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French election

The second round of the legislative election was won by the far-left after the first round had gone to the far-right.

UK election

The Labour Party more than doubled their seats in the House of Commons and Sir Keir Starmer is the new prime minister.

Economic news

Economies that have been resilient - the US, Canada, and the eurozone - showed signs of softening.

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If I had to pick a theme to summarize last week's major headlines, it would be "reversal of fortune." In France, the far-left gained the most seats in the second round of the legislative election after the far-right secured the most votes just one week ago. In the UK, the Labour Party more than doubled their seats in the House of Commons. And on the economic front, economies that have been resilient showed signs of softening of varying degrees - an indicator that I expect central banks to take into consideration in their upcoming interest rate decisions.

France has averted a turn to the right - at least for now

The second round of legislative elections took place in France on July 7, and the results came as a surprise. The far-left New Popular Front (NPF) alliance garnered the most seats (182), President Emmanuel Macron's centrist Ensemble party came in second place (163), and Marine Le Pen's far-right National Rally (RN) came in third (143).¹ This comes after National Rally secured the most votes in the first round just a week ago.

The change in fortunes was certainly helped by the agreement between Macron and Jean-Luc Melenchon, leader of the NPF alliance, to ask candidates who came third in constituencies led by the RN to step down in order to consolidate the anti-RN vote around one candidate in each district.

There is no absolute majority, and so there is uncertainty about what the government will look like going forward. We now face an approximate three-way split in the National Assembly with the far-left NFP as the largest bloc. Macron's centrists are a sizeable group and the second-largest bloc, though they are nowhere near a majority and are very unlikely to be the driving force in policy. The far-right is further behind, though together with the center-right, the political right does have a significant representation in parliament.

In assessing the first round of elections last week, we considered three possible scenarios: far-right majority, far-left majority, and some kind of a temporary solution. Keep in mind that another election cannot be called for at least 12 months, so a government must be formed from this new parliament. In the absence of any majority, and with any minority government having too few seats to operate, we think there will likely be either a coalition of some kind or some type of administrative solution, such as a technocratic government or a continuity cabinet. Prime Minister Gabriel Attal announced that he would resign, but Macron refused his resignation and asked him to temporarily remain in power to ensure the continuity of the State.

Investment implications

What are investors to make of this result? On one hand, by avoiding an RN majority, France has avoided tensions with the European Union (EU), which could have been a negative for markets. On the other hand,

uncertainty remains - at least in the shorter term - which may also weigh on markets. Any government formed might not be able to govern with strong policy, given disagreements on many issues, which is why some form of administrative solution may still be needed.

We think the net effect for markets is a bit worse than before the snap election was announced, given the crystallisation of pre-existing weakness in the centrist mainstream and the political tail risks on the far-left and the far-right. The EU and France might both be somewhat gridlocked at a time when both need to be more potent and active, which could result in renewed political instability in the future. We could even see the formation and dissolution of several different governments over the course of the next year. This could be reflected in greater volatility in markets.

However, for now markets appear relieved at the lack of extreme outcome and are in wait-and-see mode - they may need to wait until September to see what kind of government forms.

The UK has turned left with a Labour Party victory

One key takeaway from the July 4 UK election² is that this was a major reversal in fortunes for the Labour Party, which dramatically increased their representation in the House of Commons by over 200 seats, for a total of 412 seats, and made Sir Keir Starmer the new UK prime minister for potentially the next five years. This is the first time since World War II that the UK government has changed from a large, stable majority of one political party to what promises to be a large, stable majority of a different party - a wholesale change and remarkable turnaround in fortunes.

A second key takeaway is that the devil is in the details. The UK's voting system means that seat shares in Parliament can deviate significantly from actual vote shares. For example, in this election victory, Labour garnered only 34% of the national vote, versus the 40% it received in a previous election defeat. The same message comes across in the performance of the smaller parties. The centrist Liberal Democrats gained much more than expected, with 72 seats, an increase of a whopping 64 seats. The new UK Reform Party, established by leading Brexiteer Nigel Farage, gained 14% of the national vote. Despite this translating into just five seats, the significant share of the vote will probably be taken into account in policy - particularly EU relations.

A third key takeaway is that the election has probably strengthened the integrity of the UK union after Brexit, which was supported by a majority in England but strongly opposed by the majority of voters in Scotland and Northern Ireland. The Scottish National Party won just nine seats - down significantly from the 48 it won in the 2019 election. This probably reflects corruption allegations in the party, but effectively puts a new Scottish independence referendum on the back burner. The question of independence could switch to Northern Ireland, but the new prime minister has said a referendum on Irish unity is not on the horizon.

Investment implications

We believe the election results point to gradual, incremental, and limited change. The specifics behind the vote count - the rejection of radicalism and the protest voting - are crucial because they suggest that Labour cannot afford to take major risks if it wishes to strengthen its chances of re-election in the next election (likely to be five years ahead).

The good news for markets is that we expect Labour to stick with its campaign commitments not to make major changes to the tax regime, to follow through with pro-business plans, and to stick with the key tenets of UK foreign policy (US special relationship, strong partnership with NATO, Ukraine and other allies, especially in Europe). The not-so good news is that we expect only limited improvements to the economic relationship with the EU, with some alignment of rules but no single-market or customs-union membership (which the incoming prime minister had already ruled out).

We expect markets will continue to welcome a return to political stability and centrism, which may result in reduced macro volatility and some improvement in the sovereign risk premium on UK assets. Specifically, this all probably means a somewhat stronger sterling than otherwise, slightly lower gilt yields and a modestly reduced equity risk premium, in our view.

We also believe this election result will make little-to-no difference to the Bank of England's rate-cutting plans or to the market's expectations of such, largely because the central bank and the markets will focus on inflation dynamics rather than worry about the type of major fiscal or regulatory changes that we saw under three of the last five Tory prime ministers.

UK assets represent good value and have done for some time, in our view. On several metrics UK equities trade on attractive multiples compared to similar companies in other developed markets as well as against their own historical data.³

The US economy is slowing

More data was released last week indicating that the US economy is softening.

In terms of employment data⁴:

- The June jobs report showed that unemployment has continued to rise – it is now at 4.1%, up significantly from 3.7% in January.
- While June payrolls were higher than expected, much of the gains came from government jobs. In addition, there were very significant downward revisions to the previous two months of payrolls.
- Most important for the Federal Reserve, in my opinion, is wage growth. Average hourly earnings growth has continued to fall. It is now at 3.9% year-over-year, a marked improvement over 4.35% in January.

Beyond labor-related data, the most recent ISM Purchasing Managers' Index (PMI) surveys were disappointing⁵:

- June ISM Services PMI was 48.8, well below expectations and a major drop from May's reading of 53.8. The new orders index clocked in at 47.3, moving into contraction for the first time since December 2022, and the employment sub-index was a low 46.1.
- June ISM Manufacturing PMI was 48.5, marking three months of contraction.

I think this offers enough support for the Fed to be comfortable cutting rates in the third quarter. Markets seem to agree, as stocks and bonds reacted positively to this data. This "bad news" is "good news" for markets, and with good reason.

Other economies are cooling fast as well.

Recent data has shown a softening Canadian economy as well. Unemployment for June rose to 6.4%, and there was an unexpected loss of 1,400 jobs when substantial job gains were expected.⁶ While wage growth rose to 5.6% year over year⁶, I don't think it will deter the Bank of Canada from cutting rates again soon - perhaps as early as July.

We're also seeing some weakening in eurozone data. The euro area composite PMI for June was 50.9 (versus 52.2 in May) while the manufacturing PMI was 45.8 (down from May's 47.3).⁷ While strong, the euro area services PMI for June was down slightly from May. The European Central Bank (ECB) will likely not be as quick to act as the Bank of Canada. ECB President Christine Lagarde has made it clear that her central bank will not be rushing to cut rates again. She stressed that "data dependence doesn't mean data-point dependence"⁸ and I think she will need far more convincing before she cuts again.

Conclusion

In summary, recent elections have shown that there can be very significant reversals of fortune – some can occur over the course of years and some can occur in the course of a week. Central banks should also be reminded of the potential for abrupt reversals of fortune for their respective economies. After all, economies that have heretofore been resilient can quickly change direction – especially under the pressure of high rates. I'm optimistic that central banks are seeing the cracks appearing now in a number of different economies and will act appropriately – which means quickly enough to avoid any serious economic downturn. This should be supportive of risk assets.

Looking ahead

All eyes will be on the US Consumer Price Index this week. I think the preliminary reading of the University of Michigan's consumer inflation expectations will also be important as the Fed will hopefully see a mosaic of data suggesting inflation should no longer be its biggest concern.

With contributions from Paul Jackson, Arnab Das, Emma McHugh

Dates to watch

Date	Event	What it tells us
July 8	Eurozone Sentix Investor Confidence	Tracks economic expectations for the eurozone over the next six months
	US Consumer Credit	Measures most credit extended to individuals, excluding loans secured by real estate
	US Consumer Inflation Expectations (Conference Board)	Tracks consumers' expectations for US inflation
July 9	Mexico Consumer Price Index	Tracks the path of inflation
	Japan Producer Price Index	Measures the change in prices paid to producers of goods and services
	China Consumer Price Index	Tracks the path of inflation
	Reserve Bank of New Zealand Monetary Policy Decision	Reveals the latest decision on the path of interest rates

Date	Event	What it tells us
July 10	OPEC Monthly Report	Analyzes key developments impacting global oil market trends
	Brazil Consumer Price Index	Tracks the path of inflation.
	Fed Chair Powell's Humphrey-Hawkins testimony	Gives further insight into the central bank's decision-making process
	Bank of Korea Monetary Policy Discussion	Gives further insight into the central bank's decision-making process
July 11	UK gross domestic product	Measures a region's economic activity
	UK Industrial Production	Indicates the economic health of the industrial sector
	China New Loans	Measures total value of outstanding bank loans issued to consumers and businesses
	Germany Consumer Price Index	Tracks the path of inflation.
	Bank of England Credit Conditions Survey	Analyzes trends and developments in credit conditions
	US Consumer Price Index	Tracks the path of inflation
	China Trade Balance	Measures the difference in value between imported and exported goods and services
July 12	Japan Industrial Production	Indicates the economic health of the industrial sector
	India Consumer Price Index	Tracks the path of inflation
	US Producer Price Index	Measures the change in prices paid to producers of goods and services
	University of Michigan Consumer Inflation Expectations (preliminary)	Assesses US consumers' expectations for the path of inflation
	University of Michigan Consumer Sentiment	Assesses US consumer expectations for the economy and their personal spending.

Notes

¹Source for French election results: CNN, as of July 8, 2024

²Source for all UK election results: CNN, as of July 8, 2024

³Source: MSCI as of June 30, 2024. The price-to-earnings ratio for the MSCI UK Index was 11.33, compared to 17.41 for the MSCI All Country World Index. Past performance is no guarantee of future results. An investment cannot be made directly in an index.

⁴Source: US Bureau of Labor Statistics, as of July 5, 2024

⁵Source: Institute for Supply Management, July 2024

⁶Source: Statistics Canada, July 5, 2024

⁷Source: S&P Global/HCOB, July 2024

⁸Source: Bloomberg, "Lagarde Says ECB Needs Time to Weigh Inflation Uncertainties," July 1, 2024

Important information

All investing involves risk, including the risk of loss.

Past performance does not guarantee future results.

This does not constitute a recommendation of any investment strategy or product for a particular investor. Investors should consult a financial professional before making any investment decisions.

In general, stock values fluctuate, sometimes widely, in response to activities specific to the company as well as general market, economic and political conditions.

The risks of investing in securities of foreign issuers, including emerging market issuers, can include fluctuations in foreign currencies, political and economic instability, and foreign taxation issues.

Fixed-income investments are subject to credit risk of the issuer and the effects of changing interest rates. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa. An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer's credit rating.

The MSCI United Kingdom Index is designed to measure the performance of the large- and mid-cap segments of the UK market.

The MSCI All Country World Index is an unmanaged index considered representative of large- and mid-cap stocks across developed and emerging markets.

Purchasing Managers' Indexes (PMI) are based on monthly surveys of companies worldwide and gauge business conditions within the manufacturing and services sectors.

The Consumer Price Index (CPI) measures changes in consumer prices. Core CPI excludes food and energy prices, while headline CPI includes them.

The price-to-earnings (P/E) ratio measures a stock's valuation by dividing its share price by its earnings per share.

UK gilts are bonds issued by the British government.

The opinions referenced above are those of the author as of **July 8, 2024**. These comments should not be construed as recommendations, but as an illustration of broader themes. Forward-looking statements are not guarantees of future results. They involve risks, uncertainties and assumptions; there can be no assurance that actual results will not differ materially from expectations.