POINT OF VIEW SERIES

JANUS CAPITAL® Group

Allez, Les Bleus!

Macron Win Clears Path for Growth

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Key Takeaways

- Macron's election removes one of this year's largest sources of uncertainty for global markets and pushes back on the tide of populism in Europe.
- The dissipation of Frexit risk removes political headwinds weighing on confidence and European risk markets.
- We believe the ripples emanating from the possibility of a liberalized French economy and from growing investor confidence in the continued existence of the EU will be felt globally.

The election of Emmanuel Macron as the youngest ever President of France removes one of this year's largest sources of uncertainty for global markets, and may present a once-in-a-generation opportunity for France and Europe to institute meaningful and sustainable reform.

With a substantial victory over far-right challenger Marine Le Pen, Mr. Macron's victory pushes back on the tide of populism in Europe. The dissipation of Frexit risk removes political headwinds weighing on confidence and European risk markets, and eliminates any immediate concerns over a new European crisis.

We caution, however, that the Italian general election – which must be held before May of next year – will be the next test for a unified Europe and presents similar risks to those avoided Sunday in France.

Now the Hard Work Begins, With an Eye on June's Legislative Vote

Mr. Macron's globalist, pro-European, pro-economic reform policies – a clear counterpoint to Ms. Le Pen's anti-EU, anti-immigration and protectionist platform – are a necessary step to help stabilize the French and European political picture, potentially giving investors a window of opportunity in continental Europe they lacked for a long time.

The timing of Mr. Macron's victory is auspicious as France is ripe for change. Results from the first round of the election, which delivered only 26 percent of votes to the two major mainstream parties, highlight this. Similarly, the more sober policy platforms of Mr. Macron (center-left) and François Fillon (center-right) illustrate the need for structural reform across the economy to unlock growth.

Achieving this will not be easy.

Mr. Macron will seek to gain support from members of Les Républicains or Parti Socialiste if he is unable to secure a majority in parliamentary elections on June 11 and 18. En Marche! – or Onwards!, the party Mr. Macron founded last year – is polling well in the latest National Assembly projections, indicating he may have the support necessary, either outright or in collaboration, to begin relaxing sclerotic regulations that have throttled French economic growth for decades. One note of caution: A significant number of blank ballots were cast in Sunday's vote, which raises uncertainty about the outcome of June's legislative election.

The alternative scenario, in which Mr. Macron is forced into co-habitation with an opposition majority in Parliament, would make his reform efforts far more challenging. We note again, the desire to reform is shared across both the En Marche! and center-right platforms, which may allow for progress to be made even in the instance of co-habitation.

With regulatory shackles loosened, the potential of the eurozone's second-largest economy would be unleashed, making us optimistic on both French and broader European growth.

Global Impact

European equities should continue to perform well, although European fixed income may not enjoy the same upside. With Mr. Macron in place, the market's focus will now shift to the European Central Bank (ECB) and the possibility that it will curtail bond purchases, which should put upward pressure on core European sovereign yields. Risk that the ECB's quantitative easing will taper, coupled with concerns about the impending Italian election, suggest that semi-core and peripheral bonds are at fair value. We also view investment-grade bonds on the continent as fully valued, but believe European high-yield debt can continue to perform well for the time being.

While we expect the euro to appreciate, the Fundamental Fixed Income Team prefers to express this view against currencies such as the Japanese yen and the Swiss franc, and similarly prefer to express our positive view on Europe via satellite currencies such as the Swedish krona.

Market impacts will not be limited to France. The ripples emanating from the possibility of a liberalized French economy and from growing investor confidence in the continued existence of the EU will be felt globally. By removing the prospect of Frexit and a return of the franc, a significant sell-off was avoided, along with the possibility of bank runs, capital controls and credit losses that could have destabilized the whole of Europe, leading to global contagion.

The removal of political headwinds, coupled with improving economic data for the continent over the past six to nine months, may encourage investors to roll out of haven assets such as German and Japanese government debt, U.S. Treasurys, the yen and low-volatility equities, into more cyclical classes such as financials, energy, industrials and technology.

While equities are not historically cheap, European stocks, especially in these cyclical sectors, are trading at some of the lowest valuations in the world.

Although cyclical equities in France, Spain and other peripheral European countries may outperform their counterparts in Germany – historically viewed as the safest bet in continental Europe – Mr. Macron's victory will likely spur a significant rally in risk assets globally as he seeks to implement his reforms in the world's sixth-biggest economy.

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