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.

I'm Graham Allen, Senior International Portfolio Manager for Tortoise Credit Strategies. Welcome to today's podcast where we will briefly review the economic implications of the French election results and take a look at some of the post-election global market trends worthy of note:

As we know, Emmanuel Macron won the presidential election of France to become the youngest ever French president at 39.

Although the election appeared to be a contest between two ideological visions for France, which has been settled for now, the real conflict that lies ahead for Macron is economic.

Macron is obviously pro EU in his stance for France and its future in the EU. He gains power without any major political support as his new party, to be renamed The Republic Moving Forward party , has no seats in the legislative lower house. Over the coming month he has to work hard to build support to form a majority government. Given the diversity of views of the six main candidates leading up to the election, it's unlikely the new party will attain a majority in the lower house elections in June, making his success in implementing new labor reforms and other policies questionable. Polls indicate that more than 60% of voters do not want to give the new party a majority in the June elections.

Macron has also asked for a bigger role for France in the EU; the problem is, that comes at a price. A price that France will most likely be unable to pay given its economic disparity with Germany. If France is to become more competitive it must undergo some very severe economic reforms. Simply put, this means more austerity and some significant labor reforms. France still maintains its maximum 35 hour week and a retirement age of 62 (although the average age of retirement is 65). Macron has proposed changes, but in doing so has immediately alienated most of the trade unions and the left. This is likely to hurt him in the lower house elections in June and gets to the heart of the economic dilemma that both France and Macron face in the coming years.

His mandate therefore is to improve the competitiveness of French industry, reduce unemployment, bring down the budget deficit and reduce social spending. Without this, the country will never be competitive with Germany, and therefore unlikely to have a bigger say in Europe despite his demands. It is a tough problem.

The whole situation is worsened by the upcoming Brexit negotiations which are looking increasingly contentious. One element currently being overlooked is that ultimately the UK will withdraw from the EU itself. The UK is a net annual contributor to the EU to the tune of about 8 billion euros per year, after rebates and subsidies received. Existing members will have to make up that shortfall or further cuts will be needed in the EU budget once the UK departs.

Finally a word on Marine Le Pen. Although Sunday's vote was seen as a defeat for Le Pen, and she was disappointed that she did not get at least 40% of the vote, the Front National viewed the result as a positive step. Just as in the recent Dutch elections, the anti EU party made massive gains compared to the previous election, and Marine Le pen became the official voice of the opposition. There is no doubt she will be a force in the 2022 election.

Flying under the radar, the UK also held local elections over the weekend in which the Labor party was decimated in local council elections. They lost over 500 seats and 11 local authorities to the Conservatives. This was nothing short of a rout and implies that Theresa May will win a big majority in the UK election giving herself a strong mandate to negotiate Britain's way out of the EU. Despite the hardening stance taken by Brussels and Germany over the Brexit negotiations following the Macron win, the truth is the EU is in a weak bargaining position given the UK runs an estimated €60 billion annual trade deficit with Europe as a whole. Further, local German elections also held over the weekend indicate that Chancellor Merkel stands a good chance of re-election in Germany come October.

In the end, the market reaction to the French election was quite muted. The Euro was relatively stable and, in general, bond yields around the world drifted slightly higher, with the 10- year Bund yield rising to +44bs.

Outside of Europe there are other trends worthy of note. In the commodity markets, iron and copper prices continue to deteriorate. Iron ore continues to fall as inventories rise, caused by lower Chinese demand and the likelihood that large new production capabilities are coming online in Brazil and Australia in the second half of the year

Copper prices have been affected by an inventory surplus. So far the fall in commodities has been linked to the technicalities of an inventory build-up and not necessarily a slowdown in global economic activity. However the price declines should not be taken lightly if it turns out that behind the rising inventories is an actual decline in demand. In the meantime it certainly dampens inflation expectations and is supportive of global bond prices.

Concern has also been building that the Chinese are beginning to tighten monetary policy. Chinese growth has recently been increasing with GDP presently running at 6.9% annualized in the last quarter. Short term Chinese interest rates, as measured by the Shanghai interbank offered rate known as SHIBOR, have recently risen from 2 to 2.87%. This is a sign that policy could be tightening. Recent announcements on financial market reforms by the Chinese authorities are also making markets nervous. A tightening move should not come as a surprise as the Chinese have been managing their economic activity lower since the unsustainable double digit levels of growth seen prior to the great recession. Any rise in activity therefore is likely to be checked by the authorities.

Here in the U.S., the Fed minutes proved a non-event with only a slight change of emphasis. It was prepared to overlook the weakness in 1st quarter U.S. data and acknowledged the slight drop in inflation. It did however maintain its commitment to adjust monetary policy to maintain steady growth and expected inflation of 2.0%. In short we see no immediate upward pressure on U.S. interest rates.

Thanks for listening; we hope you have found this podcast 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.