# Tortoise QuickTake Podcast

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**Welcome to the Tortoise QuickTake podcast. Thank you for joining us. Today, a senior member of Tortoise provides a timely update on trending topics in the market.**

Welcome to this special Tortoise Credit podcast on the upcoming French presidential elections to be held this Sunday, May 7th 2017. I'm Graham Allen, Senior International Portfolio Manager for Tortoise Credit Strategies.

Today, I'm going to answer briefly four quick questions

1. Why on the face of it, is this election so important for France and the Eurozone?

2. What are Marine Le Pen's chances of winning?

3. What could be the market risks if she wins? And;

4. Why the outcome may not matter in the long run.

The reason this election is so important is because one of the candidates, Marine Le Pen, has openly said that she would hold a referendum on whether France should remain within the EU in the event of her victory.

Although she has slightly softened her stance in the lead up to the election she has made it clear in interviews that this is her whole raison d'etre for running for President of France. Indeed, and this may not be widely known, she has also said that in the event that a referendum is held, and French voters decide not to leave the EU, she would then subsequently resign as President of France. The reason being that of all of the 144 reforms that she would like to implement, none of them would be possible within the framework of the EU, and that's a direct quote. One proposal would include the return of the French Franc for use as a domestic currency, and the continued use of the Euro as a trading currency. So her intentions are unambiguous, and of course this is why the EU establishment, and Germany, is so keen to see her not elected.

In the event of her election we have still a long way to go before an actual Frexit, but an exit by France would be an earth-shattering event for the Eurozone, especially as France is a core member of the Eurozone itself. It should also be noted that the French parliamentary elections will also be held in June 2017 and will have an impact on how much influence any new President will have in governing, although this will exclude the right to hold a referendum.

Her opponent, Liberal Centrist, is Emmanuel Macron who is a former Finance Minister under President Hollande and has formed a new political party, En Marche, (On the Move). This party has no existing representation in the French lower house whereas the Front National only has two of the existing 577 seats! Le Pen has made an effort to identifying Macron with the failed Presidency of Hollande

So what are her chances of winning? Marine Le Pen has been closing in the polls but still remains about 18 points short of Macron, implying Macron would get 59% of Sunday's vote. Of course this is a huge gap and would indicate that Macron will win easily. However polls show that there is approximately 18% of the voters that still do not know how they will vote in this final round. Of course, as we know, the polls were not indicative of the result in both Brexit and the U.S. election. Added to the undecideds, there is also a fear that a large portion of the voting public will not vote at all, perhaps as high as 28%, as they do not like either candidate. In that event this is the window by which Marine Le Pen could steal a victory. The more people who do not vote because they are apathetic to both candidates, the more chance she has of winning. To be fair, the polls in the first round of voting were quite accurate, but there is no question that there exists the same feelings in rural France that existed in the north of England among traditional Labor voters, that became the marginal swing voters in the Brexit victory. It remains to be seen if they become the silent majority once again. As Le Pen has said all along this election is about patriotism versus globalism, not right versus left. By this Monday we will know.

Her performance in last night's fiery debate was effective in directly associating Macron with the unpopular government of outgoing President Hollande, who leaves the post with a single digit popularity rating. As an untested politician, Macron also performed well and the consensus seemed to be that Macron may have had the edge. While the result remains difficult to call, I think the market risk of a Le Pen victory has been underestimated in the investment markets. This of course was also the case in Brexit and the U.S. presidential election.

Most notably the biggest risk probably remains in the European bond markets. Peripheral spreads, that is the spread between German Sovereign bonds and countries like Portugal Spain and Greece, have narrowed recently implying a Macron victory. This narrowing has been quite prominent in the last 2 months.

For example, Greece's 10-year sovereign spreads have narrowed by 200 basis points this year and Portugal's by 100. If Le Pen wins, this narrowing would almost certainly be wiped out immediately and probably by an even larger margin. The outlook for European equities is more uncertain as there is definitely a recovery in economic strength underway in Europe. In the first quarter alone, European earnings are up by approximately 24%. If Brexit and the U.S. presidential election are anything to go by, equities have subsequently strengthened; although there was no doubt that this election will initially cause a lot of uncertainty in European markets if she wins. It is also worthy of mention that it was the BREXIT result that propelled the U.S. 10-year bond yield to its lowest ever level of 1.35% in July of 2016.

Finally, and perhaps most importantly, here's why the election result may not matter much in the end.

A quick study of history shows that it was France, spearheaded by then French President Francois Mitterrand, that actually expedited the formation of the Eurozone at the end of the eighties following the reunification of Germany. There was real concern that a reunified Germany could once again pose a threat to European peace as it had done twice before in the 20th century. Indeed it was this haste that some have claimed led to the inconsistencies and fundamental flaws that plague the Eurozone today. So at the core of the Eurozone today is a stabilizing economic bond between France and Germany. An exit by France would be construed as a death knell for the whole European project as it would defeat the objective of the Eurozone in the first place.

Among several there are two main economic flaws to the Eurozone. Firstly, 19 different fiscal policies are difficult to manage when you only have one monetary policy, presently controlled by the ECB. Under the Maastricht Treaty, member countries' spending is controlled by limiting annual budget deficits of 3% of GDP as defined by the treaty. A limit incidentally that France has not achieved since 2007.

Secondly, without free movement of labor, chronic areas of unemployment build-up have to be continually subsidized by richer areas of the union, in this case mostly Germany. In theory this is possible under the Schengen agreement but despite this Europe today is plagued by pockets of very high unemployment

This election gets to the heart of both issues. Solving the first problem can only be done by centralized control of the budget process in Brussels under the EU for all 19 member states. Ultimately this is what Macron's policies advocate, in other words, a rapid move towards a European Super State. In stark contrast Marine Le Pen wants to take power away from Brussels. The answer to the problems of Europe is not more Europe, many have said.

The second point gets to the free flow of immigration and is of course a huge election issue in France. Le Pen wants to restore France's borders with strict immigration control which would limit the free flow of labor. Macron again wants to increase enforcement of the EU borders which presently are managed ineffectively on a country by country basis.

The bigger problem however is the competitiveness gap that France maintains with Germany. Chancellor Merkel has criticized this imbalance several times, including at the G20 meeting in Cabo San Lucas back in 2012. Unless this is addressed by France itself, then the economic relationship with Germany will continue to be strained. For example France has a 10% unemployment rate, Germany's is 5.8% and falling, France has a budget deficit of 3.4%, still outside the required 3%, Germany has a surplus of 0.8% and finally and perhaps more importantly, France spends 32% of its GDP on social spending , the highest in the G20, while Germany spends only 25%. The U.S. coincidentally spends only 19%.

The policies of BOTH candidates on Sunday do not offer any meaningful solutions to solve these imbalances between the two countries in the long-term meaning, meaning that whoever wins, the Euro project could still be imperiled at some point down the road.

Thank you for listening and we hope you found this useful.

**Thank you for joining us. And stay tuned for our next cast. Have topics you want covered or other feedback to share? Write us at info@tortoiseinvest.com.**