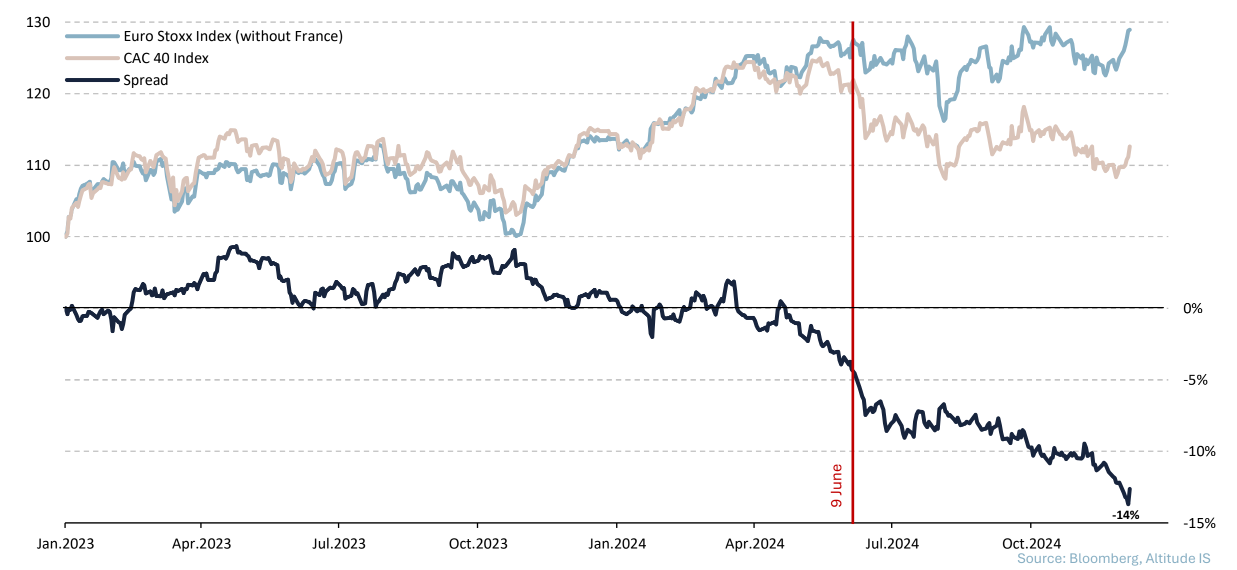
weekly investment focus

The flexiweekly that reaches new heights - published on 9 December 2024

"CRISIS IN FRANCE... WHAT IF IT RHYMED WITH CHANCE AND PATIENCE?"

- Government impeachment prevents swift stabilisation of public finances
- Growing uncertainty weighs on bonds, equities and the euro
- Stress may not have reached its peak, but opportunities are emerging
- It all depends on the level of protection investors need

CHART OF THE WEEK: "The political crisis has already taken its toll on listed companies"



Source: Bloomberg, Altitude IS

FINANCIAL MARKET ANALYSIS

Since the dissolution of the National Assembly on 9 June, France has been a source of concern for investors. The ensuing legislative election has created an unprecedented situation of parliamentary deadlock, with three opposing groups: the far right, the centre parties, and the coalition comprising the left, the far left and the ecologists. President Emmanuel Macron appointed Michel Barnier as Prime Minister in an attempt to find compromises and vote for a credible budget for 2025. From the moderate right, albeit in a minority, he was one of the few people who could hope to win majority support in the House. It was a failure. Last week, his government was toppled by a motion of censure, plunging France once again into a political impasse and investors into a new phase of uncertainty.

In his last public appearance, Emmanuel Macron expressed his willingness to serve until 2027, rejecting implicit calls for him to resign. He must now appoint a new Prime Minister, capable of overcoming deep divisions in parliament to another vote of no confidence, while stabilising public finances. In fact, **the future government will have to submit a special bill before the end of the year,** allowing tax collection and the running of the state to continue until a final budget is approved early next year. **Although this is a special law, it will nevertheless have to be passed by parliament.**

The current political crisis must not mask the structural challenge facing France: the budget deficit and public debt exceed 6% and 112% of GDP respectively (see Figs. 2 and 3). Paradoxically, the French are increasingly opposed to austerity policies. **Rating agencies such as S&P Global Ratings have warned** that ambitious fiscal consolidation is now unlikely, increasing the risks to public finances in the medium term and thus the likelihood **of a downgrade of the current AA- rating.**

Fig. 2 - Public deficit: France vs Germany

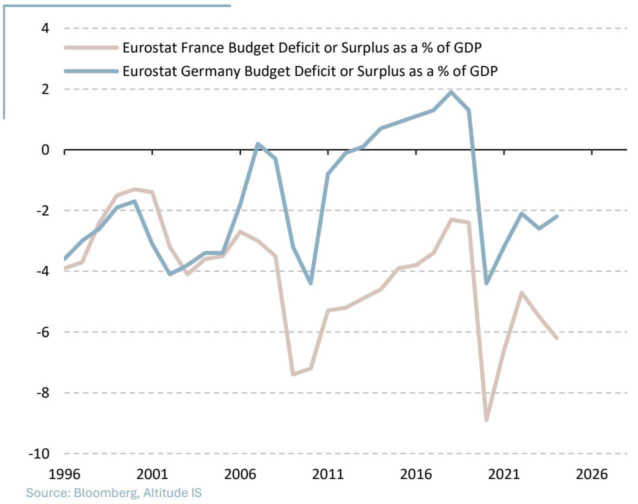
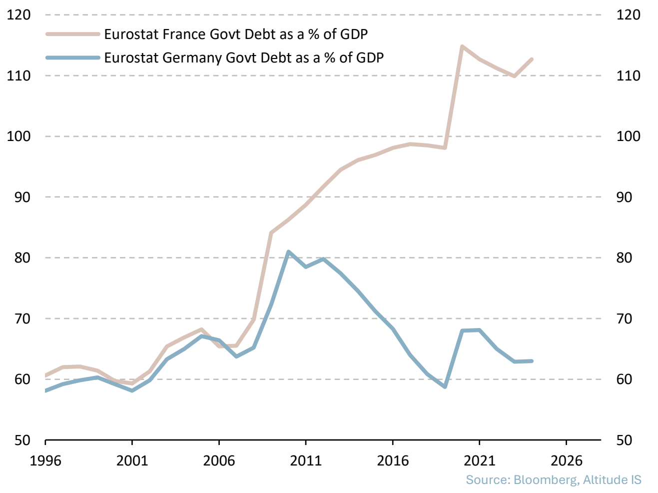


Fig. 3 - Public debt: France vs Germany



Marine Le Pen, the leader of the far right, has managed to take advantage of this crisis. By saying that she was prepared to work with the government, provided that budgets reflected her party's priorities, she succeeded in extending her influence over French politics. She also hinted that a budget could be adopted quickly if the government agreed to a more gradual reduction in the deficit, marking a turning point in the fiscal debate and its influence on the financial markets. Following the announcement on Thursday 5 December, spreads and CDSs contracted, while CAC 40 companies rallied. These movements suggest either that investors are anticipating a rapid resolution to the political crisis, or that they believe the economic fundamentals remain solid.

Investors' fears are not linked to the political camp of the members of parliament, but essentially to France's budgetary future, the ratings given by the agencies, and corporate tax rates. They are reluctant to take on more exposure to France, when most other Eurozone countries offer more attractive political stability. **However, although bondholders have become more nervous in recent weeks, they have not succumbed to panic.** The spread between French and German 10-year bonds recently touched 88 basis points higher, a record since the European debt crisis in 2012 (see Fig. 4).

Credit Default Swaps (CDS) on French sovereign debt, which measure the cost of insuring against default, rose before the announcement of the fall of Michel Barnier's government, then fell afterwards (see Fig. 5). On 5 December, the five-year CDS on France stood at 36 basis points, compared with a recent peak of 41 points. This easing reflects investor sentiment that, despite political instability, the risk of default remains limited for the time being.

Fig. 4 - 10-year yield spread

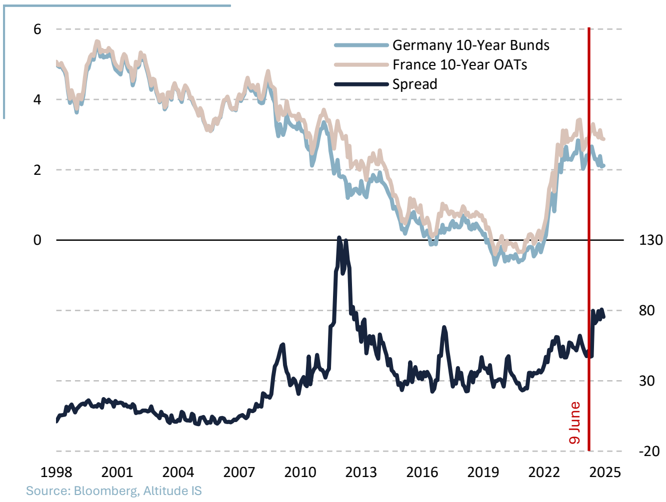
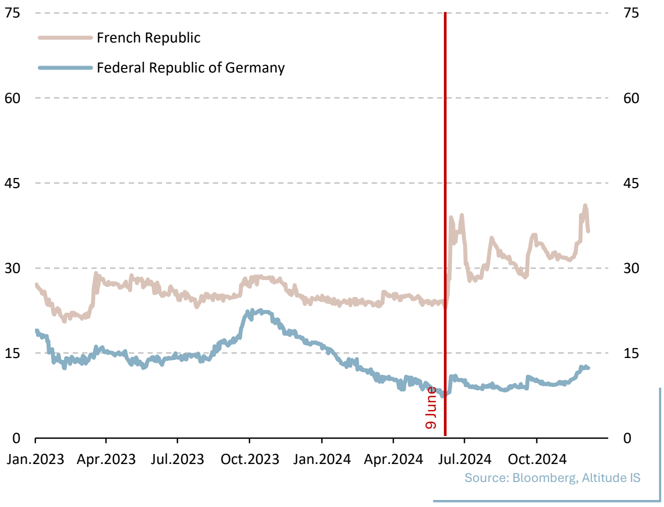


Fig. 5 - 5-year credit default swap



By way of comparison, the election of Liz Truss in the UK on 5 September 2022 and that of Giorgia Meloni in Italy on 22 October 2022 caused spreads to widen by around 140 basis points. It is likely that the next French government(s), confronted with economic and financial reality, will end up naturally backing down on the most controversial electoral measures, as was the case in Italy. It is also possible that the markets themselves will exert a significant constraint, forcing the government(s) to adopt a more pragmatic and balanced policy, as was the case in the UK. Under this assumption, **France's spread should not exceed 140 basis points for long**. **Similarly, the CDS should not settle above 70 basis points**.

France's flagship equity index, the CAC 40, also showed some resilience. On 5 December, it gained 0.6%, buoyed by gains in the technology and consumer goods sectors. This performance is partly explained by the global nature of the 40 companies making up the index, which are less sensitive to purely domestic factors. Investors also seem to be anticipating that the fall of the government could pave the way for political compromises to avoid a prolonged stalemate. **However, the cumulative underperformance over the last eight months has reached 14%** (see Chart of the week).

Investor concerns are probably not over yet. A reallocation of assets towards French bonds or equities is probably still premature for short-term investors and those with a strong aversion to risk. They will probably have to wait until the spread with Germany and the CDS reach 140 and 70 basis points respectively. Only investors who appreciate distressed situations and have a sufficiently long-time horizon will seek exposure to French assets now, believing that uncertainty is where the best deals are made.

To put them in alignment, we need to look at the individual performance of French equities. **Of the top 40 listed stocks, only four have seen their share prices outperform** on dissolution (see Fig. 6) and rise consistently over the past seven months (see Fig. 7). These are **Essilor (EL FP), Danone (BN FP), Schneider (SU FP), Sanofi (SAN FP) and Safran (SAF FP).** These companies are little affected by the political and fiscal situation in France. Each for its own reasons, not least their low exposure to French growth, they are weathering the storm perfectly.

Fig. 6 - Performance in the week of 6 June 2024

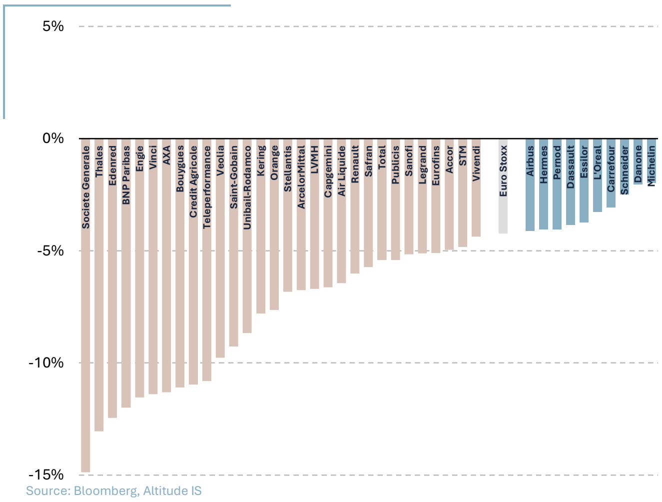
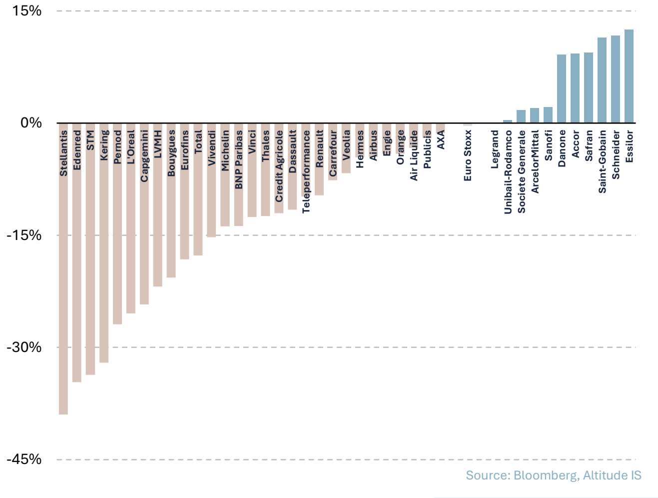


Fig. 7 - Performance from May to December 2024



As for the companies that have suffered the most, such as Stellantis (STLAP FP), Edenred (EDEN FP), Kering (KER FP) and Bouygues (EN FP), they should be among those to recover significantly once the storm has passed. In this second phase, which will come later, banks, utilities and industrials will outperform the CAC 40, which is itself rising faster than its European counterpart. So, although the political events generated major upheaval at the outset, they will ultimately prove to be opportunities, even for the sectors most affected.

The repercussions of political uncertainty in France extend beyond the country's borders. As the Eurozone struggles with sluggish growth and fiscal tightening, the instability of its second-largest economy is sending shockwaves through the currency markets, where confidence in France plays a crucial role in guaranteeing the currency's stability. The euro has lost some 3% since June. **Logically, the single currency is suffering, but it is not at risk.** In the worst-case scenario, i.e. if the French risk were to spread to the rest of the Eurozone, and provided Paris undertakes to balance its public finances, the European Central Bank (ECB) could intervene. It has many tools at its disposal for managing liquidity and solvency crises. Its involvement would make a major contribution to restoring investor confidence. The ECB would thus succeed in stabilising the markets, as Mario Draghi did during the European debt crisis. Such intervention is not desirable, but it could prove crucial in preventing a spiral of economic and financial deterioration across the Eurozone. This prospect offers a degree of insurance against a worst-case scenario.

Conclusion:

Despite recent past and future turbulence, there are some great opportunities in France's political imbroglio, whether via the bond or stock markets, or via structures that are backed by them.

RETURN ON FINANCIAL ASSETS

Markets Performances (local currencies)	Last Price	Momentum Indicator (RSI)	1-Week (%)	1-Month (%)	2024 Year-to-Date (%)	2023 (%)	2022 (%)
Equities							
World (MSCI)	873.7	70.79	1.3%	2.4%	22.5%	22.8%	-17.9%
USA (S&P 500)	6 090	69.26	1.0%	2.9%	29.3%	26.3%	-18.1%
USA (Dow Jones)	44 643	61.05	-0.5%	2.4%	20.6%	16.2%	-6.9%
USA (Nasdaq)	19 860	72.22	3.4%	4.7%	33.2%	44.7%	-32.5%
Euro Area (DJ EuroStoxx)	513.7	63.77	3.0%	3.5%	12.0%	19.5%	-11.4%
UK (FTSE 100)	8 309	57.95	0.3%	2.2%	11.3%	7.7%	4.6%
Switzerland (SMI)	11 781	48.98	0.1%	-0.6%	9.2%	7.1%	-14.3%
Japan (Nikkei)	39 139	54.61	2.3%	-1.0%	18.7%	31.0%	-7.3%
Emerging (MSCI)	1 105	51.56	2.5%	-2.3%	10.8%	10.2%	-19.8%
Brasil (IBOVESPA)	125 946	42.41	0.2%	-3.4%	-6.1%	22.3%	4.7%
Mexico (IPC)	51 349	55.38	3.1%	-0.2%	-8.1%	22.4%	-5.8%
India (SENSEX)	81 742	61.91	2.4%	1.7%	14.6%	20.3%	5.8%
China (CSI)	3 962	54.54	1.4%	-1.2%	19.2%	-9.1%	-19.8%
Com. Services (MSCI World)	126.9	70.87	3.7%	4.2%	33.9%	38.1%	-35.3%
Cons. Discretionary (MSCI World)	434.3	78.60	4.9%	7.9%	24.2%	29.5%	-31.5%
Cons. Staples (MSCI World)	284.9	56.05	-0.2%	2.7%	9.1%	3.2%	-6.0%
Energy (MSCI World)	251.4	37.29	-3.0%	-2.1%	7.4%	6.0%	34.5%
Financials (MSCI World)	187.0	67.06	0.0%	2.2%	29.9%	16.4%	-9.2%
Health Care (MSCI World)	367.2	40.32	-1.1%	-2.1%	6.6%	4.1%	-5.7%
Industrials (MSCI World)	399.0	56.14	-0.3%	0.4%	19.3%	22.5%	-12.6%
Info. Tech. (MSCI World)	789.6	68.38	3.6%	4.0%	35.3%	51.4%	-30.9%
Materials (MSCI World)	330.0	40.16	-0.8%	-3.3%	-0.6%	12.6%	-11.0%
Real Estate (MSCI World)	1 009	46.23	-1.9%	1.3%	5.6%	5.3%	-26.6%
Utilities (MSCI World)	168.1	41.79	-2.4%	1.1%	17.7%	1.6%	-3.8%
Bonds (Bloomberg)							
World (Aggregate)	3.49%	60.93	0.3%	1.4%	0.7%	5.7%	-16.2%
USA (Sovereign)	4.16%	65.30	0.4%	1.9%	2.5%	4.1%	-12.5%
Euro Area (Sovereign)	2.52%	74.45	0.2%	2.7%	3.5%	7.1%	-18.5%
Germany (Sovereign)	2.05%	64.80	-0.1%	2.2%	2.0%	5.6%	-17.8%
UK (Sovereign)	4.25%	57.82	-0.2%	2.4%	-1.4%	5.6%	-17.1%
Switzerland (Sovereign)	0.42%	65.78	-0.1%	1.5%	5.7%	7.9%	-12.5%
Japan (Sovereign)	0.84%	45.98	0.0%	-0.6%	-1.8%	0.9%	-2.8%
Emerging (Sovereign)	6.77%	75.24	0.7%	1.5%	9.4%	11.0%	-17.4%
USA (IG Corp.)	4.98%	65.95	0.4%	1.1%	4.7%	8.5%	-15.8%
Euro Area (IG Corp.)	3.03%	72.37	0.0%	1.3%	5.4%	8.2%	-13.6%
Emerging (IG Corp.)	6.33%	69.85	0.3%	0.6%	8.3%	6.7%	-14.9%
USA (HY Corp.)	7.05%	80.90	0.3%	0.8%	9.1%	13.4%	-11.2%
Euro Area (HY Corp.)	5.61%	92.33	0.5%	0.9%	8.1%	12.1%	-10.6%
Emerging (HY Corp.)	8.27%	80.14	0.6%	1.4%	16.1%	13.1%	-12.4%
World (Convertibles)	455.9	71.73	0.4%	3.4%	13.2%	12.3%	-18.2%
USA (Convertibles)	624.7	70.80	0.3%	4.6%	14.9%	14.6%	-20.1%
Euro Area (Convertibles)	234.5	78.55	0.9%	4.3%	15.5%	7.3%	-11.1%
Switzerland (Convertibles)	257.9	57.93	2.7%	-0.5%	-4.2%	5.8%	-19.1%
Japan (Convertibles)	224.0	56.25	0.4%	0.2%	5.2%	7.6%	-1.3%
Hedge Funds (Bloomberg)							
Hedge Funds Industry	1 585	80.17	n.a.	-0.5%	9.4%	7.8%	-6.9%
Macro	1 321	61.53	n.a.	-1.7%	5.7%	1.6%	1.3%
Equity Long Only	2 213	72.63	n.a.	-1.9%	12.1%	15.9%	-16.4%
Equity Long/Short	1 656	79.49	n.a.	-0.2%	12.6%	7.7%	-10.7%
Event Driven	1 709	77.83	n.a.	-0.2%	7.7%	7.3%	-4.7%
Fundamental Equity Mkt Neutral	1 626	95.20	n.a.	0.6%	10.7%	6.6%	2.3%
Quantitative Equity Mkt Neutral	1 643	85.77	n.a.	-0.4%	8.4%	7.8%	-2.0%
Credit	1 584	95.81	n.a.	0.2%	7.7%	8.1%	-5.0%
Credit Long/Short	1 603	100.00	n.a.	0.3%	8.4%	11.2%	-1.4%
Commodity	1 742	80.41	n.a.	2.1%	11.7%	7.3%	10.5%
Commodity Trading Advisors	1 313	48.38	n.a.	-3.1%	5.5%	-3.6%	5.3%
Volatility							
VIX	12.77	33.76	-5.5%	-21.5%	2.6%	-42.5%	25.8%
VSTOXX	14.48	33.65	-14.6%	-21.7%	6.7%	-35.0%	8.4%
Commodities							
Commodities (CRB)	537.6	n.a.	0.3%	0.8%	5.3%	-8.0%	-4.1%
Gold (Troy Ounce)	2 642	n.a.	0.1%	-1.6%	28.1%	13.1%	-0.3%
Silver (Troy Ounce)	31.14	n.a.	2.1%	1.5%	30.9%	-0.7%	2.8%
Oil (WTI, Barrel)	67.20	n.a.	-2.2%	-6.3%	-6.2%	-10.7%	4.2%
Oil (Brent, Barrel)	72.63	n.a.	-2.2%	-4.5%	-6.4%	-4.5%	5.5%
Currencies (vs USD)							
USD (Dollar Index)	106.16	54.36	-0.3%	1.1%	4.8%	-2.1%	8.2%
EUR	1.0541	43.45	0.4%	-1.1%	-4.5%	3.1%	-5.8%
JPY	150.10	58.22	-0.3%	2.4%	-6.0%	-7.0%	-12.2%
GBP	1.2727	47.82	0.6%	-1.1%	0.0%	5.4%	-10.7%
AUD	0.6385	33.04	-1.4%	-2.9%	-6.3%	0.0%	-6.2%
CAD	1.4170	32.01	-0.9%	-1.7%	-6.5%	2.3%	-6.8%
CHF	0.8801	49.22	0.7%	0.1%	-4.4%	9.9%	-1.3%
CNY	7.2786	32.27	-0.1%	-0.9%	-2.5%	-2.8%	-7.9%
MXN	20.192	51.72	1.0%	0.7%	-15.9%	14.9%	5.3%
EM (Emerging Index)	1 745.3	41.65	-0.2%	-0.7%	0.3%	4.8%	-4.3%
XBT	99 225	n.a.	1.4%	29.8%	133.4%	157.0%	-64.3%

Source: Bloomberg, Altitude Investment Solutions — Total Return by asset class (Negative \ Positive Performance)

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