

La France “*En Marche*”

April 24th 2017

Dear investors,

The first round of the French presidential elections took place over the week-end, with a turnout of circa 78%, broadly in line with previous elections. As of this morning, official results show that **Emmanuel Macron** and **Marine Le Pen** will be the two candidates competing in the second round of the presidential elections in 2 weeks, with respectively 23.75% and 21.53% of the votes. Further to this outcome, we wanted to share a few thoughts.

New kids on the block

In line with recent elections in other countries, **France expressed a profound rejection to the traditional political parties**. For the first time ever in the history of the French 5th Republic, neither the Socialist Party nor the mainstream right party will access the second round of the presidential elections.

- Les Republicains, the party of former president Nicolas Sarkozy, paid the price of the scandals which affected Francois Fillon. Despite securing circa 20% of the votes, Fillon coming third is a blow for the mainstream right party, which had always reached the second round of the presidential elections since the 1980s.
- The Socialist Party (party of the incumbent President Francois Hollande) suffered a massive defeat, with only 6.35% of the votes for the socialist candidate Benoit Hamon, i.e. only 2.2m voters. This compares with 10.2m votes in the first round of the 2012 presidential elections when Francois Hollande was the socialist candidate.

The two candidates in the second round embody a new political landscape, with two “**newcomers**” arising from non-traditional political parties.

- Former France Finance Minister, Emmanuel Macron, 39, has never held any elected positions. He created his political movement “**En Marche**” just a year ago, with the ambition to **break the traditional left/right divide in the French political landscape**. 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**. He has the ambition to implement significant economic reforms and believes in a stronger Europe.
- As anticipated, France did not escape the rise of populism witnessed in other countries and there will be an “anti-system” candidate in the second round. While the far left candidate Melenchon gathered a record support with close to 20% of the votes, the far-right candidate **Marine Le Pen** is the one that gained access to the second round. Her position is focused around nationalist themes, with a tough stance on immigration and most importantly clear positions against Europe. Her economic program is still quite unclear at this stage, however she came up first in most of the rural areas, winning in over 14,000 cities (i.e. in circa 40% of the French cities) while she only received 5% of the votes in Paris.
- In our view, the fact that Emmanuel Macron came ahead Marine Le Pen in the first round is a significant event as it **prevents the Front National from picturing itself as the 1st French political force**.

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Rejuvenating the European project

The second round of the elections is likely to be portrayed by Marine Le Pen as a European referendum, which could appeal to the anti-system voters, in particular to the 19% of voters who supported far-left candidate Melenchon.

This danger of turning the second round of the presidential election as a European referendum should not be underestimated. The top 2 candidates only gathered 44% of the votes, which is very low compared to 2012 (when Francois Hollande and Nicolas Sarkozy together gathered over 55% of the votes), and therefore leaves room for volatility ahead of the final vote on May 7th.

However, we think that France overall will remain pro-Europe and that the anti-Le Pen alliance will prevail. **Opinion polls and surveys show Emmanuel Macron should win with over 60%**. Importantly, Macron immediately received official endorsements yesterday night from Les Republicains (Francois Fillon) and the Socialist Party (Benoit Hamon). **The “everything but Le Pen” stance of the mainstream political parties should guarantee a broad political base to Emmanuel Macron**, and we believe he will become the next French President.

Macron, the French “New Deal”?

The real uncertainty now lies around the June Parliamentary elections. Indeed the “anti-system” fragmentation of the votes is the other major inflection point of this election. This will have deep consequences on the Parliamentary elections, where it takes 12.5% to qualify for the second round¹, pointing to a potential dislocation of the traditional left/right majority. Being elected president, Emmanuel Macron’s challenge will be to obtain the parliamentary majority to carry out the long overdue reforms that he is promoting. Macron’s election, provided he gets a workable majority at the Parliament, will rejuvenate the European project, and should free up France from some of its obstacles to compete in the global economy.

This being said, **we believe that valuations in the credit and equity markets are not cheap.** Overall, market positioning remains long with most European credits trading at all time highs (or highs) across European AT1s, High Yield and Investment Grade. **We see very little premium for a negative outcome in the French elections (parliamentary in particular), 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,

A handwritten signature in black ink, appearing to read 'Loïc Féry'.

Loïc Féry, CEO & Co-CIO

A handwritten signature in black ink, appearing to read 'Frédéric Couderc'.

Frédéric Couderc, Co-CIO

For any further information, please contact **Investor Relations** at +442072593600, or email ir@chenavari.com

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