives about the potential implications for global fixed income and global equity investments based on Emmanuel Macron winning the presidency.

Emmanuel Macron’s victory over Marine Le Pen in the French election was a largely expected and positive outcome for Europe. However, while Macron’s victory provides some near-term relief from populist pressures to abandon the euro, the risks of populism across Europe have not been fully extinguished. Euroskeptic movements are likely to be an ongoing issue in Europe until the underlying causes are mitigated. Although France and Europe have avoided seeing a populist euroskeptic elected to a head of government, those elements still exist in various wings of governments. Unfortunately, the factors that have generated populism (i.e., immigration issues, the refugee crisis and terrorism), and given rise to candidates such as Le Pen in France and Geert Wilders in the Netherlands, do not show signs of diminishing, in our opinion—thus the risks of populism remain.

In financial markets, bond valuations remain uncompelling across much of Europe, in our assessment. We continue to expect bond yields in the eurozone to remain low to negative with ongoing monetary accommodation from the European Central Bank. We also expect fundamental weakening of the euro against the US dollar as rate differentials widen between low yields in the eurozone and rising US Treasury yields. Additionally, the euro remains vulnerable to populist and euroskeptic political risks across Europe.
Emmanuel Macron secured a victory in the second round of the French presidential election, vindicating pollsters and eliciting a collective sigh of relief among investors and policymakers desiring stability and continuity in Europe. Markets had priced in optimism about Macron’s prospects since his strong showing in the first round, primarily due to his market friendly pro-business and pro-growth agenda. We expect to see additional strength in European risk assets, particularly in the periphery and banking sector, going forward. In broad terms, our portfolios were well-positioned for this outcome. Templeton’s value orientation has exposed our portfolios to some of the market’s more cyclical sectors, which tend to benefit in the type of reflationary, “risk-on” environment suggested by a Macron win. More specifically, our exposure to European banks may benefit from continued European integration and deregulation under Macron, while exposure tolowly valued consumer cyclical and industrial firms may benefit from Macron’s agenda of personal tax reform and economic stimulus. A likely reduction in corporate tax rates in France would also help bolster the European earnings recovery across all sectors, in our analysis.

As investors with a favorable view of European equities and healthy allocation to the eurozone, we were encouraged by the election’s implication for stability and continuity in the region. Relatively strong economic data support our views, including eurozone gross domestic product that is expanding at a rate close to or above the underlying trend in all major economies. Additionally, firmer demand and improving pricing power have been generating strong earnings revisions among European corporations. This is happening in the context of highly accommodative monetary policy, a recapitalized banking sector and fiscal policy that is turning stimulatory as the era of austerity fades. We remain encouraged by recent developments, while also continuing to monitor the political tensions and risks that remain unresolved even after this historic French election.

While we expect the election results to materially fortify the status quo of European integration and cooperation for the time being, risks to stability will likely persist given the deep divisions between globalists and nationalists in France and elsewhere. Specific to France, the upcoming parliamentary elections in early June have significant implications for Mr. Macron’s ability to form coalitions and find center ground in an increasingly fragmented political environment. Traditional French political divisions between a socialist left, economically liberal right and Gaullist/nationalist center are in disarray after an election where, for the first time in the history of the Fifth Republic, neither finalist candidate hailed from one the country’s major political parties. Indeed, French politics may be at an inflection point, and Mr. Macron will have his work cut out trying to get an assortment of traditional partisan ideologues and insurgent independents to back his pragmatic agenda of economic liberalism, deregulation, and European integration and reform. Should he fail, Mr. Macron could become little more than a figurehead for the French state, precluding the possibility of genuine progress and reform, and leaving behind a political power vacuum that his nationalist adversaries would no doubt be eager to exploit.

It is our belief that France needs a president with a strong mandate, not only to push through needed liberalization and reform at the domestic economic level, but also to fortify France’s position in Brussels, particularly vis a vis a powerful German state that opposes many key proposals for further European integration. Mr. Macron’s success or failure in this critical regard will become increasingly apparent in the weeks ahead.
WHAT ARE THE RISKS?

All investments involve risks, including possible loss of principal. Special risks are associated with foreign investing, including currency fluctuations, economic instability and political developments. Bond prices generally move in the opposite direction of interest rates. Thus, as prices of bonds in an investment portfolio adjust to a rise in interest rates, the value of the portfolio may decline. Stock prices fluctuate, sometimes rapidly and dramatically, due to factors affecting individual companies, particular industries or sectors, or general market conditions. Value securities may not increase in price as anticipated, or may decline further in value. To the extent a portfolio focuses on particular countries, regions, industries, sectors or types of investment from time to time, it may be subject to greater risks of adverse developments in such areas of focus than a portfolio that invests in a wider variety of countries, regions, industries, sectors or investments. Any further exits from the EU, or a belief that such exits will occur, may cause additional market disruption globally and introduce new legal and regulatory uncertainties.

IMPORTANT LEGAL INFORMATION

This material is intended to be of general interest only and should not be construed as individual investment advice or a recommendation or solicitation to buy, sell or hold any security or to adopt any investment strategy. It does not constitute legal or tax advice.

The views expressed are those of the investment manager and the comments, opinions and analyses are rendered as of publication date and may change without notice. The information provided in this material is not intended as a complete analysis of every material fact regarding any country, region or market. All investments involve risks, including possible loss of principal.

Data from third party sources may have been used in the preparation of this material and Franklin Templeton Investments ("FTI") has not independently verified, validated or audited such data. FTI accepts no liability whatsoever for any loss arising from use of this information and reliance upon the comments opinions and analyses in the material is at the sole discretion of the user.

Products, services and information may not be available in all jurisdictions and are offered outside the U.S. by other FTI affiliates and/or their distributors as local laws and regulation permits. Please consult your own professional adviser for further information on availability of products and services in your jurisdiction.

Issued in the U.S. by Franklin Templeton Distributors, Inc., One Franklin Parkway, San Mateo, California 94403-1906, (800) DIAL BEN/342-5236, franklintempleton.com - Franklin Templeton Distributors, Inc. is the principal distributor of Franklin Templeton Investments’ U.S. registered products, which are available only in jurisdictions where an offer or solicitation of such products is permitted under applicable laws and regulation.
IMPORTANT LEGAL INFORMATION, continued

Australia: Issued by Franklin Templeton Investments Australia Limited (ABN 87 006 972 247) (Australian Financial Services License Holder No. 225238), Level 19, 101 Collins Street, Melbourne, Victoria, 3000.

Austria/Germany: Issued by Franklin Templeton Investment Services GmbH, Mainzer Landstraße 16, D-60325 Frankfurt am Main, Germany. Authorized in Germany by IHK Frankfurt M., Reg. no. D-F-125-TMX1-08.


France: Issued by Franklin Templeton France S.A., 20 rue de la Paix, 75002 Paris France. Hong Kong: Issued by Franklin Templeton Investments (Asia) Limited, 17/F, Chater House, 8 Connaught Road Central, Hong Kong. Italy: Issued by Franklin Templeton International Services S.à r.l. – Italian Branch, Corso Italia, 1 – Milan, 20122, Italy.

Japan: Issued by Franklin Templeton Investments Japan Limited. Korea: Issued by Franklin Templeton Investment Trust Management Co., Ltd., 3rd fl., CCMM Building, 12 Youido-Dong, Youngdungpo-Gu, Seoul, Korea 150-968. Luxembourg/Belgium: Issued by Franklin Templeton International Services S.à r.l. – Supervised by the Commission de Surveillance du Secteur Financier - 8A, rue Albert Borschette, L-1246 Luxembourg - Tel: +352-46 66 67-1 - Fax: +352-46 66 76. Malaysia: Issued by Franklin Templeton Asset Management (Malaysia) Sdn. Bhd. & Franklin Templeton GSC Asset Management Sdn. Bhd. Poland: Issued by Templeton Asset Management (Poland) TFI S.A., Rondo ONZ 1; 00-124 Warsaw. Romania: Issued by the Bucharest branch of Franklin Templeton Investment Management Limited, 78-80 Buzesti Street, Premium Point, 7th-8th Floor, 011017 Bucharest 1, Romania. Registered with Romania Financial Supervisory Authority under no. PJM01SFIM/400005/14.09.2009, authorized and regulated in the UK by the Financial Conduct Authority. Singapore: Issued by Franklin Templeton Asset Management Ltd. Registration No. (UEN) 199205211E. 7 Temasek Boulevard, #38-03 Suntec Tower One, 038987, Singapore. Spain: Issued by the branch of Franklin Templeton Investment Management, Professional of the Financial Sector under the Supervision of CNMV, José Ortega y Gasset 29, Madrid. South Africa: Issued by Franklin Templeton Investments SA (PTY) Ltd which is an authorized Financial Services Provider. Tel: +27 (21) 831 7400 Fax: +27 (21) 831 7422. Switzerland: Issued by Franklin Templeton Switzerland Ltd, Stockerstrasse 38, CH-8002 Zurich. UK: Issued by Franklin Templeton Investment Management Limited (FTIML), registered office: Cannon Place, 78 Cannon Street, London EC4N 6HL. Authorized and regulated in the United Kingdom by the Financial Conduct Authority. Nordic regions: Issued by Franklin Templeton Investment Management Limited (FTIML), Swedish Branch, Blasieholmsgatan 5, SE-111 48 Stockholm, Sweden. Phone: +46 (0) 8 545 01230, Fax: +46 (0) 8 545 01239. FTIML is authorized and regulated in the United Kingdom by the Financial Conduct Authority and is authorized to conduct certain investment services in Denmark, in Sweden, in Norway and in Finland.

Offshore Americas: In the U.S., this publication is made available only to financial intermediaries by Templeton Franklin Investment Services, 100 Fountain Parkway, St. Petersburg, Florida 33716. Tel: (800) 239-3894 (USA Toll-Free), (877) 389-0076 (Canada Toll-Free), and Fax: (727) 299-8736. Investments are not FDIC insured; may lose value; and are not bank guaranteed. Distribution outside the U.S. may be made by Templeton Global Advisors Limited or other sub-distributors, intermediaries, dealers or professional investors that have been engaged by Templeton Global Advisors Limited to distribute shares of Franklin Templeton funds in certain jurisdictions. This is not an offer to sell or a solicitation of an offer to purchase securities in any jurisdiction where it would be illegal to do so.

CFA® and Chartered Financial Analyst® are trademarks owned by CFA Institute.

Please visit www.franklinresources.com to be directed to your local Franklin Templeton website.