LEGG MASON
GLOBAL ASSET MANAGEMENT

French election 2017:
Markets march on

Emmanuel Macron's victory over anti-euro leader Marine Le Pen in the French presidential election removes some of the political risk that had weighed on financial markets so far this year. The centrist candidate's victory is seen as a positive for European stability, something which supports the global reflation trend that has been building up since last summer. Economic data in Europe, Asia and the US has been improving, underpinning traditional risk assets, such as stocks, and high yield and emerging market bonds. However, today's post-French election market reaction was muted as the result had been widely anticipated. **This is what Legg Mason's portfolio managers say:**

Martin Currie, Michael Browne, portfolio manager: After Macron's decisive victory, there will be a huge sigh of relief from Brussels and the establishment. But there are huge steps to be taken before he can push through his agenda of de-regulation and social protection. The market's reaction has been one of relief. The threat posed by the right and left to the French and European economy, has rescinded for another 5 years. If anything this election has masked the real and accelerating momentum in the European economy. Company results and sales have improved faster than expected, optimism continues to rise as does employment. The European Central Bank remains on hold, correctly realising inflation is currently cost-push not demand-pull. A removal of negative interest rates would be a substantial positive and is still years away. We have shifted our focus away from the exporters which have led the recovery, to the European cyclicals. Normally when data gets this good, Europe finds a way to derail it. Whilst there is still the German, UK and possibly Italian election to contend with, the election in France was always going to be the real danger.

French and Italian spreads fell after Le Pen's victory chances dropped after the 1st round. Sovereign bond spreads over German bunds, in basis points. Past performance is no guarantee of future results Source: Bloomberg as of 8 May 2017. RHS is right hand side.

Brandywine Global: Macron's victory was the best case scenario for Brandywine Global, as we were comfortable with his background in investment banking and ministry position. He will likely adopt pro-business policies to attract investment flows into France while also pursuing progressive policies. However, as a political outsider, he will have to build a grand coalition in the same vein as Germany in order for parliament to pass his ambitious agenda. Macron's victory should sustain the risk rally. We also think that safe-haven yields, like Japanese Government Bonds, German bunds, and U.S. Treasuries, will start to rise. We believe French yields could trend sideways or possibly higher based on eurozone growth and inflation expectations; regional manufacturing, as measured by Purchasing Manager Index (PMI) reports, showed strong results ahead of the election. If all else remains equal, Macron's presidency should also pave the way for the European Central Bank (ECB) to taper asset purchases later this year, and generally pursue tighter monetary policies. Once the European election season is over, market and economic forces should no longer be held captive by political forces.

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RARE Infrastructure: In the lead up to the run-off election, RARE's base case assumption was a Macron victory. With one of the largest European political risk events mitigated, we expect to see positive returns for French assets and investors switching their focus back to fundamentals. Within Europe, RARE continues to see attractive long-term opportunities in listed infrastructure. Fundamental performance remains strong with favourable operating conditions and good cash flow generation. We expect the continued quantitative easing by the European Central Bank to support economic growth in the medium-term (solid but unexciting growth), which in turn supports the valuations of economically sensitive securities, namely toll roads, airports and rail stocks. Market attention will now turn to next month's legislative elections as this will determine whether Macron has the parliamentary support to see through campaign promises.

Western Asset. Andrew Belshaw, Head of Investments. London The result is in line with the polls, and what they have been consistently pointing to for the last 3 months. Consequently, the market reaction has been muted, with French spreads to Bunds marginally wider this morning. Attention now switches to the French Assembly elections in June and whether or not En Marche can not only become the largest party but secure a majority.