

POLITICAL FOOTBALL

REVIEW OF THE WEEK
24 JUNE 2024



FRANCE GOES TO THE POLLS FOR THE FIRST ROUND OF VOTING, THE TWO CANDIDATES FOR THE WHITE HOUSE SPAR AND THE EURO KNOCKOUT PHASE BEGINS.

This week is one for the sports nuts and politics junkies. The Euros group stage closes out, giving way to the knockouts as the Copa America kicks off. Meanwhile the first round of the one-two French snap election will be held on Sunday. And President Joe Biden and Republican challenger Donald Trump will spar in the first – unusually early – debate of the US election campaign on Thursday.

In Europe, most attention will be focused on the football, and there's no judgment here! Both elections and national football tournaments tend to be on a cycle of four years or so, both tend to inspire hope and cynicism in varying measures. And only one in 24 ends in jubilation, the rest a mixture of disappointment and regret. Yet only football makes for truly compelling entertainment.

It will be interesting to see how much the overlap with the Euros will affect voter turnout in France. From a highpoint of 80% in the 1970s, the proportion of people filling out a ballot in the nation's parliamentary elections has dropped steadily to less than half by the last vote in 2022. Opinion polls suggest President Emmanuel Macron's centrist alliance will be unseated by enlarged left and right wing opponents, which would lead to a new government led by one or the other (with Macron remaining as head of state).

Famously, polls have been wrong before, yet the prospect has spooked European markets. Governments-in-waiting, faced with debt greater than GDP and heavy spending, plan to *increase* spending, roll back modest pension reforms and talk of nationalisation. It's no wonder prices for French government bonds and bank shares and bonds have dropped sharply. Yet long-time followers of our analysis will know that we have done lots of research on 40 years of past elections in developed nations which shows that they rarely divert an economy or its financial markets from the path they were already on. Now, the outliers are when the vote ushers in properly radical governments, particularly of the left.

The main example in our work was Francois Mitterrand, who entered the Elysée Palace in 1981 and ushered in the first left-wing government of the Fifth Republic. Financial markets welcomed Mitterrand with a 20% plunge in the French stock market and the franc dropping like a stone. And yet, after a couple of years, French stocks actually kept

pace with other nations' after Mitterrand tacked slightly towards the centre. Things happen quicker these days. The sizeable moves ahead of the election have already encouraged right-wing prime ministerial hopeful Jordan Bardella to row back on many promised splurges. Perhaps the 28-year-old has already grasped that the premiership is a poisoned chalice, recently saying he wouldn't form a government unless his National Rally party won an absolute majority (a very unlikely prospect).

France – like Britain and many other countries – is reliant on the kindness of strangers to pay its bills and enjoy the standard of living it enjoys. These strangers are the ones who buy government bonds when they are issued, giving nations the cash required to pay for pensions, new infrastructure, healthcare and everything else that today's taxes can't cover. If that money isn't used wisely, they won't buy it anymore, which means bond prices drop and higher interest rates on the debt entice someone else. Very often, the average person on street forgets this, yet politicians are reminded of it constantly. It tends to curb politicians' more outlandish notions when they make it behind the big desk.

Global investors gave French politicians a solid elbow to get their attention. From Bardella's reaction, he appears to have felt it.

Up for debate

While a 28-year-old is hogging the limelight in France, the nation its thinkers inspired is weighing up a choice between two octogenarians (to be fair, Trump is two years shy of 80).

The first debate will be the first since 1988 that isn't run by the bipartisan Commission on Presidential Debates. It's being held months earlier than normal – before either candidate has been officially nominated by their respective parties in July and August. It's also strange because Trump won the de facto Republican nomination without taking part in the Primary Debates, so it will be his first real test of political discourse this time around. As for Biden, he has faced accusations of mental degradation because of his advanced years and the strains of the last four years in the job. With polls on a knife-edge, both Trump and Biden will want to show they are fit and alert enough for the White House.

The US is in a contradictory place. Its economy is strong, unemployment is low, wealth and wages are higher than they've ever been. Yet most people are unhappy and disaffected. Companies based on the greatest means of

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communication ever devised top its stock markets, yet its politics is fractious, and its people are lonelier than ever. Like France, its government has borrowed more than its GDP and is spending a proportionally greater amount each year. It has tough decisions to make, yet the market has less effect on it – for now at least – because of its position as the world’s banker and reserve currency. The choice before the American people doesn’t seem to address these problems.

One important thing to note is that our finding that elections tend rarely to matter is based on 40 years’ worth of elections. And in those 40 years, inflation had been on a downward path, driven by institutional changes, such as independent central banks, and by economic and social trends, like the expanding output of emerging markets, like China, and a glut of workers relative to older people. We think that structural trend may be slowly reversing. Rather than, say inflation between 1% and 3%, it may move to a range between 2% and 4%. There are risks that it could head higher still because of policy mistakes or unforeseen shocks, like climate change affecting crops or another pandemic.

We think the US election does present some risks to inflation, by way of a very carefree attitude to government

spending, as well as the potential to undermine some of the domestic and global institutions which have played an important role in anchoring inflation since the mid-1980s. Because of this risk, a split US Congress may be the best outcome for sustained stock market gains because it inhibits the most extreme policy-making. Helpfully, a split Congress is most likely outcome suggested by the polls, with the Democrats controlling the House and the Republicans controlling the Senate.

We’ll release much more analysis on the US election and its implications over the summer. But, for now, because of the uncertainty, it doesn’t make sense to tailor our portfolios to one particular outcome. Instead, we’re concentrating on the improving upward momentum of company earnings. Particularly in the US, the world’s largest stock market, **the number of businesses upgrading their profits is the highest in two years.** That’s more boring than a football match or a slugfest between 80-ish-year-olds, but it’s good news for everyone.

If you have any questions or comments, or if there’s anything you would like to see covered here, please get in touch by emailing review@rathbones.com. We’d love to hear from you.

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