



MONTHLY Market Review

May 1, 2017

The Road Less Traveled

Macron's rise soothes nervous markets;
Trump's unconventional first hundred days

After meandering listlessly for much of April, equities surged following Emmanuel Macron's first place finish in the first round of the French presidential election held on April 23rd. It averted the feared outcome of having the right-wing Marine Le Pen and the radical leftist Jean-Luc Mélenchon being the two finalists in the May 7th run-off. Given the roughly 20 point lead that Macron enjoys over Le Pen in the various polls, it appears that the former is likely to be the next French President. The diminishing risk of Frexit, which Marine Le Pen has threatened to carry out if she were to move into the Élysée Palace, drove the euro higher. Likewise, the British pound soared against the greenback after Prime Minister Theresa May made the surprise call for a snap election. It is believed that a strong showing by the Tory will strengthen her hand in the Brexit negotiation. Furthermore, President Trump boosted market optimism by unveiling his "massive" tax cuts as one of his first hundred days achievements. Although it turned out to be a mere one-page wish list, it was nevertheless a starting point of negotiation. Bond markets, however, were not impressed. The U.S. 10-year Treasury yield dipped below the 2.3% lower bound of the prior trading range. Gold also moved higher while commodities from crude oil to base metals retreated. The advance estimate of the U.S. real GDP growth in the first quarter of 2017 came in at a soft 0.7% annualized pace. Most economists, however, believed it was just a fluke and still looked for growth to pick up. Importantly, higher inflation has pushed the nominal GDP growth to 3%. Corporate earnings also posted double-digit growth versus a weak quarter a year ago.

JIMMY CHANG, CFA
Chief Investment Strategist
212-549-5218
jchang@rockco.com



Equity Markets Indices ¹	3/31/2017 Price	4/30/2017 Price	MTD Change	YTD Change
MSCI All Country World	449	455	1.4%	7.9%
S&P 500	2363	2384	0.9%	6.5%
MSCI EAFE	1793	1834	2.3%	8.9%
Russell 2000 ^{®2}	1386	1400	1.0%	3.2%
NASDAQ	5912	6048	2.3%	12.3%
TOPIX	1513	1532	1.3%	0.9%
KOSPI	2160	2205	2.1%	8.8%
Emerging Markets	958	978	2.0%	13.4%

Fixed Income				
2-Year US Treasury Note	1.26%	1.26%	1	7
10-Year US Treasury Note	2.39%	2.28%	-11	-16
BarCap US Agg Corp Sprd	1.18%	1.16%	-2	-7
BarCap US Corp HY Sprd	3.83%	3.71%	-12	-38

Currencies				
Australian (AUD/\$)	1.31	1.34	-1.8%	4.0%
Brazil Real (Real/\$)	3.12	3.18	-1.7%	2.5%
British Pound (\$/GBP)	1.26	1.30	3.2%	5.0%
Euro (\$/Euro)	1.07	1.09	2.3%	3.6%
Japanese Yen (Yen/\$)	111	111	-0.1%	4.9%
Korean Won (KRW/\$)	1118	1138	-1.7%	6.0%
US Dollar Index (DXY)	100.35	99.05	1.3%	3.2%

Commodities				
Gold	1249	1268	1.5%	10.1%
Oil	50.6	49.3	-2.5%	-8.2%
Natural Gas, Henry Hub	3.10	3.17	2.2%	-14.0%
Copper (cents/lb)	265	260	-2.1%	3.6%
CRB Index	186	182	-2.2%	-5.6%
Baltic Dry Index	1297	1109	-14.5%	15.4%

SOURCE: BLOOMBERG

The Man Who Would Be President?

It was quite an unusual path for a French politician, and Hollywood couldn't have come up with a better script. Growing up as a precocious kid who excelled in piano and dabbled in boxing, Emmanuel Macron studied philosophy at the prestigious Paris Nanterre University, and later trained for a senior civil service career at the elite *École nationale d'administration* (ENA). Upon graduation in 2004, he worked for the French Ministry of Economy until 2008, when he bought out of his government contract for €50,000 so he could join Rothschild & Cie Banque as an investment banker. The move was a risky one as investment bankers are reviled by many French plebeians. He excelled nevertheless – in four years, he made partner, took the lead role in advising Nestlé on its \$12 billion acquisition of Pfizer's infant nutrition unit, and earned the nickname "the Mozart of finance" as well as a lot of money.

Macron's personal life was as equally unconventional. He met his future wife Brigitte Trogneux when he was 15. Brigitte, 39 years old at the time (24 years his senior), was a married mother of three and his high school drama teacher. She confided at an interview last year that, at 17, Macron told her he would marry her. They wedded in 2007 and Macron now boasts 7 step-grandchildren.

In 2012, Macron returned to public service as deputy secretary-general of the *Élysée*, a senior role on President Hollande's team. Two years later, he was appointed the Minister of Economy and Finance, which gave him a platform to roll out various deregulation bills -- especially on France's calcified labor market -- dubbed the *Macron Law*. By early 2016, Macron and his aides were studying the insurgency candidacy of Barack Obama's 2008 campaign and political movements such as Greece's Syriza and Spain's Ciudadanos and the Podemos. In April 2016, the 39-year-old political phenom announced the formation of the centrist En Marche! party. He resigned from his government post in August and launched his

presidential candidacy in November 2016, his first ever electoral campaign.

As luck would have it, France's political establishment heavyweights were falling by the wayside. To Macron's right, one-time frontrunner François Fillon fell from grace over payments to his wife and children for alleged non-existent jobs. President Hollande decided not to seek re-election due to persistently low approval ratings. The Socialist Party nominated leftist firebrand Benoît Hamon over former Prime Minister Manuel Valls. All of sudden, the heretofore untested Macron became a white knight for the anxious Europhiles and investors to save France from the far-right populist Marine Le Pen and the far-left Jean-Luc Mélenchon.

The risk of European populist backlash may have ebbed for now, but the fundamental issues that powered the movement remain unresolved.

The Cohabitation Era

Since the beginning of 2017, we have felt that European equity markets represented an attractive opportunity on the thesis that investors appeared to have over-discounted the risk of a Le Pen victory in the French presidential election. After the first round of the election, the strong likelihood of a Europhile becoming the next French president (Macron is leading Le Pen 60-to-40 in the polls) has enabled Europe to finally outperform the U.S. YTD through the end of April; the MSCI Europe Index gained 11.6% in U.S. dollar terms compared to the S&P 500's 7% total return. With sentiment having turned more positive now, we suspect that European markets' low hanging fruits may have been picked, and continued outperformance will now depend on earnings and economic fundamentals rather than further improvement in sentiment.

Indeed, it will be interesting to see how effective Macron, assuming he wins the presidency on May 7th, will be in implementing his pro-reform domestic policies. While En Marche! intends to field candidates in all 577 constituencies in the June legislative elections, the National Assembly is likely to be controlled by either the Socialist Party, the Republicans, or a coalition government if no party captures the majority. This means that the next French prime minister, to be named by the

president but confirmed by the National Assembly, will most likely not be an En Marche! member.

The awkward situation of the French president and the prime minister hailing from different political parties is called “cohabitation”. The last instance was in 1977, when Republican President Chirac reluctantly named Socialist leader Jospin as the prime minister after the Socialist Party captured the majority of the legislature. Cohabitation is likely to weaken the president’s domestic policy mandate. Without an effective party apparatus in the parliament, Macron could wind up as a lame duck president.

In short, although the Eurozone’s existential threat will diminish materially with Macron’s anticipated victory on May 7th, a political gridlock between Macron and the National Assembly could wind up helping the anti-establishment populist movement, which has already been making inroads especially among France’s disaffected young voters. If Marine Le Pen indeed captures roughly 40% of the popular votes as indicated by the polls, it would mark a significant advancement from her father’s 17.8% showing in the 2002 presidential run-off versus Jacques Chirac. The risk of European populist backlash may have ebbed for now, but the fundamental issues that powered the movement remain unresolved. Indeed, nearly half of the ballots in the first round of the French presidential election went to either the extreme left or right candidates.

The First Hundred Days

Much ink has been spilled on President Trump’s first hundred days in the Oval Office. The term was first used by President Franklin D. Roosevelt in his radio address on July 24, 1933, when he referred to the 100-day session of the 73rd U.S. Congress that passed a record volume of new laws. Statistically, the number of bills passed within the first hundred days of a president’s first term has diminished in recent decades as Congress became more partisan and its subcommittees more powerful.

Be that as it may, President Trump does not have a cohabitation issue as the Republicans control both chambers of the Congress. As such, it was a setback for

Trump that the Republicans failed in their initial attempt to replace Obamacare. Some of his plans on the immigration front have run into judicial and budgetary issues as well. On the other hand, the president’s ardent supporters would point to the confirmation of Supreme Court Justice Gorsuch and various agencies’ efforts in reversing many of the Obama Administration’s regulations as President Trump’s accomplishments so far.

Ironically, the most important thing may be what the President has not done so far – kicking off a trade war with China. The new administration has neither named China a currency manipulator nor slapped punishing tariffs on Chinese goods as the North Korean situation has unexpectedly helped Sino-U.S. relations for now. A constructive relationship between the world’s two largest economies is essential to global economic as well as geopolitical developments.

However, one should not assume that the specter of protectionism won’t make a return. In the midst of the North Korean escalation, President Trump suddenly threatened to tear up the five-year old trade agreement with South Korea and demanded that Seoul pay for the THAAD missile defense system. In recent days, the President has also threatened to exit NAFTA, and the Commerce Department has imposed a 20% tariff on softwood lumber imported from Canada, a controversial dispute that dates back to 1982. Furthermore, the Administration is exploiting the rarely used Section 232 of the 1962 Trade Expansion Act which authorizes the Secretary of Commerce to investigate the effects of any imports on national security – President Trump has just ordered an expedited investigation on whether steel and aluminum imports are jeopardizing our national security. It’s a veiled shot at China’s greater-than-50% market share in the global steel and aluminum markets.

In the final analysis, keeping others guessing still appears to be the mercurial President’s preferred negotiation tactic. The good news is that the President has a first-rate national security team, and on the economic front, some of his advisors with more mainstream views appear to be gaining more influence of late. ●



ROCKEFELLER
ASSET MANAGEMENT

For More Information on Rockefeller & Co:

ROCKCO.COM

insights@rockco.co

New York, NY
10 Rockefeller Plaza
3rd Floor
New York, NY 10020
212-549-5100

Washington, DC
900 17th Street NW
Suite 603
Washington, DC
20006
202-719-3000

Boston, MA
99 High Street
17th Floor
Boston, MA
02110
617-375-3300

Rockefeller Trust Company, N.A.
10 Rockefeller Plaza
3rd Floor
New York, NY 10020
212-549-5100

The Rockefeller
Trust Company (Delaware)
1201 N Market Street
Suite 1401
Wilmington, DE 19801
302-498-6000

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