LA FRANÇAISE

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Uchronia and Marine Le Pen: but what about the markets?

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Photo : T.PAVIOT

If Pétain had had a heart attack in 1940, we would all be Communists today: the June 1940 armistice would not have been signed, leaving the USSR time to rally to defeat Hitler without the help of the Americans. And Western Europe would now be part of the USSR, which would not have collapsed.

So what would have happened if Marine Le Pen had been elected in May 2017? The question is obviously highly speculative, and that is why it enters the realm of utopian uchronia: everyone knows that none of this will ever happen… "This is clearly not the most probable outcome," cries the chorus of political scientists. The National Front gets all of its votes in the first round; it would need an abstention rate of 60% for it to win the run-off. Once political uncertainties have receded in Europe, the markets, which have been on a resolutely upward trend since August – shrugging off Brexit, the American elections and the Italian referendum – will welcome the resumption of European integration that we will surely see in conjunction with the reforms that will undoubtedly be undertaken.

However, in today's B-series soap opera of a presidential campaign, the collapse of incumbent political parties, the populist wave in the West and a wave of attacks orchestrated by DAESH could cause the implausible to become feasible.

How would the markets react if the implausible did indeed transpire and the National Front's promise of monetary, legislative, territorial sovereignty became reality?

All the big asset managers and the economic and political institutes unanimously conclude that the unprecedented situation with which we would be confronted in that case would at best result in national paralysis throughout the National Front's term of office and at worst in a collapse through a decision tree:

- Would Ms Le Pen win a parliamentary majority under the current electoral system? The answer is no.

- Could she change the parliamentary electoral law between her election and the June parliamentary elections in order to usher in a preferential system and win an absolute or relative majority? The answer is again no.

Constrained from the first day of her term by an unprecedented form of cohabitation in view of the split between the various tendencies of the left, right and centre – not forgetting "En Marche" – a National Union led by Marine Le Pen would be impossible, leaving the populist president to govern by referendum.

Clearly anti-European, Marine Le Pen could call a referendum on "Frexit" (in the probable absence of a three-fifths majority of the joint houses of Parliament) by virtue of Article 11 of the French Constitution, which gives the President the power to hold referendums on matters relating to the organisation of government – relying on a groundswell of popular support. Let us suppose that the Constitutional Council does not invalidate the referendum leading to an exit from the euro...

The consequences in the event of a Yes to such a referendum would be obvious:

- The break-up of the euro;

- Debt repaid in national currency with, as at the time of the Greek crisis, uncertainty as to whether this constitutes a default, triggering a temporary surge in the CDS (Credit Default Swap) price;

- A hefty increase in long-term interest rates;

- A drastic devaluation in relation to the Deutsche Mark;

- A significant drop by the Eurostoxx;

- A spike in inflation (domestic and imported);

- A collapse in the price of residential property;

- An economic recession and a spiral of stagflation.

For now, the markets are not envisaging a scenario of this nature.

The question is therefore not, as in the Keynesian beauty contest, whether the assumptions described above will materialise, but what the markets would anticipate in the event of a victory by Marine Le Pen in the presidential election. In other words, how would the markets react to a very negative "digital" event at a time when they are so high?

As an asset manager, such a scenario would have immediate consequences for La Française in the markets after the presidential election:

Long-term interest rates:
- The OAT would increase to 3%, representing a 20% drop in the price, with the fall contained by support from the ECB;
- The Bund would move to 0%;
- The Italian BT would move to 4%;
- The US 10-year rate would ease to 1.8%.

Currencies:
- The euro would fall by 10% against the dollar;
- By 15% against the yen;
- By 15% against sterling, with Brexit taking on new meaning by more firmly anchoring the perception of a possible collapse of the eurozone;
- By 10% against the Swiss franc, with the Swiss limiting the rise of their currency.

Equities:
- The CAC would fall by 20%, driven by a 30% drop by "financials"; again, its fall would be limited by the fall in the euro;
- The FTSE Mib would also fall by 20%;
- The Eurostoxx would limit its fall to 15%;
- The Vstoxx volatility index would reach 35%.

Credit risk:
- The subordinate debt of financials would fall by 15% in an illiquid market;
- Credit spreads (Itraxx Main and Xover) would not deteriorate much more than the OAT;

Real estate:
- Residential property would become totally illiquid, with prices falling by 10% to 20% within six months;
- Tertiary property would serve as a relative safe haven, with an increase in the capitalisation rate capped at 100bp, i.e. a 10% decrease in prices and as such a contraction in the risk premium vs the OAT shifting by more than 200bp.

These expectations are not based on historical stress tests, because no comparable exists. They are drawn from our perception of immediate reaction to an unlikely event with potentially dramatic consequences for the national and European economies.

Subsequently, the trend would depend on the capacity of the National Front to implement its manifesto, with the risk of seeing the scenario described above materialise.

However, since this outcome is the least likely, and since a Macron or Fillon victory would, by contrast, result in a resumption of European integration and as such a narrowing of the OAT-bund spread accompanied by stronger markets, I advise – as in my letter dated 21 February under the title "Digicracy or populism" – maintaining investments recommended at that date. Those who fear a win by Ms Le Pen could alternatively adopt the following hedging strategies:

- Invest in REITs investing widely in German real estate;
- Hedge risks to the extreme, notably through the acquisition of long volatility funds;
- Acquire out-of-the-money caps on European government rates, notably to hedge real estate assets;
- Play the widening of the Bund-OAT spread;
- Invest in inflation-linked funds (inflation being likely to rise in any event);
- Invest in equity funds that explicitly benefit from a "hedged equity" type of hedge (optional hedging strategy);
- Invest in premium risk funds (dispersion with high granularity of volatility spreads);
- Keep an eye on gold as the final refuge.

And let's hope that the evening of 7 May comes around quickly so that we can say that all this was just uchronia, the rewriting of history from the modification of a past event.

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