

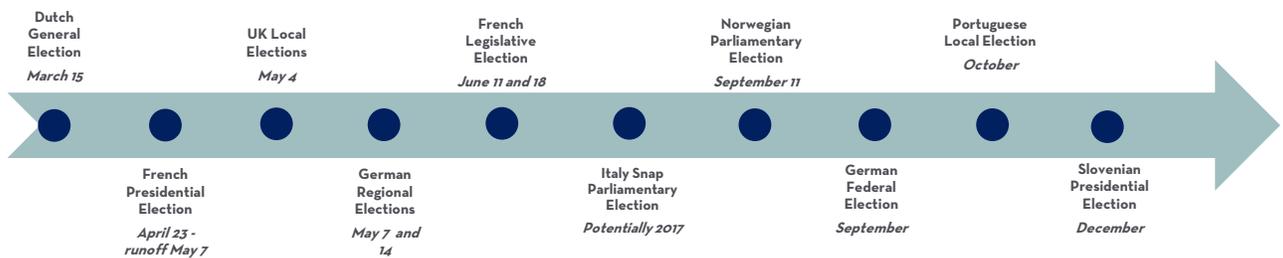
MARKET CHATTER: GLOBALIZATION BACKLASH- EUROPE'S POLITICAL ROADMAP

2016 marked a watershed year for global politics with the seemingly-unlikely outcomes of Brexit and the US presidential election. While the long-term impact of these events remains to be seen, there is little doubt that populist movements across the Western world have gained momentum, upending the established political order. The number of influential elections on the horizon in 2017 (Exhibit 1), combined with the fragile political environment of the European Union (EU), is a pivotal test for how Europe will evolve with a rapidly changing political landscape.

finances of the EU. Seizing the issue, populist candidates in Germany and Netherlands have gained traction at the polls with uncompromising anti-immigration platforms that also challenge the open-border policies within the EU.

At its core, populism appeals to the will of the people. It is a movement rooted in the disconnect between the political establishment and the working class. Increasing income disparity and stagnant wage growth over the last 25 years have given momentum to the current wave of populism

Exhibit 1: Europe's Election Calendar



Source: NEPC

Taking center stage in the upcoming elections are the contentious issues of immigration policy, economic growth, and EU membership - the debate surrounding these topics poses a direct challenge to the political and economic orthodoxy. While the established political parties continue to embrace a more open view, they are paying the price at the polls as voter discontent reaches fever pitch.

sweeping the Western world. This trend has been exaggerated in the EU, especially in France and Italy whose economies have yet to fully recover from the Eurozone debt crisis and still struggle with high unemployment and low economic growth.

For example, in Germany and Netherlands, debates over immigration and open-border policies have become a campaign lightning rod as millions of refugees fleeing from the Middle East and North Africa have sought safety within the con-

Of critical importance is the looming presidential election in France, which is the third-largest economy in Europe and a cornerstone member of the EU. The election will be held on April 23 and a majority is required to win. In the event that a single candidate does not achieve a majority in the first round, a run-off election will be held between the top two candidates on May 7. The three main

candidates in the race are Marine Le Pen of the National Front, the Republican candidate François Fillon, and Emmanuel Macron, founder of the upstart party En Marche! (Exhibit 2).

Le Pen's platform is based on anti-establishment rhetoric as she intends to hold a referendum on EU membership, withdraw from the euro, and close the country's borders. In contrast, Fillon and Macron hold more moderate views on immigration and advocate an expansion of pro-growth policies within the framework of the EU. Given the incendiary nature of Le Pen's views, it is believed that her victory would destabilize European markets and cloud the future of the euro. To this end, as Le Pen's poll numbers track higher, the euro has weakened and French bonds have sold off relative to German sovereign debt. Nevertheless, while Le Pen is expected to advance to the run-off election, polling indicates she is trailing by a sizable margin in a head-to-head race with François Fillon or Emmanuel Macron.

A more immediate concern for investors is the upcoming general election in Netherlands on March 15. The election is seen as a bellwether of the political climate in Europe and Geert Wilders' Freedom Party is the leading contender to win the most seats in the 150 seat parliament. Wilders is an outspoken critic of Islam and the current refugee policy, and his party platform includes withdrawing from the EU and closing the country's borders. However, should the Freedom Party win the most seats in the election, the practical impact is low as it is highly unlikely that Wilders would be named prime minister as all other major political parties in Netherlands have stated they would not include him in a coalition government. That said, if the Freedom Party exceeds expectations and wins more than 30 seats, it could bolster support for anti-establishment candidates across Europe and elevate market uncertainty.

Exhibit 2: France's Presidential Candidates

- Anti-establishment
- Anti-immigration
 - Tighter borders
- Euroskeptic
 - EU referendum
 - Withdrawal from Euro
- Nationalism

Marine Le Pen

National Front



- Business-friendly
- Labor market reform
- Socially conservative
- Pro-EU
- Investigation over misuse of public funds

François Fillon

Republican



- Independent
- Open-door immigration policy
- Economically and socially liberal
 - Pro-growth
- Negotiate for less austerity-driven EU

Emmanuel Macron

En Marche!



Source: NEPC

This unpredictable and volatile environment may rattle investors, fueling anxiety around the impact of these elections on market returns. While the dissolution of the EU represents a lower probability "tail-risk" for markets, perceived concerns of political instability are overshadowing broad macroeconomic improvements in Europe. We believe these economic trends—declining unemployment, improving credit growth, and a more optimistic consumer and business sentiment—are tangible catalysts in driving a recovery in European corporate earnings. In line with our view, we advocate an overweight position in non-US developed market equities. Furthermore, we recommend implementing this developed market equity exposure with a partial currency hedge as increased political uncertainty will likely intensify currency volatility. That said it is important to remind investors that while political events can fuel short-term volatility, it is market fundamentals that ultimately shape investment returns. To this end, we encourage investors to look past the political uncertainty and objectively assess the valuation opportunities offered by the market.

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