



Aquila & Co. AG | 21 April 2017

France and the problems of political "cohabitation"

In the unlikely event of an election victory for Mr. Mélenchon (Far Left) or Mme. Le Pen (Far Right), French politics would probably be less radicalized than many fear. Between an extremist President and his or her Prime Minister a problematic, quasi-marital relationship would develop in a framework of pre-defined tensions, involving at times contentious decisions on the program to be put through Parliament. Why should this be the case?—Because a President from an "extremist" party, either right or left, will most probably have to choose a Prime Minister from another party. "Cohabitation" – a feature of Parisian political life between 1986 and 2002 – may be about to resurface.

The first round of voting takes place on Sunday April 23rd. Opinion polls have Mr. Macron as the victor with around 23.5% of the vote, closely followed by Mme. Le Pen with around 22.5%.

Mr. Mélenchon, "the man out of nowhere", is expected to get around 19% and Mr. Fillon 19.5%. Indicated support for these two has picked up recently. Indeed, at nearly 20%, they are both not far off second place. But one third of the electorate still says it is undecided. All in all, there is no clear favorite.

The second round of voting in the Presidential election takes place on May 7. Opinion polls suggest that Mr. Macron would clearly beat Mme. Le Pen in a run-off between the two.

The first round of the Parliamentary vote will be on June 11 followed by a second round on June 18.

The new President will have to work with Parliament and will need its support. Otherwise the Presidential program will either not be implemented, or passed through only in a very watered down form.

Current investor nervousness over Mme. Le Pen, who amongst much else wants to detach France from the Eurozone, seems overdone to us. The same could be said of the fears concerning Mr. Mélenchon. The latter wants France to leave Nato, the IMF, the WTO, the World Bank, the EU and Eurozone and "much else" in order that France can be set free on a path trail blazed by Mélenchon heroes such as Hugo Chavez and Fidel Castro.

Even in the unlikely event of Mme. Le Pen or Mr. Mélenchon achieving the Presidency it is hard to see that they could implement a significant anti-European program. This is because, having elected an "extremist" President, the French electorate would probably choose Parliamentary candidates from the "middle ground" as a sort of counterbalance. The French appetite for risking something new is not comparable to America's. It is almost unthinkable that a future President Mélenchon or Le Pen would have control of France's next Parliament. For this, they would need to control 289 out of the total 577 seats.

Thus, if faced with a President from the "extreme right" or the "extreme left", France would seek a balance through the Parliamentary elections, opting in effect for a watered-down revolution. We think it highly likely that Mr. Fillon's Republican party will emerge as the dominant player in the new Parliament. And the new President would have to choose a Prime Minister who commanded the

support of Parliament. If either Mr. Macron, Mr. Mélenchon or Mme Le Pen were to emerge victorious on May 7, the new Prime Minister would almost certainly have to come from another party. We would then have another period of “Cohabitation”: a marriage-like relationship which could quickly find itself on the rocks. A President has less control over a Prime Minister who comes from another party, implying a more powerful Prime Minister. Should the new President try to take France out of the Eurozone, or even just to hold a referendum on the issue, a nasty fight could quickly ensue.

In the past “cohabitation à la française” has frequently led to a political impasse, triggering early elections. Following these, a new cohabitation was established, lasting until the inevitable pressures led to a further political impasse and so on....

One should not forget either that, while a majority in France is now highly critical of the EU, nearly 70% are in favor of France remaining in the Eurozone. In the unlikely event of a referendum on France’s position in the Eurozone, by far the most likely result would be a clear decision to remain.

Conclusions:

1. Investor worries about the upcoming French elections are exaggerated and should not deter investors from overweighting Euroland equities.
2. Nevertheless, European markets would probably suffer a panic attack should either Madame Le Pen or Monsieur Mélenchon emerge victorious. Such an attack would most probably provide a good entry point into the markets. But, as the results of the French parliamentary elections will only be known in June, a shock outcome in the Presidential election could result in a more serious and longer-lasting sell-off than the markets’ post-Brexit swoon last June. The message here is do not move too early in the unlikely event of an unwelcome Presidential election result. Better wait for the subsequent Flash article from Aquila.
3. If this Sunday’s vote points clearly to an eventual Macron victory there may a short recovery rally.

In comparison with US stocks Euroland stocks are significantly cheaper. While investors have to pay \$28 to have access to one dollar of cyclically adjusted, sustainable earnings from the US stock market. The only have to pay 18 Euros to have access to one euro of cyclically adjusted, sustainable earnings from the stock markets of Euroland.

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