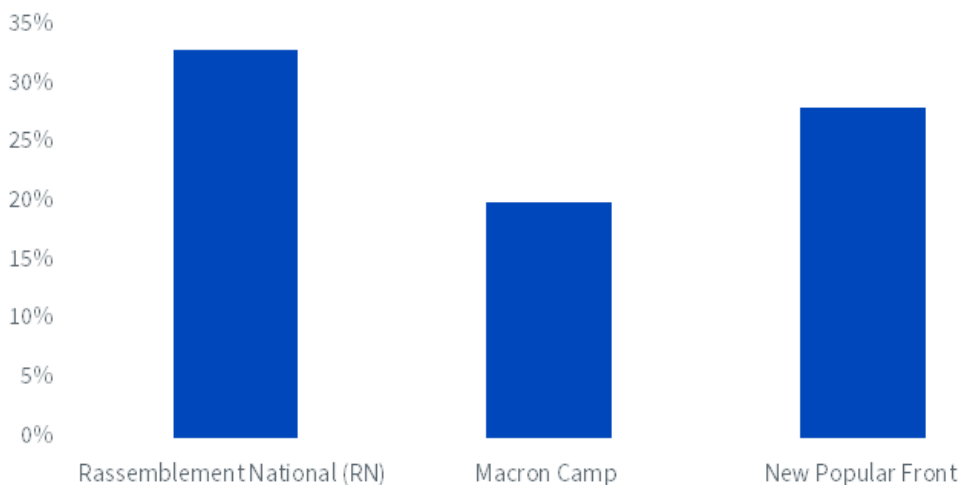


FRENCH FIRST-ROUND ELECTIONS: LE PEN'S PARTY SCRATCHES AT THE MAJORITY

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Marine Le Pen's National Rally (RN) and its allies dominated the first round of voting Sunday, locking up 33.2% of the vote. The New Popular Front, formed by left-wing parties, got 28%, while the parties supporting President Macron got 20.8%. Overall participation was strong at 67%.¹ Even though Macron's presidency isn't formally at stake –and he's said he has no plans to resign– Sunday's result indicates it's likely he will either have to share governing responsibilities with Le Pen's group or manage a parliament that is basically gridlocked.

Figure 1: Share of Votes in the First Round of the French Parliamentary Elections



Source: Le Monde, wisdomTree as of 1 July 2024.

Macron Camp and Left Alliance See Greater Coordination

The Macron camp and the left-wing alliance have announced they will withdraw their candidates if the other camp's candidates perform better in the first round. The emerging cooperation between the Macron camp and the New Popular Front reduces the RN's chances of winning an absolute majority of parliamentary seats.

In an early sign that Macron's team is seeking to build alliances with the left, the prime minister decided Sunday evening to suspend the implementation of an unpopular change to unemployment insurance. The government had said the plans would encourage people into work by paring back the generosity of welfare, but opposition parties widely criticized the move at a time when joblessness has risen².

France under Pressure over Budget Deficit

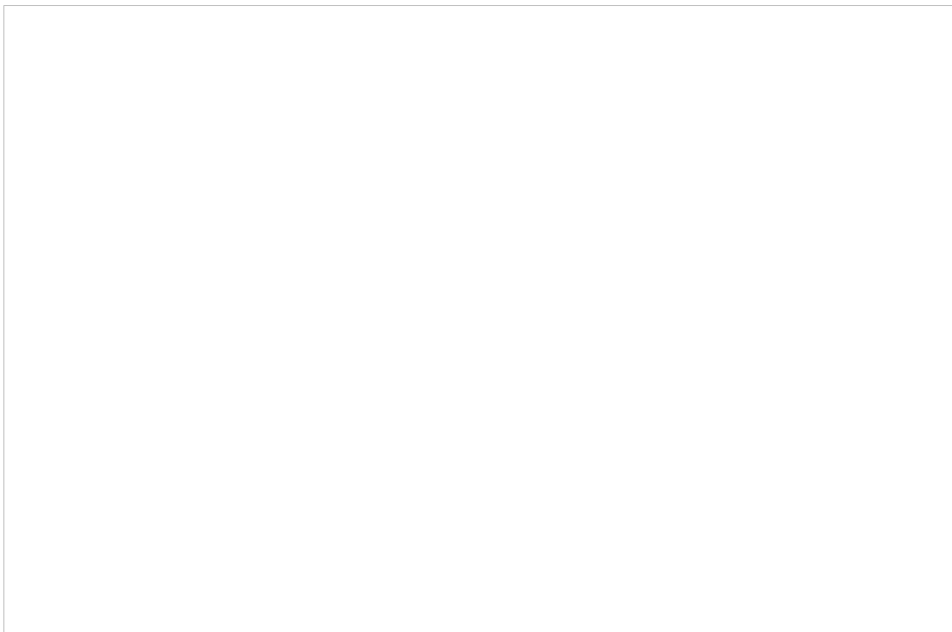
France's deficit stood at -5.5% of gross domestic product (GDP) in 2023 (exceeding the bloc's deficit 3% threshold) and is set to narrow only slightly this year to -5.3% and next to 5%.³ The start of the Excessive Deficit Procedure (EDP) by the European Commission (EC) for Belgium, France, Italy, Hungary and Malta brings debt sustainability back on the radar.⁴ Despite France's high investment needs and weak growth, the times of unlimited fiscal stimulus are over.

Both the far right and left coalitions have fairly expansionary fiscal policies in mind. Calling a snap election was a gamble for Macron's party but it comes at a time when France's debt sustainability comes under scrutiny. While Macron's government was already struggling with fiscal consolidation, the campaign pledges by the French political parties of both the far right and far left threaten to bust an already swollen government budget, push up French interest rates and strain France's relation with the European Union. Macron's is playing to his strengths. We believe the snap elections will provide a rude awakening to voters of the implications of surrendering to parties whose campaigns have abandoned any pretense of fiscal discipline.

Wide Market Dislocations Triggered by French Elections

The run-up to the French snap elections have already seen a widening of bond yield spreads, with France's 10-year Obligations assimilables du Tresor (OAT) yield versus German 10-year Bunds increasing by nearly 20 basis points to reach an annual high.⁵ The first-round results have sparked a positive reaction in the euro, primarily owing to some market relief over the RN's lower chances of winning an absolute majority of parliamentary seats. Yet fiscal concerns, alongside the uncertainty around the outcome of the second-round results, remains an unattractive proposition for the euro.

Figure 2: The Premium France Pays over Germany to Issue Debt



Source: Source: Bloomberg, WisdomTree January 2, 1990 to July 1, 2024.

French equities have fallen 5.3%⁶ in the wake of the announcement of the French snap elections, in comparison to a 2.1% decline for the broader [European EuroStoxx 600 Index](#). However, only 15% of sales of companies are domestically exposed with France's benchmark [CAC 40 Index](#). It's a very global market from a revenue perspective. A lot of international companies are based in France and not particularly exposed to the domestic environment in terms of revenue. As a result, we have seen some specific pockets being hit hard, especially the domestically exposed names within the financials, infrastructure, utilities and defense sectors.

In the domestic market, banks were hit hard as they hold a large amount of debt and are

likely to suffer from higher credit costs. There has been an increase in [risk premiums](#) related to French Bank owing to a proposed windfall tax and capital gains tax on dividends. Infrastructure-related stocks have also come under pressure as the government could require these companies to lower retail prices. Utilities have come under pressure owing to the government intervening to force lower retail prices. Defense stocks have performed well in Europe over the last couple of years, relating to increased spending following Russia's invasion of Ukraine, but there is concern that the far-right party might be less concerned about foreign interventions and focus more on domestic security. Amid the higher uncertainty around domestically oriented equities, adopting a tilt toward profitable and growing European exporters could be a prudent alternative.

Tilting toward Dividend-Paying Eurozone Exports

On July 2, 2012, WisdomTree launched its [Europe Hedged Equity Index](#). The two main ideas behind the methodology are:

1. Each constituent needs to derive more than 50% of revenues from OUTSIDE Europe. This means that the focus is on global businesses that are based in Europe. If we consider the French election as a more local market shock, it may be that global businesses deliver share price returns highly correlated to more locally focused businesses, but then, over time, the fundamentals respond more to the global than the local picture. It's possible that more localized shocks could create interesting opportunities for truly global companies.
2. The returns of the WisdomTree Europe Hedged Equity Index take the returns of currency off the table and focus the returns solely on the stocks. If the U.S. dollar is appreciating against the euro, this impact is mitigated. Similarly, if the euro is appreciating against the dollar, this impact is also mitigated. It's possible that localized shocks, like a surprising result in the French elections, could cause the euro to depreciate against the U.S. dollar and this could be mitigated by such a currency-hedged strategy.

WisdomTree has a well-known strategy, the [WisdomTree Europe Hedged Equity Fund \(HEDJ\)](#), that is designed to track the WisdomTree Europe Hedged Equity Index before fees and expenses. Localized surprises in Europe could create notable points of entry into global businesses that happen to be located in Europe.

¹Le Monde, as of 6/30/24

²Adghirni et al. "Macron, French Left-wing Rivals Race to Stop Le Pen Momentum." Bloomberg, accessed through Yahoo Finance. July 1, 2024.

³European Commission, 12/31/23

⁴Euractiv, 6/19/24

⁵Bloomberg, as of 6/28/24

⁶Bloomberg, CAC 40 Index, 6/10/24-6/28/24

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

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STOXX Europe 600 Index : The STOXX Europe 600 Index is derived from the STOXX Europe Total Market Index (TMI) and is a subset of the STOXX Global 1800 Index. With a fixed number of 600 components, the STOXX Europe 600 Index represents large, mid and small capitalization companies across 18 countries of the European region: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the United Kingdom.

CAC 40 Index : The French stock market index that tracks the 40 largest French stocks based on market capitalization on the Paris Bourse (stock exchange).

Risk premium : Equity investments are not risk free, but it is thought that investors buy stocks because the returns they expect are high enough to allow them to take the risk.