



French Election Outcome Favorable for Financials

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Over the past several quarters, we have been positioning our international equity strategy in a more cyclical direction, recognizing that a broad-based global economic expansion was taking hold. Financials has been a particular area of focus, specifically the European banking sector, based on a range of catalysts:

- Positive GDP growth trends should stimulate demand for business credit and reduce non-performing loan losses.
- Bank capital ratios have been strengthened, reducing the likelihood of financial distress or dilutive equity issuances.
- Evolving European banking regulations (i.e., Basel IV) appear to be less restrictive than originally feared.
- Steepening yield curves should boost banks' net interest margins.
- Bank valuations (price/cash flows, price/book, etc.) are attractive relative to our investment universe as well as their own long-term averages.

As we've been increasing our financials exposure, we've been keeping close tabs on the political climate in the European Union. Post-Brexit, the concern has been that the election of populist candidates in other EU nations could create a ripple effect that could potentially change the path forward for the euro region.

The headwinds of electoral uncertainty began to subside in March with the prime minister election in the Netherlands, when the conservative incumbent Rutte defeated the populist challenger Wilders. Of even greater significance were last weekend's first-round results of the French presidential election which saw the centrist (and anti-Frexit) candidate Emmanuel Macron rise to the top of a crowded field that included far-right leader Marine Le Pen. Macron and Le Pen now advance to a runoff election on May 7 that will determine the winner. While a plausible path to victory still exists for populist Le Pen, expectations are for Macron to prevail, lifted by the support of a consolidated coalition of supporters from the eliminated candidates.

The French election outcome removes (for now) much of the lingering political uncertainty, and we believe shines a new light on positive fundamentals underpinning the European banking sector, which have rallied strongly. We are optimistic this development will prove a key waypoint on the path forward that will see fundamental valuation return to the fore of what drives stock prices, and the EAFE universe begin to recover from five-plus years of significant cumulative performance lag relative to U.S. markets.

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