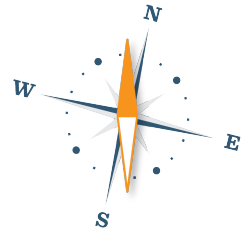




ASPIRIANT

Market Perspective



April 2017

YOU'RE UP!

Voters head to the polls across Europe in 2017

Overview

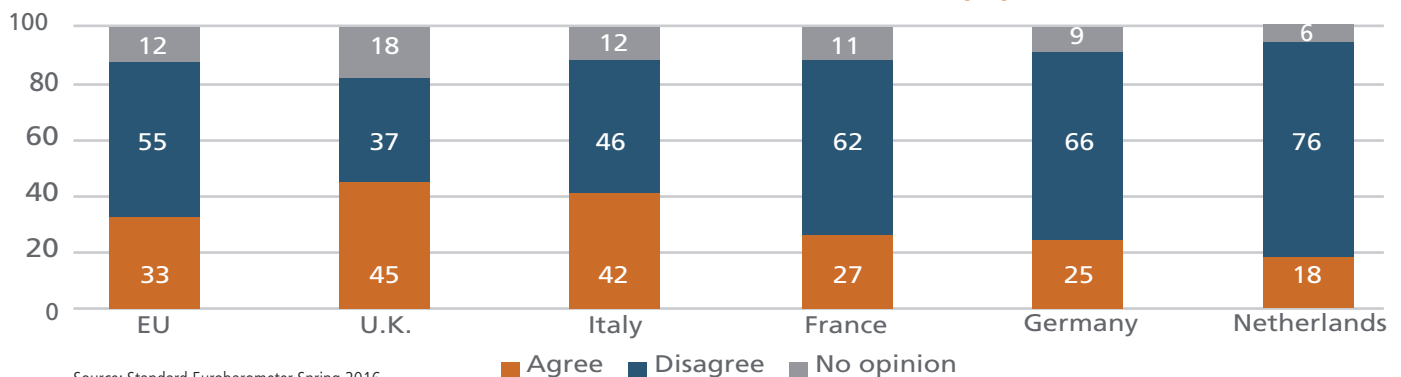
The pillars of post-World War II prosperity and peace in Europe — economic integration and the free movement of goods, services, capital and labor — have been uprooted in recent years by the uneven gains accruing to member countries, rising burdens of the state (e.g., taxes and regulation) and mounting anxieties over personal security from assimilating refugees from the Middle East and Africa. Up until the global financial crisis, citizens of Europe eagerly embraced stronger ties within the continent — first, by the creation of common markets, and later by expansion of the European Union (both in scope and geography) and the introduction of a shared currency, the euro. Today, those bonds are increasingly called into question as populist movements across Europe re-examine the merits of sacrificing lost sovereignty for unsettled political and economic rewards. As these political currents stream across Europe and disrupt familiar conventions, voters in three of the largest economies go to the polls to choose key leaders throughout the year, as other vital constituents (i.e., United Kingdom and Italy) grapple with circumstances that are of similar consequence.

Netherlands

Beleaguered by neither high unemployment, a mass influx of refugees nor recent terrorist attacks, the Netherlands, ostensibly, would seem less susceptible to the rising wave of populism. Despite these apparent advantages, the anti-immigrant and Eurosceptic party, the Party for Freedom (PVV), was favored for much of the winter¹ to win the greatest number of seats in parliament in the March 15 election. A one-page electoral program released in August of last year by Geert Wilders, head of the PVV, pledged to close all mosques and Islamic schools, ban the Koran, prohibit immigration from any Muslim country and leave the European Union

(EU), among other measures.² Confounding pollsters once again, the incumbent party, the People's Party for Freedom and Democracy (VVD), prevailed and is predicted to win 33 seats (of 150) based on preliminary results. The Labor Party, a coalition partner to the VVD, had a particularly disappointing night, garnering only 10 seats, a decline of 28 seats from the prior election in 2012. PVV placed second with 20 seats, an improvement from the 15 seats it held previously. Negotiations to form a governing coalition (with control over 76 or more seats) may last for weeks. The election outcome in favor of Prime Minister Mark Rutte's VVD may have swung on his

Can Better Face the Future Outside the EU (%)



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tougher language on immigration in recent days and, quite simply, the widespread view among the Dutch that their prospects are better within the EU than outside it.

France

With persistently high unemployment, sluggish economic growth and rising nationalism, France is more fertile ground for a populist movement or election surprise. To that end, the National Front, a traditionally far-right political party that espouses protectionism, opposes immigration, disapproves of the EU, and favors closer ties with Russia, has grown in popularity, particularly since the election of Marine (Marion) Le Pen as its leader in 2011. Le Pen is widely considered to be one of the leading candidates in the upcoming presidential elections to be held on April 23. If no candidate wins a majority, a run-off among the top two candidates will occur two weeks later on May 7. President François Hollande, suffering from historically low approval ratings,³ declined to run for re-election. Former Minister of National Education, Benoit Hamon will run in place of Hollande as the Socialist Party (center-left) candidate. The other main political party in France, the Republicans (center-right), selected former Prime Minister François Fillon, in November, as its nominee. Fillon has been buffeted in recent weeks by allegations of providing no-show jobs to his wife and children for the past several years. Despite falling support, Fillon has resisted calls to drop out of the race. Former Minister of the Economy, Emmanuel Macron is running as an independent and rounds out the list of major contenders.

While Le Pen has recently polled strongly and has made strides in softening the National Front's image, she must overcome past voting patterns and broaden her appeal beyond the party's enthusiastic core. Among a field of several candidates, Le Pen looks poised to be one of the two candidates in the second round of the presidential elections.⁴ Historically, the National Front, however, has not fared well in second round ballots as votes coalesced around traditional party candidates. In 2002, Le Pen's father, Jean-Marie, placed second to Jacques Chirac in the first round of presidential voting, 19.9% to 16.9%. In the run-off, Jean-Marie's backing edged up by less than 1%, and he lost by the largest margin in French history, 82.2% to 17.8%. More recently, the National Front received the largest percent of votes in the first round of voting in the 2015 regional elections, but placed third, and only marginally

History of the European Union

1951 The European Coal and Steel Community (ECSC) was formed to create a common market for steel and coal, and to initiate regional integration among prior adversaries as a means to promote a lasting peace. France, West Germany, Italy, Belgium, Netherlands and Luxembourg are its founding members.

1967 The ECSC, together with the European Atomic Energy Commission is subsequently merged into the European Economic Community (EEC).

1973 Denmark, Ireland and the United Kingdom joined the EEC and represented the first of several enlargements. Countries accede to the union and obtain privileges of membership by becoming party to the founding treaties, and thereby partially delegate sovereignty to the institutions of the community. Today the European Union is comprised of 28 member states and represents approximately a quarter of global nominal GDP.

1985 The Schengen Agreement is signed in by five members of the EEC and abolishes passport and other controls among shared borders.

1990 A common visa policy is established in 1990. The U.K. opts out of the Schengen Area but maintains an open border with Ireland (through Northern Ireland). The Schengen Area today encompasses 26 European countries.

1993 The Maastricht Treaty became effective, creating the EU and the three pillars of common integration. The European Community (formerly the EEC) pillar handled economic, social and environmental policies. The Common Foreign and Security Policy (CFSP) pillar addressed foreign policy and military matters. Police and Judicial Co-operation in Criminal Matters (PJCCM) brought together co-operation in fighting crime. The Maastricht Treaty, more notably, also led to the creation of the euro, the common currency of the EU. The U.K. negotiated an opt-out from the Maastricht Treaty that would have required it to adopt the common currency.

1999 The euro is introduced in non-physical form in January and all national currencies of participating countries are locked at fixed exchange rates against each other.

2002 Euro banknotes and coins replaced national currencies in 12 of the member states. Since then, the eurozone has expanded to 19 countries.

2009 The pillar system was eventually abandoned with the adoption of the Treaty of Lisbon and the merger of the three pillars into a single consolidated entity, the European Union.

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grew its support in the decisive and final vote. A recent poll by Elabe⁵ suggests a similar result for the approaching presidential elections: Le Pen garnering the highest level of support in the first round of voting but losing in a run-off to either Macron (65% to 35%) or Fillon (59% to 41%). Even if Le Pen were to win the presidency, her ability to starkly pivot on any number of issues, including France's relationship with the EU, will likely be hindered by a lack of support from deputies in the National Assembly. Currently, the National Front holds only two of the 577 seats, with Socialists and Republicans in control of 474 seats (82%). National Assembly elections are planned for June. Perhaps most noteworthy, Le Pen has tempered her rhetoric on France's ties to Europe as the election approaches. In early January, Le Pen reaffirmed her objective to hold a referendum on EU membership within her first months in office but indicated an interest in using it as an instrument to only restructure France's relationship with the EU and restore control of its borders. She has also called for retaining the euro.⁶

Germany

As the largest, wealthiest, and, arguably, the most financially sound (i.e., fiscal surpluses, manageable debt balances, low unemployment) economy in the EU, Germany steadies an economic bloc beset with north and south divisions (due to economic disparities) as well as east and west tensions (due to a newly assertive Russia). Federal elections are set for September 24. Chancellor Angela Merkel has recently declared her intent to run for a fourth term.

For most Germans, European integration has been a resounding success as both the larger continental market and lower value of the euro (compared to the currency it replaced, the Deutsche Mark) have stimulated exports, as well as better relative economic and job growth. However, Merkel's Christian Democrats (CDU) suffered their worst-ever results in regional elections in Berlin in September 2016, with the anti-immigrant, anti-EU Alternative for Germany (AfD) party picking up their first seats in the Berlin state parliament since the 1990 reunification.⁷ With the December 19 Berlin terrorist attack, German unease with immigration and, more pointedly, Merkel's decision to allow Syrian refugees to apply for asylum has only grown. Today, Germany (population of 82.2 million⁸) has 1.4 million asylum seekers, and receives approximately 66% of the applicants across all of the EU.⁹

Moreover, Germany provides asylum seekers with a range of social benefits (including free shelter, food, medical services, and extra monies to cover basic needs and incidentals¹⁰) that further animate resentment among the populace.

Notwithstanding its rising popularity, AfD's support reached a record high of 16% in September of last year,¹¹ the far-right Alternative for Germany continues to trail the traditional parties, CDU and Social Democrats (SPD), and lacks the infrastructure of the mainstream, more centrist establishment to drive turn-out. Moreover, AfD has had no experience governing. Meanwhile, Merkel must also check the surging popularity of the Social Democrats, who have edged ahead of the CDU¹² according to one poll. Martin Schulz, the former president of the European parliament and the SPD candidate for chancellor, has sharply rebutted comments made by U.S. President Donald Trump on immigration and refugees that have resonated with the disapproving German public and fueled his party's momentum.

U.K. and Italy

The elections in the Netherlands, France and Germany closely follow landmark referendums in two other large EU economies in 2016. The United Kingdom, in a vote that caught both pundits and markets by surprise, chose to leave the EU by a narrow margin of 52% to 48% in June of last year. Prime Minister Theresa May, who replaced David Cameron following the Brexit vote, began the formal two-year exit process from the EU (by invoking Article 50 of the Treaty of Lisbon). With deep trade ties to the EU, the U.K. would like to maintain significant access to the bloc's markets. However, EU member countries, Germany in particular, are unlikely to grant such a request if the U.K., as it has signaled, restricts immigration of EU nationals.¹³ If the U.K. wishes to have control over immigration, stop paying into the EU budget, negotiate its own trade deals (and abandon the customs union), then a clean break or "hard exit" is the probable outcome. U.K. leaders also have to assess the impact of a separation on its relations with Northern Ireland and Scotland, both of which support continued EU membership.¹⁴ Consensus is building that the Brexit should take place before European elections in May or June of 2019 and the next U.K. general election (to be held no later than May 2020).

Months after the U.K. vote, Italy, held a referendum in December to amend the appointment and powers of the

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Parliament, including a substantial decrease in the membership and power of the Senate. Experiencing a similar fate as David Cameron, Prime Minister Matteo Renzi, resigned shortly after the package was emphatically defeated by a 59% to 41% margin. As the vote results were based not only on the merits of the proposed reforms, but also on Renzi's stewardship of the Italian economy, the referendum was widely regarded as a victory for the populist Five Star Movement (M5S). Founded in 2009, M5S has quickly become Italy's biggest opposition group. In the general election in 2013, M5S took a quarter of the vote and, last June, M5S candidates won local races in Rome and Turin.¹⁵

Recent polls show M5S slightly trailing the (incumbent) Democratic Party 30.6% to 27.6%.¹⁶ The next Italian general election must occur no later than May 23, 2018, but could be called well before then. M5S has pledged to hold a referendum on Italy's continued use of the euro, which is widely perceived to have hurt the economy and exports in particular (M5S supports continued membership in the EU).

With a respectable chance of winning the next election, M5S may be frustrated in its attempt to hold a referendum on the euro if it is unable to win strong majorities in both chambers of Parliament. Additionally, Italy's highest court in January overturned parts of an electoral law passed in 2015 that was seen as friendly to M5S. By determining a run-off (two rounds of voting) system unconstitutional, the court decision has made a coalition government the most likely outcome as no party is likely to top the 40% threshold and be awarded bonus seats to gain a majority. This result may prove challenging for M5S, a group that does not self-identify as a political party and has refused to cooperate with other organizations in the past. Moreover, recent polls show that Italians favor a single European currency by 54% to 35%.¹⁷

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1 Peil.nl, January 8, 2017.

2 www.geertwilders.nl.

3 The Economist, Into the Abyss, November 5, 2016.

4 Paris Match, January 10, 2017.

5 Reuters, France's Fillon battered by scandal, blames opposition plot, February 1, 2017.

6 The Independent, January 5, 2017.

7 The Telegraph, September 18, 2016.

8 Federal Statistical Office, Wiesbaden.

9 Eurostat, Asylum in the EU Member States, December 15, 2016.

10 Politico, Germany's Far Right Rises Again, December 21, 2016.

11 RT.com, September 23, 2016.

12 Wall Street Journal, Candidate for German Chancellor Finds a Rallying Cry: Trump, February 7, 2017.

13 Stratfor, A Trade-Off in the Brexit Negotiations, January 10, 2017.

14 BBC, EU referendum: The result in maps and charts, June 24, 2016.

15 The Economist, Italy's Five Star Movement, October 24, 2016.

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Equities. The S&P 500 is a market-capitalization weighted index that includes the 500 most widely held companies chosen with respect to market size, liquidity and industry. The Russell 2000 Index measures the performance of the small-cap segment of the U.S. equity universe. It is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership. The MSCI EAFE Index (Europe, Australasia, and Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S. and Canada. The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. The MSCI ACWI Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets.

Fixed Income. The Barclays U.S. Aggregate Index represents securities that are SEC-registered, taxable and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis. The Barclays Municipal Bond Index is a rules-based, market-value-weighted index engineered for the long-term tax-exempt bond market. The index has four main sectors: general obligation bonds, revenue bonds, insured bonds and pre-refunded bonds. The Barclays High Yield Municipal Bond Index is an unmanaged index composed of municipal bonds rated below BBB/Baa.

Real Assets. The S&P GSCI® is a composite index of commodity sector returns representing an unleveraged, long-only investment in commodity futures that is broadly diversified across the spectrum of commodities. The returns are calculated on a fully collateralized basis with full reinvestment. Wilshire Global RESI is a broad measure of the performance of publicly traded global real estate securities, such as Real Estate Investment Trusts (REITs) and Real Estate Operating Companies (REOCs). The index is capitalization-weighted. The Alerian MLP Index is a gauge of large and mid-cap energy Master Limited Partnerships (MLPs). The float-adjusted, capitalization-weighted index includes 50 prominent companies and captures approximately 75% of the available market capitalization.