Perspective

Are the planets aligning once again?

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Seldom have the global financial markets paid so much attention to France, going so far as to consider the French presidential election a “game changer” with regard to the euro’s survival. This was especially the case among UK and US investors with little familiarity of the contours of the French constitutional and electoral system.

After Emmanuel Macron's first-round victory over Marine Le Pen, the markets hurled themselves forward to a favourable election outcome. As there was no longer any risk of a second-round duel between the far left candidate, Jean-Luc Mélenchon, and the far right candidate, Le Pen. This triggered a steep rally of the euro against the dollar, a drop in gold, and a rebound in both European and US markets. The most heavily exposed stocks, like French banks, benefited the most.

Now that the hand-wringing is behind us, what can we expect from the markets?

In the short term, inflows are likely to continue, given how eagerly US and UK investors awaited the election outcome before returning to the euro zone. After being scared off in recent years by the uncertain political environment, there now appears to be little reason to worry. With expectations of a favourable epilogue to elections in the Netherlands and France, and with the 24 September German federal elections pose no major threats. True, Italian legislative elections are still impending but not until the first half of 2018. With all that in mind, it's not too early to ask whether the planets are once again aligning.

In 2015, the European financial markets went through what was then deemed an "aligning of the planets". Featuring lower interest rates, a lower dollar and lower oil prices.

The current alignment is based on a favourable combination of:

- the euro zone's strongest EPS growth since 2010, with about 14% forecasted for 2017 and with stronger earnings revision momentum than is currently seen in the US;
- moderate and attractive valuations by historical standards and compared to other international markets or other asset classes, bonds in particular.
- and, now, a political context that, when looked at optimistically, could lead within a year to a Europe whose main countries - Germany, France and Italy - would be governed by parties with firm European credentials and which, now that the psychological shock of the French election is past, are likely to take pro-growth pan-European political initiatives.

Indeed, it can be argued that Europe's problem is mainly excessive savings and "balkanisation", as surpluses from northern Europe are not being invested in southern Europe but, instead, are being "exported". The restoration of confidence could help keep these savings "at home" and enhance potential growth.

This will be the challenge of the coming months, a challenge that the markets will seek to anticipate - "or not" - in an increasingly mature international climate in which the global index has surpassed its 2015 peak by far and its 2007 peak even more. In the US, Goldilocks would love the markets right now, with growth that is solid but moderate enough not to worry the fixed-income markets and strong enough to allow companies to post earnings growth that the markets are taking note of. However, there is little room for further earnings growth, and valuations are not offering much in the way of premiums, given the degree of uncertainty over President Trump's chances of getting his economic programme passed. Emerging markets, meanwhile, have been driven up by the rally in commodity prices. As for China, there is some short-term concern over the cycle, but the political agenda is favourable there, with President Xi Jinping's ambition to win a second five-year term at the Chinese Communist Party Congress.

Even after gaining 26% over the past year and even though they are above their April 2015 peaks, European markets still offer some upside potential in the aforementioned environment. The receding of political fears could help shrink the risk premium that has dogged euro zone markets, which would then set them up to outperform international markets in 2017.

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We are keeping our portfolios positioned in favour of these cyclical and financial themes, which are those that are most likely to benefit from a normalisation of European markets featuring higher interest rates, strong earnings growth, and a reduction in the risk premium. Our funds, R Club and R Conviction Euro in particular, are well placed to benefit from this new aligning of the planets.

	2016	2015	2014	2013	2012
R Conviction Euro C	-2.5%	9.4%	0.3%	36.6%	23.4%
R Club C EUR	-0.6%	8.1%	2.6%	29.6%	23.1%

Source Rothschild & Cie Gestion, 28/02/2017

Risk scale:

The synthetic indicator used to position the UCITS on the risk scale is based on the annualised historical volatility over a period of 5 years. This scale is non-linear. The level of risk of this UCITS is 6 (volatility between 15% and 25%) and reflects its positioning in the eurozone equities market. The historical data used to calculate this synthetic indicator may not be a reliable indicator of the fund's future risk profile. The risk category associated with the UCITS is not guaranteed and may shift upwards or downwards over time. A rating of 1 does not mean that the investment is "risk-free". The capital invested in the fund is not guaranteed.

"Your money shall be invested primarily in financial instruments selected by the management company. These instruments will be subject to market fluctuations and uncertainties."

Investors in this fund expose themselves primarily to the following risks: risk of capital loss, risk associated with discretionary management, market risk, currency risk, rates risk, counterparty risk, overexposure risk and performance risk. For further information, please consult the fund's prospectus.

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