

April 2017

The extreme short-term pessimism that we shared on the 16th set the stage for this week's move higher. The catalyst this time was last Sunday's 1st round of the French election, with the centrist Macron (24.0%) outdistancing the anti-EU nationalist Le Pen (21.3%). Polls indicate an insurmountable lead for Macron in May 7th's runoff. French stocks were up over 4% on Monday, with other European stock markets also strongly higher, adding to foreign stocks' recent outperformance.



Friday's edited weekly Global Investment Strategy:

The Establishment Strikes Back

28 Apr 2017

Davos Man Is Happy

Populist forces have been in retreat of late. First came the Austrian presidential elections, which saw voters reject a populist right-wing challenger in favor of a former Green Party leader who pledged to be an "open-

mindful, liberal-minded, and above all a pro-European president." Then came the Dutch elections, where Prime Minister Mark Rutte won more seats than the maverick Geert Wilders.

Last week the pound surged after U.K. Prime Minister Theresa May called for a fresh election. May's announcement was designed to expand the Conservative Party's majority, thus neutralizing the ability of a few hardline Tories to scuttle a Brexit deal. These uncompromising MPs would rather see negotiations break down than acquiesce to any of the EU's demands, including that the U.K. pay the remaining £60 billion portion of its contribution to the EU's 2014-20 budget.

This week we have the results of the first round of the French presidential elections. Despite the media's absurd characterization of Emmanuel Macron as an "outsider," the former government minister was, in fact, the establishment's dream candidate: pro-business and fervently Europhile. Current polls show Macron beating Le Pen in a runoff by 21 points (**Chart 1**).

Finally, on the other side of the Atlantic, Donald Trump has caved on most of his populist campaign pledges. He agreed to drop his requests that Congress pay for a border wall with Mexico and defund Planned Parenthood. The move **adverted** an imminent government shutdown. In addition, Trump backed off his pledge to scrap NAFTA. This follows on the heels of his decision not to label China as a "currency manipulator," something he had promised to do during the campaign. And to top it all off, Trump released a one-page tax plan with all the goodies the Republican establishment has been craving: Lower corporate and personal tax rates and the abolition of the estate tax.

Risk Assets Will Benefit...

Not surprisingly, global equities have responded positively to these developments. The MSCI All-Country World Index (**the All Cap version of which is our benchmark**) hit a record high this week (**Chart 2**). A rebound in corporate earnings is helping to propel stocks higher. Our global earnings model points to further upside for profits over the coming months.

The laggard remains the Treasury market. Trump's tax plan will add about \$5 trillion to the national debt over the next decade above and beyond what the Congressional Budget Office is

Chart 1
Macron Leading Le Pen

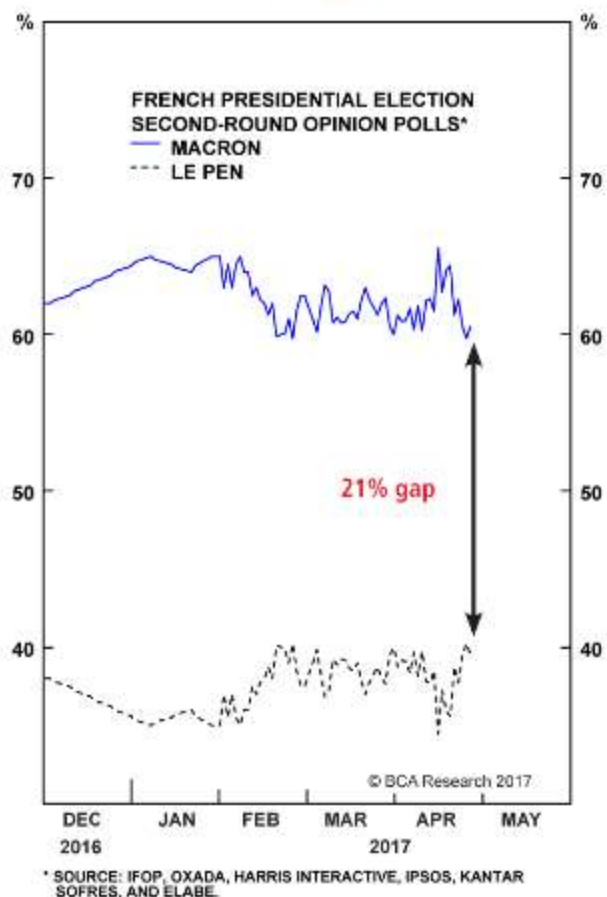


Chart 2
Global Equities At Record Highs



already projecting. Yet, the 10-year Treasury yield remains 30 basis points below where it was in early March. The market is pricing in just under two rate hikes over the next 12 months. This is below the Fed's guidance and our own expectations. ...

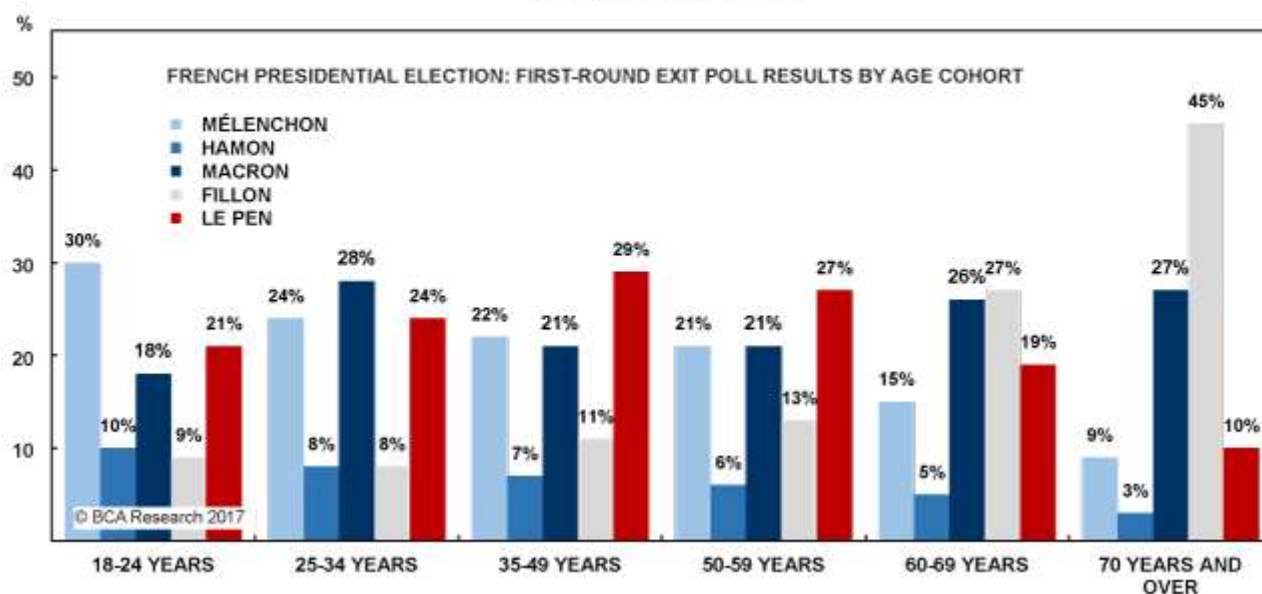
Higher U.S. rate expectations should lead to a further widening of rate differentials between the U.S. and its trading partners. Mario Draghi underscored yesterday that the ECB has no plans to remove monetary stimulus anytime soon. If anything, rising inflation expectations in the euro area on the back of a firming economy could lead to lower real yields there, putting downward pressure on the euro. ... We continue to see EUR/USD reaching parity later this year.

...But Populists Will Triumph In The End

Steady growth and falling unemployment will reduce support for populist parties over the coming 12 months. This will help keep global equities in an uptrend. Beyond then, the clouds are likely to darken. We argued in our *Q2 Strategy Outlook* that global growth could begin to slow in the second half of next year. If that happens, support for mainstream political parties will fade.

Structural forces will further bolster support for populist leaders. **Chart 7** shows that Le Pen won the plurality of voters between the ages of 35 and 59. Young voters tilted towards **the far-left** Mélenchon (19.6%), while older voters overwhelmingly went for Emmanuel Macron and **the other centrist candidate** François Fillon (20.0%). If recent voting trends are any guide, the elderly of tomorrow will be more sympathetic to Le Pen than the elderly of today. Le Pen's populist message on the economy could resonate more with younger voters (indeed, Le Pen beat Macron among voters between the ages of 18 and 24).

Chart 7
Who Likes Le Pen?



Meanwhile, worries about terrorism will undermine support for the establishment. There are 17,000 people on the French government's terrorist watch list, 2,000 of whom have fought in Syria and Iraq. Macron's feeble pledge to hire 10,000 additional police officers will do little to thwart future attacks.

In the U.S., Trump's pivot towards the establishment wing of the Republican Party could prove to be short-lived. Most Republican voters have mixed feelings about Donald Trump *the man*. They voted for Trumpism,

not Trump. Either Trump will start delivering on the promises that endeared him to blue-collar workers in states such as Ohio and Pennsylvania, or he will go down in flames in the next election.

Bottom Line: Investors should overweight global equities in a balanced portfolio over the next 12 months

Positions

We closed a client's position in TOTL (where we park excess cash when we are sufficiently concerned rather than invest it in Transitional Funds) on 4/17, and added to her position in IVAL for more foreign equity exposure.