Incorporating Investec Wealth & Investment (UK)

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Tremors in Europe

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A bank holiday and the turn of the month meant that a few weeks have elapsed since the last Weekly Digest. A brief glimpse at market indices over the period would suggest that investors have been serenely enjoying another period where global aggregate equity indices have been making new all-time highs (mainly thanks to continued strength in the United States), but, as ever, there has been plenty going on to raise concerns. Last week's monthly commentary focused on geopolitical risk and how we, as investors, deal with it. I didn't get deep into the weeds of elections in large developed countries but did refer back to the Brexit referendum and Donald Trump's victory in the 2016 US Presidential Election as events that "signalled a tectonic shift in the political economy".

The tectonic plates shifted a little further last weekend. The epicentre of the latest quake was located in France, but tremors were also felt strongly in Germany. In the European Parliamentary elections, President Macron's centrist Renaissance party and Chancellor Olaf Scholz's centre-left Social Democratic Party were beaten by the more right wing National Rally (RN) and Alternative fűr Deutschland (AfD) parties. Indeed, these two parties are often labelled as "far right", mainly owing to their strong opposition to immigration.

Having said that, the more extreme parties did not have it all their own way. The largest share of German votes went to the conservative Christian Democratic Party, and far right candidates in Poland, Finland, the Netherlands and Sweden failed to meet their various parties' expectations. Furthermore, the current ruling coalition, the European People's Party, retained its majority in the European Parliament. And so, for now, the status quo ante remains.

Europe has had previous scares. The election of Giorgia Meloni, leader of the Brothers of Italy (FdI), as Prime Minister, was of great concern. One only has to read the thumbnail of FdI's Wikipedia entry to get a flavour of what the party is about: "Academics and observers have variously described it as conservative, national-conservative, right-wing populist, social-conservative, nationalist, neo-fascist, post-fascist, nativist and anti-immigrant." My guess is that the more left wing the observer or academic, the more right wing they would view the FdI as being, and so one has to be careful of talking such labels at face value, but it is certainly clear on which side of the political spectrum it lies.

Or is it? The descriptor that is not included in the aforementioned list, but which is widely applied to the FdI, RN and the AfD is "populist". Over the last few years, "populism" has become a catch-all word used to describe any political movement that deviates far from the traditional "centre". It is an emotive word (and deliberately so), in that it brings to mind mass rallies in support of charismatic (and ultimately despotic) leaders who have, in the past, led Europe into tragic conflict, or, in the case of several leaders in Latin America, economic disarray.

Populist policies can be drawn from either side of the political spectrum. Anti-immigration policies are usually associated with the far right, whereas wealth redistribution is generally the preserve of the far left (socialists). A skilled populist leader can cherry pick policies from anywhere on the menu to tap into the concerns of the electorate or to play on their fears. The right plays on fears of "immigrants stealing jobs" or the gradual dilution of once-strong native cultural identities. The left focuses on wealth inequality and "fat cat" business leaders and promises to redress the balance. Neither mentions the need for skilled immigrants to make up for the lack of natural labour force growth in maturing developed economies, nor the benefits of proper incentives to deliver investment and innovation in largely capitalist societies. The ideology trumps the practical business of actually running a country for the benefit of the majority of its population.

That's not to say that there is not a kernel of truth in the arguments of more populist leaders. At the very highest level, thirty years of globalisation have had a profound effect on the jobs market, especially in mass manufacturing and in the sorts of clerical jobs that can be outsourced to take advantage of cheap labour on the other side of the world. Financial markets have increasingly valued capital much more highly than labour. Monetary policy following the Global Financial Crisis has accelerated the wealth generation of those who already had wealth, while making it even harder for those aspiring to wealth to catch up. These trends were already evident even before the Covid pandemic and then Russia's invasion of Ukraine increased the gaps even further.

If this makes it seem as though some sort of revolution is on the horizon, I am not trying to sound alarmist. A decade or so ago, Greece was threatening to split from Europe and was pretty much bankrupt. Today, its economy is thriving, and it has become a paragon of virtue in terms of things like collecting taxes from people who owe them. Admittedly, it had to go a through an existential crisis to get here, but it was amazing how its populist leaders, once in power, engaged in more "sensible" policymaking. In Italy, too, the Meloni administration has not met the market's worst fears.

None of that stopped markets from reacting negatively to the initial news of the results when they opened on Monday. The main casualties were French bonds and equities. France's benchmark 10-year bond yield jumped from 3.09% to 3.22%. This was not a crisis by any means, but signalled investors' concerns. France's CAC-40 Index opened around 2% down and has continued to drift lower. Within the equity market, the biggest losers have been the leading banks, seen as easy targets for windfall taxes owing to their current strong profitability. At Tuesday's market close, shares in Société Général were down 12% from Friday, while those of BNP Paribas were down 8%. The worries were also reflected in a one cent fall in the euro versus the pound and the dollar – handy for anyone heading to the Continent for their summer holidays.

Economic Commentary

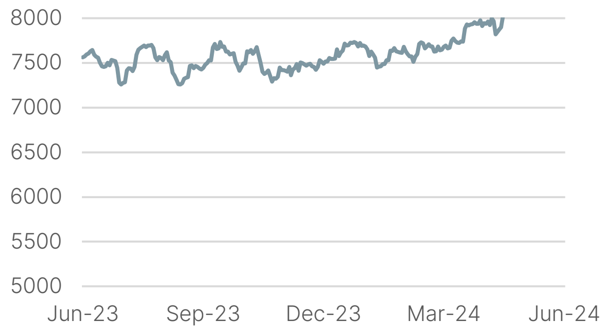
FTSE 100 weekly winners

Entain PLC	6.1%
Smith & Nephew plc	4.8%
St. James's Place Plc	4.3%
Rightmove plc	3.9%
Sage Group plc	3.7%
Pershing Square Holdings, Ltd. Public Class USD Accum.Shs	3.6%
RELX PLC	3.4%

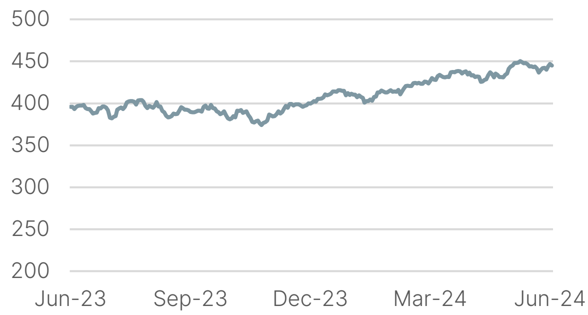
FTSE 100 weekly losers

Fresnillo PLC	-9.8%
B&M European Value Retail SA	-9.5%
GSK plc	-7.8%
Johnson Matthey Plc	-6.7%
Standard Life Aberdeen	-5.5%
Vodafone Group Plc	-5.4%
BP p.l.c.	-5.2%

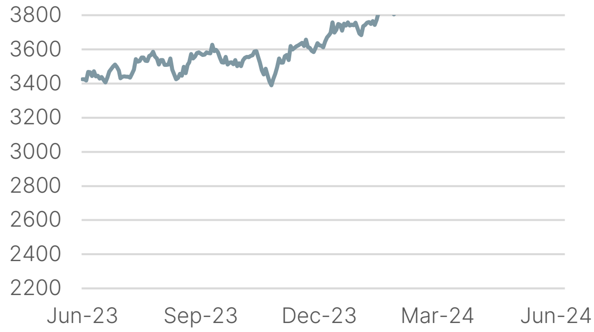
FTSE 100 index, past 12 months



EuroStoxx 600 index, past 12 months



S&P 500 index, past 12 months



All data shown in GBP.

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