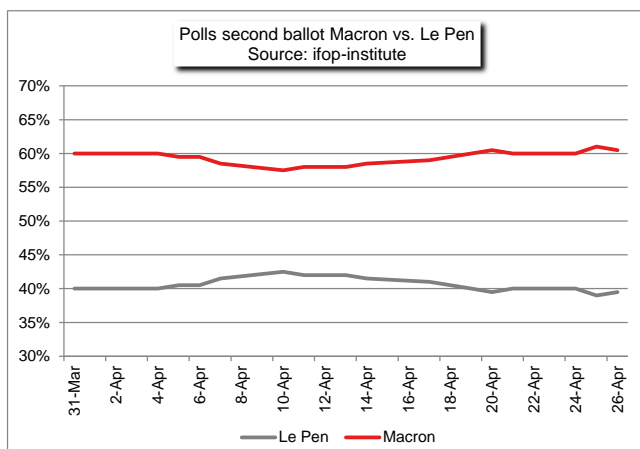


ECONOMIC SITUATION AND STRATEGY

Presidential election in France: Five years' probation

The euro will probably remain France's legal tender in 2018. In view of very clear poll numbers, it is quite unlikely that Marine Le Pen will pull off an outsider victory in the presidential election. According to a survey by polling and market research firm IFOP (Institut français d'opinion publique), 60.5% of voters now prefer Emmanuel Macron, the social liberal favorite for president, while only 39.5% are inclined to vote for Le Pen. Moreover, since 90% of potential Macron voters are certain of their decision, a surprise outcome is unlikely.



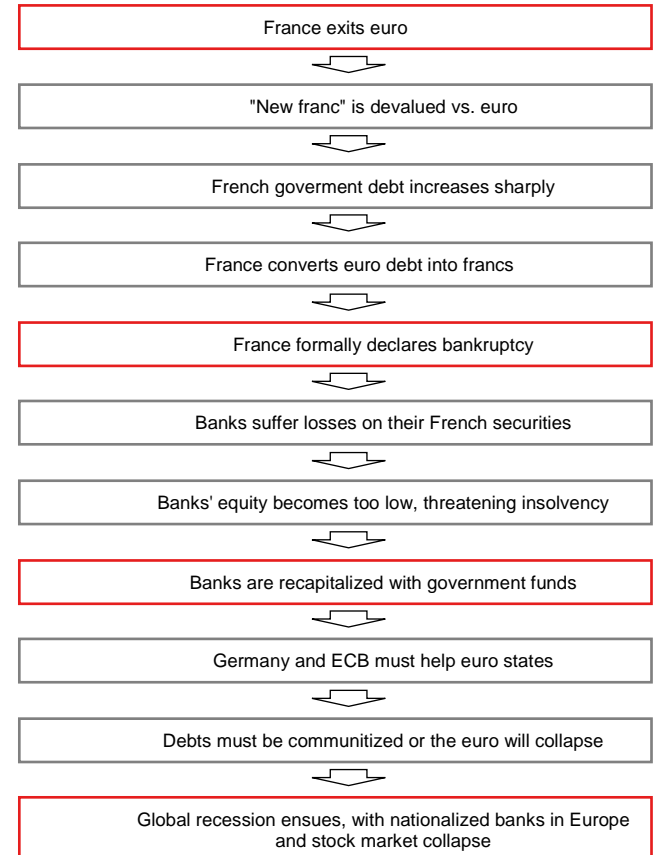
That will calm the nerves of many people in Germany and the rest of the world. For, parts of Le Pen's campaign platform read like a horror novel. While the populist measures, such as deporting foreigners, introducing border controls, and lowering the retirement age from 62 to 60, may still be classified as client politics with appreciable, but controllable economic effects, taxing imports, financing a huge expansion of government debt via the French central bank, and most importantly seeking to exit from the euro and the European Union would be an "all-or-nothing" play with considerable risks for France and the entire global economy.

If one thinks through the consequences of just an exit from the euro, it would almost inevitably mean a large-scale nationalization of major European banks, a correspondingly huge increase of government debt, and a global recession. For, 18 years after the launch of the euro, the European banking system is so closely interlinked that a conversion of French debt from euros into a "nouveau franc" would result in such high writedowns that many banks could not survive without government support. The magnitude of the writedowns would be proportionate to the presumably substantial devaluation of the new French currency against the euro.

Investors were accordingly much relieved by the outcome of the first ballot in the election. Prices of bank stocks like Société Générale and Deutsche Bank jumped 10% because the chances of Macron becoming president are considered

very high. Conversely, if Le Pen were elected French stocks would probably plummet by a third or more.

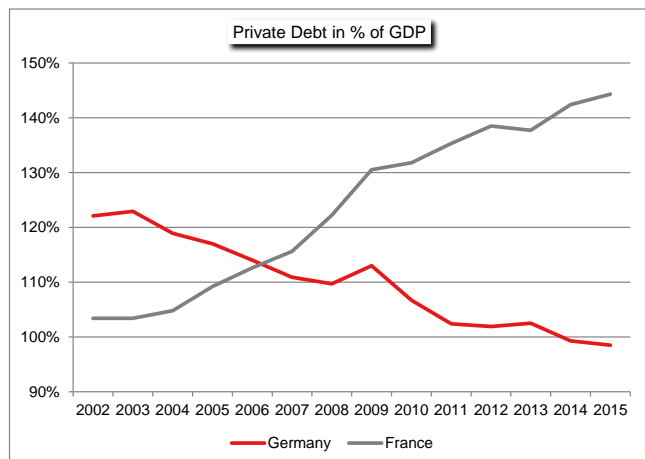
Scenario analysis: France exits euro



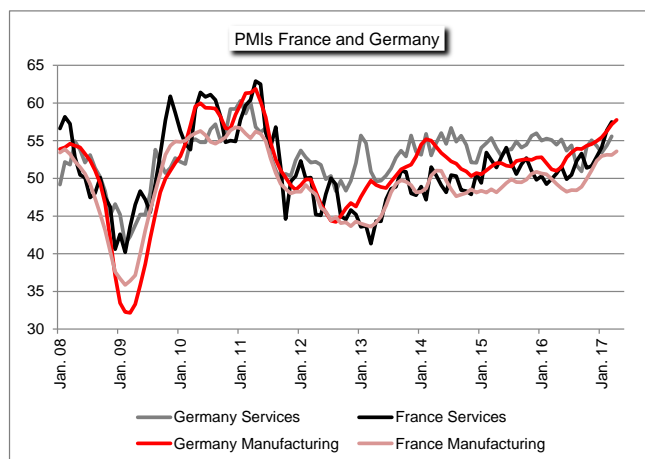
In contrast, Emmanuel Macron's campaign platform reads like a European love story. A proponent of Europe, he will seek to promote EU unity. However, some work will probably still be necessary to convince political leaders in Berlin to establish a common European ministry of economics and finance and complete the unification of the banking system, as planned. As president, Macron plans to implement dynamic reforms that will dispose Berlin in favor of these objectives. They include easing regulations protecting workers from dismissal, softening the 35-hour rule for the working week, and trimming the public sector by eliminating 50,000 jobs. Parallel to that, personal and corporate income tax cuts and a EUR 50 billion capital spending program are supposed to stimulate the economy to achieve political support for these tough cuts.

However, two big hurdles must be cleared first. First, Macron needs support for new legislation from the French parliament, which is up for election in two ballots on June 11 and June 18, 2017 based on plurality votes in the election districts. Macron's En Marche! party is on the ballot in every district, but it is very unclear how many seats this new party can win against the established parties and politicians. It is very likely that Macron is dependent on shifting support from other parties, which will markedly dilute his course. On the other hand, he must win the fight for reforms not only in the parliament, but also in the streets. The

French have traditionally been very prone to strike and in particular will oppose the labor market reforms and job cuts. The country has shown little ability to reform in the past. In any case, the willingness to reform appears higher now than it has been in a long time. However, it remains to be seen whether this basically positive and supportive attitude will reverse itself as soon as people's own wallets are affected.



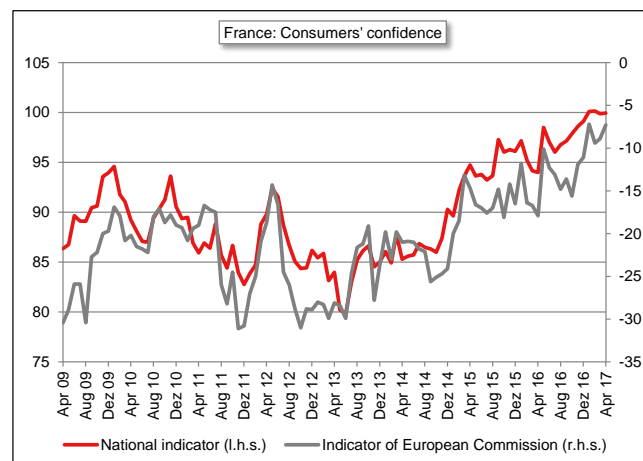
A closer look at the economic data reveals that reforms are urgently needed. France's economic growth, which has lagged behind Germany's by about one percentage point per year on average since the beginning of 2009, is a rather sugarcoated indicator of the French malaise. For, a large part of the achieved growth is financed on credit. Between 2010 and 2015, government debt increased from 82% to 100% of gross domestic product, while Germany reduced its debt burden over five years from a similarly high 81% to 77%. The trends in private debt are even more divergent. While German businesses and households have managed to lower their debt ratio by about 20% since 2002, the debt ratio in France has risen by about 40%.



Instead of the rather insignificant 1.2% per year, France might not have achieved any growth at all without large-scale additional borrowing. The need for borrowed capital could not be completely covered by domestic sources, which is reflected in the annual current account deficits since 2008. This makes France dependent on the confidence of foreign capital providers. However, the level of the current account deficit is not yet critical.

The new president is at least in luck that cyclical momentum provides a tailwind for the demanding task of making France competitive again. Sentiment has brightened appreciably among French businesses. Both manufacturing firms and service providers are in a more positive mood than at any time since 2011.

The good sentiment is also spreading to consumers. Consumer confidence has reached its highest level since the financial market crisis.



We therefore recommend giving French stocks an increased portfolio weighting in the months ahead. Unlike Italy, France has launched an impressive number of world market leaders, not only in small niches. And the greatest risks from the political side for the coming five years of the Macron presidency are likely to have been weathered.

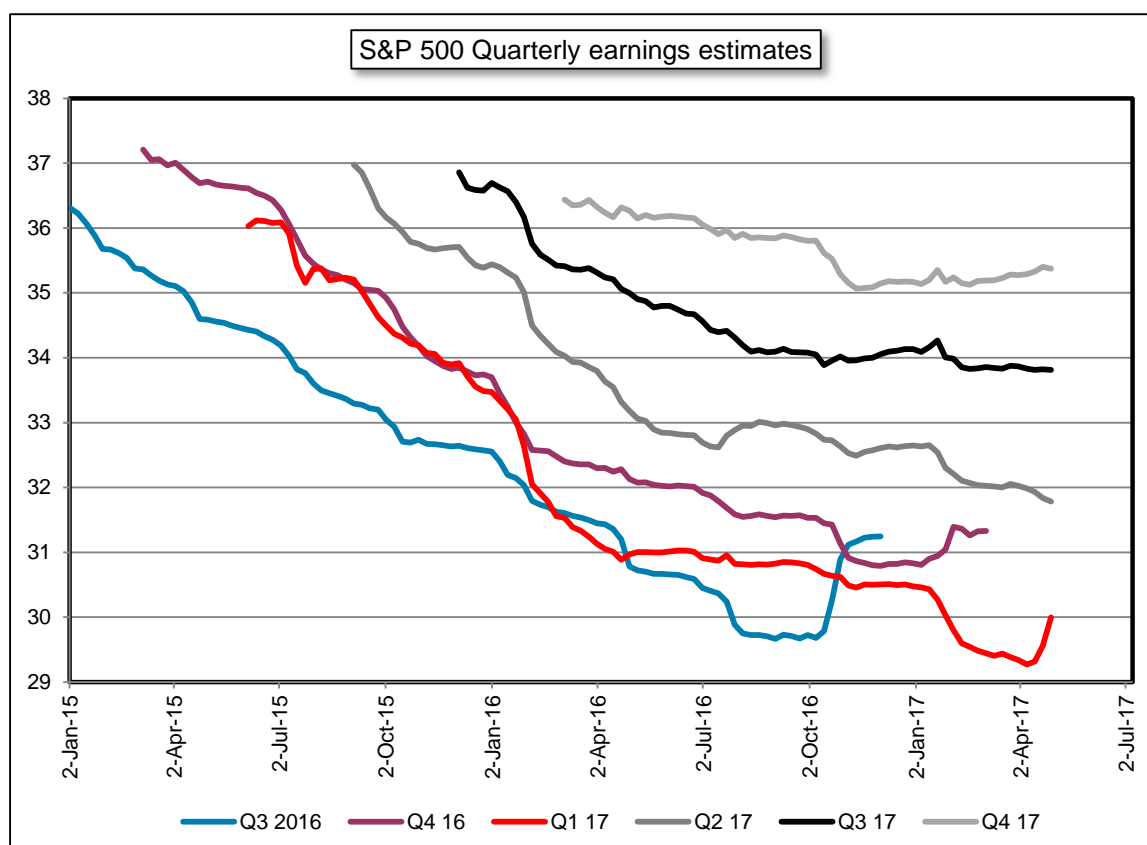
However, France is on probation, so to speak. For, if Macron is not successful, then either the right-wing populist Le Pen or the left-wing populist Melenchon will probably come to power five years from now and could put the euro exit scenario back into play. This may be an incentive for German political leaders to strongly support Macron.

Weekly outlook for May 2-5, 2017

	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	Release
DE: PMI, manufacturing, final	54.3	55.6	56.4	56.8	58.3	58.2	May 2
DE: Unemployed, change in k	-8	-21	-27	-17	-30	-10	May 3
DE: Unemployment rate	6.0%	6.0%	5.9%	5.9%	5.8%	5.8%	May 3
DE: PMI, services, final	55.1	54.3	53.4	54.4	55.6	54.7	May 4
EUR19: PMI, manufacturing , final	53.7	54.9	55.2	55.4	56.2	56.8	May 2
EUR19: Unemployment rate, sa	9.7%	9.6%	9.6%	9.5%	9.5%		May 2
EUR19: Producer prices m/m	0.3%	0.8%	1.1%	0.0%	0.4%		May 3
EUR19: Producer prices y/y	0.0%	1.6%	3.9%	4.5%	4.6%		May 3
EUR19: PMI, services, final	53.8	53.7	53.7	55.5	56.0	56.2	May 4
EUR19: Retail sales, m/m	-0.2%	-0.3%	0.1%	0.7%	0.3%		May 5

MMWB estimates in red

Chart of the Week: US reporting season up and running!



In the United States, the reporting season for the first quarter of 2017 reached full speed this week. By now, more than 200 companies from the S&P 500 have reported on their earnings and sales development. The results are impressive, with 79% of companies beating earnings expectations, and 66% beating sales expectations. In contrast, the comparable figures for the fourth quarter of 2016 were 71% and 53%, and the numbers presented so far are also significantly better in long-term comparison. This shows that the economic upswing, previously reflected more in the leading indicators than in "hard" data from the real economy, has gained momentum in recent months. As usual, analysts have lowered their estimates ahead of the reporting season. An earnings increase in the first quar-

ter of almost 14% on the year-earlier quarter was still expected at the beginning of the year, but that was reduced to 9.3% by the beginning of April. Now, the rate of increase compared with the first quarter of 2016 is 11.4%. That is the strongest earnings growth since the third quarter of 2014 (+10.8%) and before that since the fourth quarter of 2011 (+24.7%). Among the S&P sectors, the highest ratios of positive earnings surprises reported by companies are in information technology (96%), health care (91%), and consumer discretionary (85%). In contrast, the strongest percentage earnings revisions were last seen in the industrials and materials sectors.

	As of	Change versus			
	02.05.2017 13:56	05.04.2017 -1 week	10.03.2017 -1 month	11.01.2017 -3 months	30.12.2016 YTD
Stock markets					
Dow Jones	20913	1,3%	0,1%	4,8%	5,8%
S&P 500	2388	1,5%	0,7%	5,0%	6,7%
Nasdaq	5867	0,0%	0,1%	5,4%	9,0%
DAX	12465	2,0%	4,2%	7,0%	8,6%
MDAX	24750	3,1%	6,1%	10,7%	11,5%
TecDAX	2112	3,4%	7,3%	14,3%	16,6%
EuroStoxx 50	3567	2,7%	4,4%	7,8%	8,4%
Stoxx 50	3187	1,0%	2,8%	4,7%	5,9%
SMI (Swiss Market Index)	8856	2,5%	2,1%	5,1%	7,7%
Nikkei 225	18748	-0,6%	-4,4%	-3,2%	-1,9%
Brasilien BOVESPA	65403	1,0%	1,1%	4,7%	8,6%
Russland RTS	1128	-2,1%	6,9%	-2,3%	-2,1%
Indien BSE 30	29921	-0,2%	3,4%	10,2%	12,4%
China Shanghai Composite	3144	-3,9%	-2,1%	0,2%	1,3%
MSCI Welt (in €)	1882	-0,2%	-0,9%	1,9%	3,9%
MSCI Emerging Markets (in €)	980	-1,1%	2,8%	6,4%	9,8%
Bond markets					
Bund-Future	161,65	-75	264	-183	-250
Bobl-Future	131,81	-47	62	-160	-182
Schatz-Future	112,22	-16	-6	-3	-7
3 Monats Euribor	-0,33	0	0	0	-1
3M Euribor Future, Dec 2017	-0,29	-1	-9	0	0
3 Monats \$ Libor	1,16	0	3	13	16
Fed Funds Future, Dec 2017	1,21	-3	-6	10	0
10 year US Treasuries	2,33	-3	-25	-4	-12
10 year Bunds	0,33	7	-16	17	22
10 year JGB	0,02	-4	-5	-4	-3
10 year Swiss Government	-0,12	10	-9	14	9
US Treas 10Y Performance	576,94	0,6%	2,4%	0,7%	1,3%
Bund 10Y Performance	617,58	0,5%	2,8%	1,2%	0,8%
REX Performance Index	483,68	-0,3%	0,1%	0,1%	-0,3%
US mortgage rate	0,00	0	0	0	0
IBOXX AA, €	0,62	-5	-22	-12	-6
IBOXX BBB, €	1,40	-4	-22	-14	-10
ML US High Yield	6,15	-1	-14	-13	-30
JPM EMBI+, Index	806	0,2%	2,0%	3,6%	4,4%
Convertible Bonds, Exane 25	7153	1,2%	2,5%	2,9%	3,4%
Commodities					
CRB Index	418,91	0,5%	0,6%	-2,1%	-0,4%
MG Base Metal Index	299,09	-1,8%	0,9%	2,7%	6,9%
Crude oil Brent	52,01	-4,4%	0,3%	-5,6%	-8,3%
Gold	1255,82	0,6%	4,6%	6,4%	8,5%
Silver	18,27	0,2%	7,9%	9,8%	13,8%
Aluminium	1905,25	-2,2%	2,0%	8,1%	11,8%
Copper	5739,75	-2,1%	0,4%	0,9%	3,9%
Iron ore	73,50	-8,7%	-14,5%	-7,5%	-8,1%
Freight rates Baltic Dry Index	1109	-9,3%	2,1%	24,0%	15,4%
Currencies					
EUR/ USD	1,0911	2,2%	2,9%	3,9%	3,5%
EUR/ GBP	0,8446	-1,2%	-3,6%	-2,7%	-1,1%
EUR/ JPY	122,36	3,3%	0,0%	0,2%	-0,8%
EUR/ CHF	1,0852	1,3%	1,0%	1,2%	1,1%
USD/ CNY	6,8941	0,0%	-0,2%	-0,6%	-0,9%
USD/ JPY	109,62	-1,0%	-4,5%	-5,0%	-6,2%
USD/ GBP	0,77	-3,4%	-5,8%	-6,6%	-4,3%

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