

Le Pen vs Macron: How is your portfolio positioned?

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In the [first round of the French elections](#) on Sunday 23 April, Marine Le Pen, the candidate of the far-right National Front, won 21.7 percent of the vote, securing her place in the second round of the French presidential election. She's facing Emmanuel Macron, the independent, who won the first round with 23.7% of the vote. In this article we outline how investors might consider positioning their portfolios around France's second—and final—election on Sunday 7 May.

Introduction

The outlook for European equities is upbeat with polls putting pro-Europe Macron clearly ahead of Eurosceptic Le Pen in the second round, and with bullish sentiment solidifying around the polls' accurate predictions of Macron's (and Le Pen's) first round election victory.

The asset allocation overview, in a nutshell, favours risk-on positioning under a Macron win, in particular the higher beta equity plays such as European small-caps or banks which offer investors both tactical and strategic plays on the European domestic growth story.

Under Le Pen however, hedging long exposures to equities may be warranted, as is the allocation into safe-haven assets. Country-specific or export-tilted equity strategies may also appeal as the political instability of Europe puts renewed pressure on the Euro, as shown in Figure 1.

Figure 1: How the French election could impact major asset classes

		Short Term		Long Term		
		Asset Class	Market impact	Asset Allocation	Market impact	Strategy
French Presidential Election	Macron Win	Equities	Bullish	Broad equities Eurozone Banks	Bullish Europe domestic growth	Small-Caps / Quality Growth
		Fixed Income	Bearish	Bearish Bunds, Bullish BTPs	Faster ECB tightening	Bearish BTPs, Bearish Bunds
		Currency	Bullish	Euro	Stronger Euro fundamentals	Bullish Euro
		Commodities	Bearish	Gold	Diminished political uncertainty	Bearish Gold
Le Pen Win		Equities	Bearish	Hedge / short broad exposures	Heightened risk for EU	Exporters/ country-specific
		Fixed Income	Bullish	Bullish Bunds, Bearish BTPs	More monetary easing	Bullish Bunds, Bullish BTPs
		Currency	Bearish	Euro	Weaker Euro fundamentals	Bearish Euro
		Commodities	Bullish	Gold	Greater political uncertainty	Bullish Gold

Source: WisdomTree

Default scenario: Macron is bullish cyclical and high-beta equities, bearish “safe havens”

Macron’s 24-point lead in the polls makes him the natural favourite in the second round face-off with Le Pen. This advantage comes despite recent terror attacks, underscoring the difficulty of the far right in building support amongst disillusioned mainstream voters. Left and centre right voters may likely gravitate around Macron’s less risky, more liberal agenda to stave off the rise of the far-right.

This scenario sees a revival in risk-on positioning, as the threats to the European project recede. The commitment to the EU project is likely to boost investor confidence and reverse the divergence in Eurozone bond yields. Evidence of this trend is playing out in bond markets already, with French 10Y OATs spreads over German 10Y Bunds having narrowed sharply by 30bps in the aftermath of the election. But against pre-election spreads of 30bps, current 50bps spreads look overstated, suggesting more room for spreads to come down.

Within equities, broad Eurozone equity baskets are likely to continue rallying and investors positioning with conviction for a Macron win may consider high beta equity plays—such as leveraged long exposures to Eurozone Banks or German stocks as tactical bets. The case for Eurozone banks especially, is bolstered by the deeply discounted valuations at which they trade at, alongside ongoing yield curve steepening that is *reviving carry trade profit opportunities*. Small-cap strategies, and equity exposures with a quality and growth tilt should be considered as strategic style bets for the remainder of 2017.

Remote likelihood scenario: Le Pen victory is bearish risk assets, bullish gold and dislocates Europe's government bond yields to potentially new extremes

A Le Pen win on the back of surging populist support remains a possible, but highly unlikely outcome. Key to this will be Le Pen's economic policies which may resonate more with disillusioned voters from the left and centre right, than Macron's vague promises for reform. Such a dramatic shift in voter intention remains distant at this stage but cannot be discounted entirely, not least if mainstream parties are pressured to promote nationalism at the expense of EU policies. Ultimately, it will hamper coalition building in parliament or, worse, create an opening for more hard-line policies longer term.

Le Pen's radical foreign policy and incoherent economic plan is a threat to the overall stability of the European project and the French economy. This scenario puts equities, peripheral Eurozone government debt and the Euro most at risk, and investors may consider leveraged short positioning. The risk for an EU referendum, debt redenomination (into French Franc) and nationalisation, undermines investor confidence and puts renewed pressure on French OATs. It also adds to equity volatility in political sensitive sectors such as banks, energy and utility stocks.

Risk-off positioning by investors is expected in such a scenario, amplifying the already crowded trade in German Bunds and polarising Europe's bond markets anew. At near zero long term yields, gold looks set to become a viable alternative. Hedging broad European equity and peripheral bond portfolios through inverse (short) exposures should be considered.

Longer term, the pressure inflicted on the Euro could present a boon to Eurozone exporters as investors upgrade top and bottom-line growth expectations. Country-specific strategies, such as Germany, may offer the best risk-reward opportunity for investors looking to discriminate between European equity exposures, particularly when it comes to avoiding politically sensitive sectors such as utilities and energy in which governments typically hold strategic stakes, in favour of more cyclical sector exposures. WisdomTree's export-tilted strategies offer an efficient means to play these themes, combining broad baskets of dividend payers with a currency-hedged overlay designed to mitigate currency volatility for international investors.

Conclusion

The violent upswing in equity prices reflects surging expectations for a comfortable Macron victory over Le Pen. This outcome favours high beta equities, such as European small-caps or banks, that offer the best bet for investors expecting a status quo in Europe's fractured political environment and lacklustre economic growth.

By contrast, a surprise Le Pen victory would punish market complacency and risk-assets alike. Increasing political uncertainty and the pressure inflicted on the Euro would present new opportunities for broad or country-specific export-oriented equities.

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