Europe: Financial Services

Equity Research

The French election outcome positive for banks, other financials

Second key election constructive for sector …

Post the Dutch election, the 1st round of the French presidential elections yielded a result which we think is constructive for the European Financials sector.

… as the pro-EU candidate wins 1st round

Following the 1st round of voting, Mr. Macron, the pro-EU centrist candidate, won with 24% of the vote, followed by Marine Le Pen (22%). The run-off voting round takes place on 7th May. With polls indicating that Mr. Macron is likely to emerge as the winner, we believe the market will interpret the result as positive for Financials overall, and banks in particular.

Banks: BNP, UCG, CABK, KBC key calls

We see the 1st round election outcome as beneficial for Eurozone banks overall, with the French, Italian and German banks likely to react most positively. Our positioning, which assumed a "benign" outcome, remains relevant and we recommend investing in **BNP**, **UCG**, **CABK** and **KBC** (all CL Buy). The attractiveness of these stocks rises with a normalizing political situation, in our view.

Insurance: Life insurers most geared

In an economically adverse scenario, non-life names would have benefited from their perceived 'defensive' qualities. As the market moves to price in lower political risks, we see life insurers as most exposed given their macro gearing, and therefore best placed to benefit from an economically positive outcome (e.g. Buy-rated **PRU** (on CL), **STJ**).

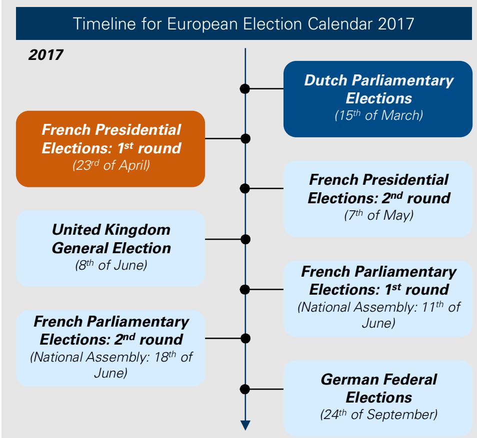
Diversified Financials: Volumes and asset price moves are key

Volatility is likely to boost trading volumes at **Euronext** (Buy) in any unexpected election outcome. An adverse election scenario is likely to boost appetite for non-EU assets, supporting **Ashmore** (Buy). **Italian asset managers** are likely to be strong in an unexpectedly positive outcome.

Real Estate: Prefer non-Eurozone in 'adverse'

In an economically benign scenario, we see upside potential from **Colonial** (CL-Buy) and **FDR**, **Icade** and **Gecina** (Buy). In a more adverse election scenario, we would expect **UK**, **Swiss** and **Nordic** landlords to outperform and highlight Buy-rated **Entra**, **Big Yellow**, and **Secure Income**.

EUROPEAN ELECTION CALENDAR



Source: Goldman Sachs Global Investment Research

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Exhibit 1: Overview of the European Financial Institutions Research Team

European Financials Research - Jernej Omahen, Head

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Source: Goldman Sachs Global Investment Research.

French election: constructive outcome, negative tail risk recedes

The French “first round”: pro-EU, centrist, candidate wins

The results of the first round election suggest the two candidates qualified for the second round are Emmanuel Macron with 24% of the vote and Marine le Pen with 22% of the vote, according to Kantar Sofres-OnePoint. This is close to the polls prior to the elections (source: Presitrack Opinionway). The same poll gives Mr Macron a large winning margin in the second round (65/35%). This is in line with our “benign scenario, in which a pro EU candidate wins the election.

A ‘Pro-EU’ candidate win likely to spark investor relief … some risk remains

Whilst the risk of an anti EU victory cannot be discounted entirely at this stage, opinion polls currently anticipate the eventual election of Mr. Macron by a wide margin. Our economists believe political risks and the associated market tension will recede on such an outcome. This view forms the central ‘base-case’ on which our forecasts and investment ratings are based.

Although seemingly remote, a Le Pen victory would be severe for the financials sector. In extremis, our economists believe this could extend all the way to break up of the Euro: for Ms. Le Pen’s *Front National* party, the manifesto includes re-setting France’s relationship with its European partners, greater protection of French industry, introduction of currency alternatives to the Euro and potentially a re-denomination of French sovereign debt.

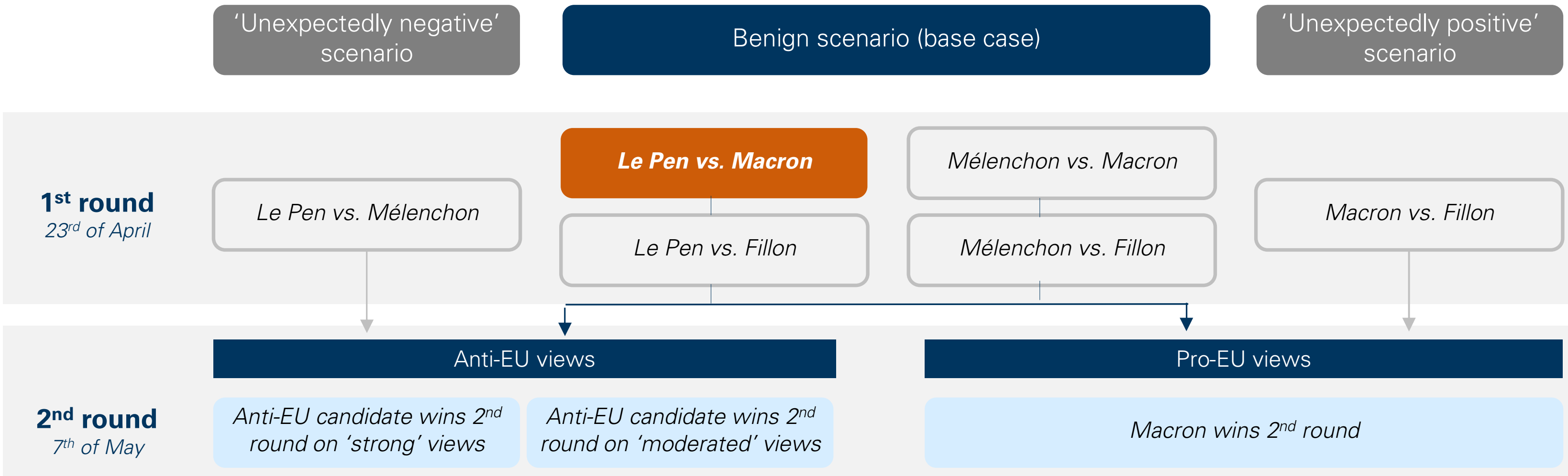
The next step from here: the set of outcomes narrows

Our economists detail a range of scenarios for the French election, we summarize their views below.

- **Base case: Pro EU Mr. Macron wins:** This is our economist’s base case. They expect the election of a ‘Pro-EU’ candidate to relieve market pressure, with declining sovereign yields, stable funding and quieter markets.
- **Tail-risk: Ms. Le Pen wins…**
    - **…with a moderated stance:** A Eurosceptic politician may opt to moderate their anti-EU rhetoric after the first round in an attempt to increase their chances of being elected President. Our economists see this as the most complex outcome for policymakers: Markets “*are likely to take a dim view*” of this outcome, in which “*few savers would be willing to hold a French bank deposit or French security ahead of a potential re-denomination and depreciation. Yet a failure of the ECB to underwrite French assets and bank funding in the face of capital flight would precipitate a de facto exit as the French financial sector seized up*”.
    - **… on an explicit Eurosceptic platform:** In the words of our economists, a victory for a Eurosceptic politician such as Ms. Le Pen “*on the basis of a clear mandate for immediate EU or Euro exit would likely render continued ECB support for French sovereigns or banks politically infeasible […] in this context, France would be subject to a ‘sudden stop’ and bank run*”. The tumult would be felt across the Eurozone, indeed “*the crisis would immediately become systemic: it would be an issue of Euro break-up”.*

Exhibit 2: Victory for Mr. Macron in the 1st round is consistent with our Economists' benign outcome view

Potential French Presidential Election scenarios, and the possible economic implications they may have, based on GS economists' views



Impact on France	Strong anti-EU views	Moderated anti-EU views	Mainstream candidate wins
Debt spreads	• Spreads widen to point of distress	• Spreads widen considerably, causing significant stress	• Spreads eventually recede from the election related widening
Bank Funding	• Full-blown 'bank run' in France	• Finance sector 'seizes up'; capital controls & deposit blocks required	• Bank funding stable with ECB liquidity lines in place
GDP	• 'Sudden stop' to the French economy	• Significant negative impact	• Baseline assumption for the outlook of the French macro remains
Financial Markets	• Sustained market volatility; broad 'market dysfunction'	• Significant 'market dysfunction'	• Market pressure relieved from election related volatility
Impact on Europe			
Political landscape	• ECB sidelined as national governments seek solution	• ECB unable to intervene; significant political uncertainty	• Membership of EU and Euro area maintained as *status quo; ECB* is 'off the hook'
Financial markets	• Significant contagion; systemic Euro-area issues	• Modest negative impact	• Baseline assumption for the outlook of the European macro remains

Source: Goldman Sachs Global Investment Research

Exhibit 3: Our stock selection is predicated on a benign outcome for the election cycle. The 1st round results are therefore supportive of our ratings
Summary of our view on the relative performance of various financial sub-sectors, and stocks within them

		Financials Sub-Sectors			
Electoral Outcome	**Key**	**Banks**	**Insurance**	**Diversified Financials**	**Real Estate**
'Unexpectedly positive' scenario	Relative to Financials sector	+ +	+	+ +	–
	Relative to sub-sector	Best for: **French, Italian & German banks**	Best for: **Life insurers**	Best for: **Italian asset managers**	Best for: **French, Spanish & Italian REITs**
Benign scenario (base case)	Relative to Financials sector	+	=	=	+
	Relative to sub-sector	Best for: **UCG, BNP, KBC, CABK**	Best for: **PRU, ZURN, ALVG SJP**	Best for: **AZMT, BGN, ASHM, ENX, EMG**	Best for: **COL, FDR, ICAD, GFCP, LOIM**
'Unexpectedly negative' scenario	Relative to Financials sector	–	=	+	+ +
	Relative to sub-sector	Best for: **UK, Swiss & Nordic banks**	Best for: **Non-life insurers**	Best for: **Ashmore & Exchanges**	Best for: **UK, Nordics & Swiss REITs**

Key

- + Positive relative to other financial sectors
- = Neutral
- – Negative relative to other financial sectors

Source: Goldman Sachs Global Investment Research.

Mapping Eurozone election cycle onto financial stocks: Elections will impact preferences

In our April 19 report (*Mapping the Eurozone election cycle onto Financials: Between two tails, a solid base case*), we examined likely impacts on the Financials sector in three scenarios. With Mr. Macron and Ms. Le Pen in the French Presidential election run-off, we can eliminate the positive tail risk scenario, given there is still an anti-EU candidate with a chance of being elected. However, (1) the absence of two anti EU candidates in the French election run-off, and (2) the polls for the run off pointing to Mr. Macron as a large winner suggest that the base case benign outcome is the most likely outcome. The two remaining scenarios are:

1. **Our base case: Benign election outcomes**: The base for our current positioning, with the added potential for a relief rally. Banks and real estate most likely to benefit.
2. **"Negative tail risk"** outcomes: Least adversely impacted - Non-Eurozone & global retail banks, non-life insurers, asset managers and real estate.

1. GS base case, and hence our positioning, is for benign election outcomes to drive a relief rally

The outcome of the recent Dutch election was at the benign end of the spectrum. This resulted in a modest tightening of Dutch spreads and a positive reaction from investors across European banks, insurers, and other financial stocks. The polls suggest a similarly benign outcome is likely in France too, while few outcomes from the German election currently seem problematic for investors.

This outcome forms the basis of our 'base case' stock-specific recommendations. We expect this scenario to prove **positive for Banks, both an absolute basis and relative to the financial sub-sectors**. A benign electoral cycle would remove tail-risk uncertainty, likely leading to tighter spreads, (even) easier funding conditions and potentially improved asset performance. We also expect **Real Estate stocks to perform well in our base case**, supported by continuation of inexpensive debt financing and an improving macro-economic backdrop.

Our current ratings reflect this anticipated outcome:

- **Banks:** As outlined in *The Aggregate Picture: Rate gearing, the great valuation gap & receding political risk*, published March 29, 2017, we favour banks where the investment case offers attractive upside even assuming the rate environment does not change. The three themes among our Buy-rated stocks on the Conviction List are: (1) capital return (**BNP**, **KBC**, **Nordea**); (2) Spain real estate improvement (**Caixabank**); and (3) credible restructuring (**Unicredit**). While all five banks are highly geared to higher rates, their investment case should not weaken if rate hikes do not materialise.
- **Insurance:** Our current top picks in the insurance sector are **Prudential** and **Zurich**, both of which are Buy rated and members of our pan-European Conviction List. We continue to see higher EPS growth for Prudential (8%, twice the level of the sector average) driven by its Asian business, which trades at a 2018E P/E of 12.3x, in line with the sector. We also believe that Zurich offers an attractive dividend yield to investors (currently 6.5% 2017E), which is underpinned by a high level of balance sheet strength. We estimate Zurich has c.CHF6.5 bn of "unencumbered liquidity".
- **Diversified Financials: Ashmore** (Buy) recently reported its first inflows in 11 consecutive quarters, highlighting the continued recovery in demand for EM debt. We are also positive on the outlook for Italian asset managers, specifically **Azimut** (CL Buy) and **Banca Generali** (Buy) which reported annualised inflows of 11% and 14%, respectively, in the first two months of the year and would benefit from a 'benign' election outcome, in our view. Our Sell-rated stocks, **BME** and

Partners Group, are expected to underperform in a 'benign' scenario, due to structural headwinds and an expensive valuation, respectively.

- **Real Estate:** Eight of 12 Buy-rated names in our real estate coverage (e.g. **Colonial**, CL Buy) are largely focused on offices, a more cyclical sub-sector. Other Buy ratings are mostly focused on niche sub-markets, such as hotels (e.g. **Hispania**, Buy). Buy-rated **Gecina**, **Icade**, and **Fonciere des Regions,** in addition to Colonial, own portfolios with over 50% of assets in France.

For more detail of how an adverse French election result might impact markets please see our Strategist's report *Frexit: what should you expect for European equities*? (March 15, 2017) and our Economist's note *The ECB and French elections — Managing market tension around a flirtation with Frexit* (February 24, 2017)

2. "Negative tail risk" not yet fully ruled out: Non-Eurozone & global retail banks, non-life insurers, asset managers and real estate

In one of the highly adverse scenarios foreshadowed by our economists (such as the election of Ms. Le Pen as President of France on an overtly anti-EU policy platform), they see risks of significantly wider sovereign spreads, strains in bank funding, material deposit flight and dysfunctional asset markets.

This would likely be **negative for the whole European Financial Services sector**. The anticipated widening in sovereign spreads is likely to be **particularly negative for European banks**. Depending on the severity and duration of any negative scenario, our economists see the potential for flight across institutional and retail deposits. We believe **Real Estate stocks would perform best on a relative basis** due to their asset backing and cash-flow support. **Exchanges may see an increase in near-term trading volumes** as a result of higher market volatility.

Mapping this scenario onto our coverage universe suggests:

- **Banks:** We view **French banks** as most exposed to an adverse outcome from the domestic election, although we would also expect **other banks with meaningful Euro-area exposures to see significant weakness too**. We anticipate that well-capitalized and profitable banks outside the Euro-area (**Nordic, select CEE banks**), and banks with substantial non-European operations (**HSBC, Standard Chartered, Santander, BBVA, Erste, ING, KBC**) would prove more defensive in such a scenario.
- **Insurance:** We see European life insurers as most acutely exposed to the likely negative mark-to-market effects on earnings and solvency positions. **Non-life insurers** (e.g. Nordics, Swiss and UK motor insurers, as well as reinsurers) are likely to benefit from their perceived 'defensive' qualities, including a lower level of macro gearing and asset leverage. Our preferred picks in this bucket include **Munich Re, Swiss Re, RSA, Saga** and **Helvetia** (all Buy-rated).
- **Diversified Financials:** Investor appetite for EM debt is likely to hold-up far better than demand for European debt products, supporting **Ashmore** (Buy). Increased volatility is likely to boost trading volumes across the French, Dutch, Belgian and Portuguese equity markets, which we view as positive for **Euronext** (Buy). The **Italian asset managers** are likely to be adversely impacted by declines in the value of Eurozone fixed-income assets.
- **Real Estate**: **French and Italian-listed stocks** or **stocks with significant portfolio exposure to these countries,** including Sell-rated **Mercialys** and **Eurocommercial** would be most exposed to an 'adverse scenario' considering the heightened uncertainty that would prevail. Additionally, a flight to quality would likely be more detrimental to **stocks with peripheral exposure** (i.e. Spain and Central Europe), more cyclical office exposure and higher financial gearing. Conversely, stocks with UK, Swiss or Nordic (to a lesser degree) exposure would fare better in our view. We highlight Buy-rated **Entra**, **Big Yellow**, and **Secure Income**. In a Euro context, German residential landlords would likely be perceived as "safer" havens considering their lower-risk business model and highlight our preference for Grand City and LEG (rated Neutral).

Eurozone election uncertainty will be a feature of the investment landscape in 2017

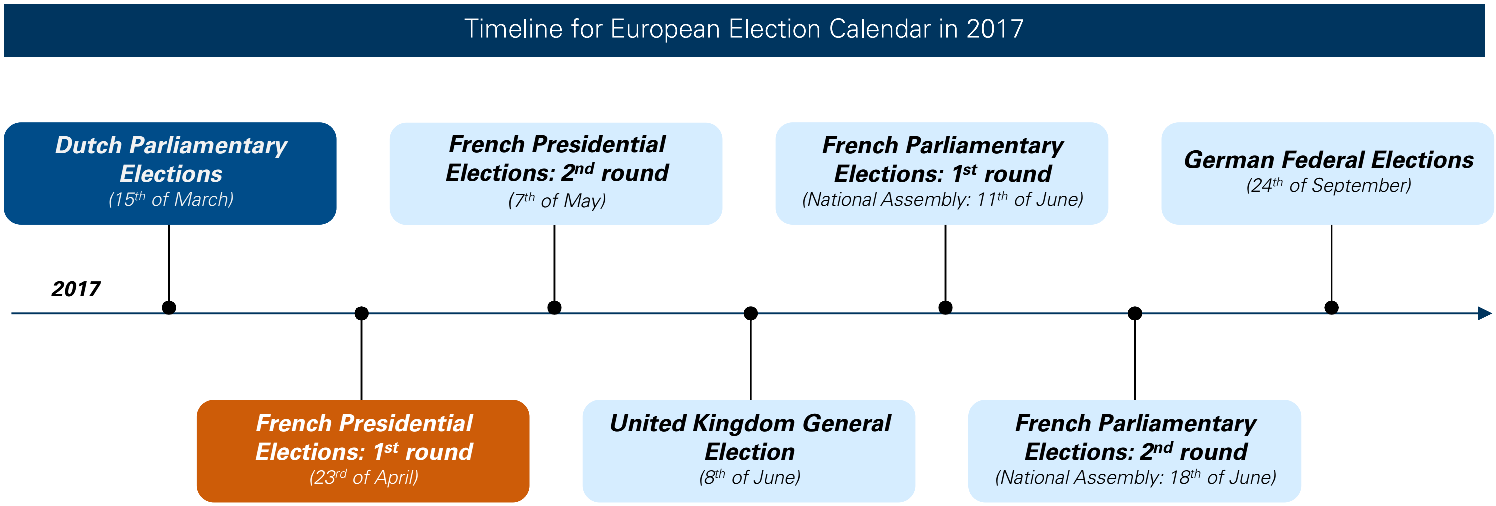
The Eurozone will see six (possibly seven) national elections this year

The recent Dutch election was the first of six votes scheduled this year across the major Eurozone countries which include:

- **French Presidential elections:** The first stage of the French Presidential elections took place on April 23. A second vote will take place two weeks later (May 7). This will be a simple run-off between the two nominees that receive the greatest share of first round votes.
- **French Parliamentary elections:** The French Parliamentary vote will follow one month after the Presidential election is concluded. The appointment of the legislature similarly follows a two-stage process, and ends with a final vote on June 18.
- **German Federal elections:** The German election comprises a single-round vote on September 24. The election is almost certain to result in a coalition government, with electoral success determining its composition and key roles, in our economist's view.
- **Italian elections**: Italy's Prime Minister, Mr. Matteo Renzi, stood down following defeat in last December's referendum. New elections must be held by May 2018, and could be held earlier should the ruling coalition collapse.

There are also national elections in a number of non-Eurozone countries this year, including in Norway (September 11), the UK (June 8) and the Czech Republic (October).

Exhibit 4: Election calendar in Europe in 2017 will see important elections in the Netherlands, France as well as Germany
Timeline for key European election calendar in 2017. There is currently no scheduled election in Italy



Source: Goldman Sachs Global Investment Research.

Why elections matter: Recent votes have been turning-points for financial services

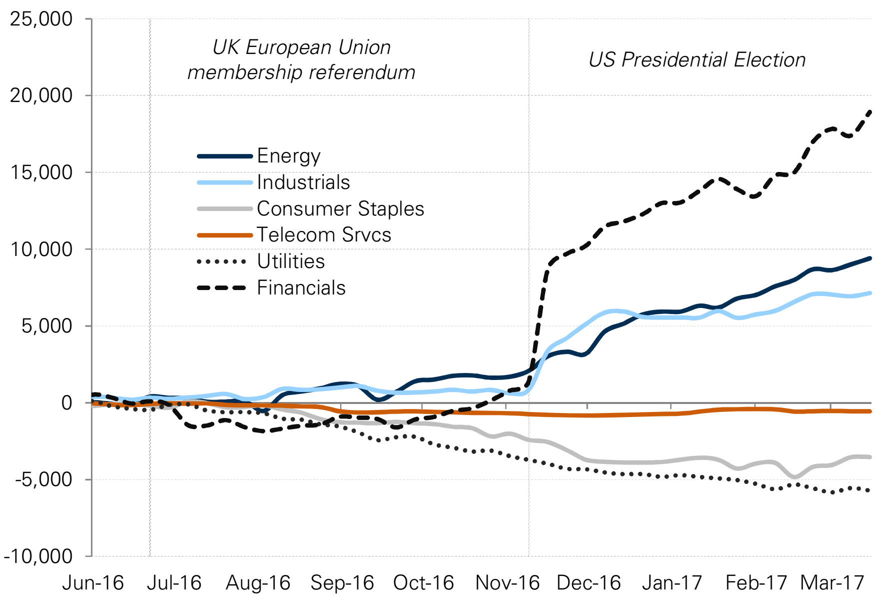
Brexit and US election demonstrate why investors need to keep an eye on the election cycle

The US election and Brexit vote both proved points of inflexion for financial stocks. This is perhaps unsurprising given the degree to which political and economic policy can influence returns across the financial sector.

- **UK referendum:** Sterling has fallen 17% since the UK voted to leave the European Union, driving translational gains for many UK groups (FX moves increased Schroders's AUM by £42 bn last year, for example). Subsequent moves in mega-cap stocks such as HSBC (which has outperformed the MSCI European banks index by 16% since the Brexit vote) illustrates the degree to which investors in financial stocks need to be cognizant of changes in the political and economic landscape.
- **US election:** US banks have outperformed the S&P500 by 21% since the US election (+31.4% vs. +10.4%), while broader US financial services stocks have outperformed by 13.1% (+23.5% vs. +10.4%). There has been some benefit for European banking groups too, which have outperformed the MSCI Europe index by 4.3% since the US election.

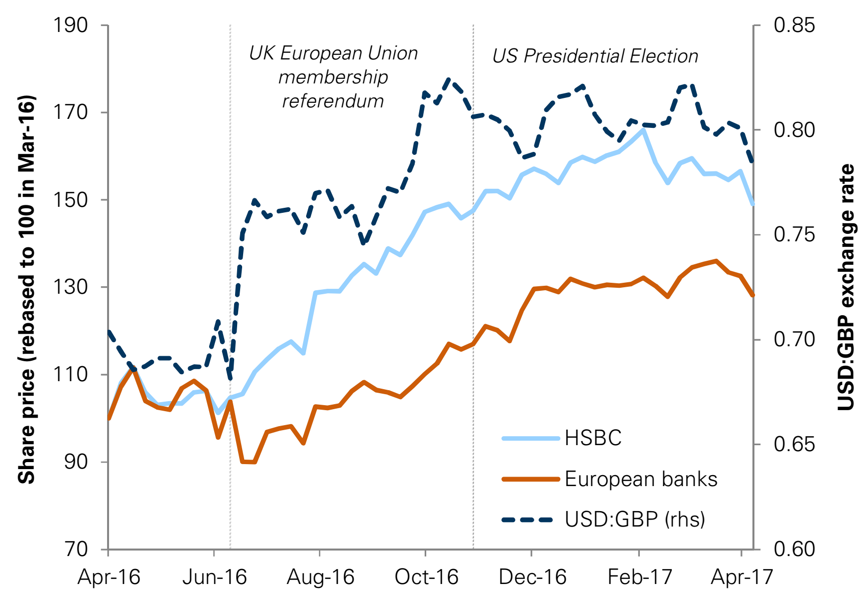
These examples reinforce the need for investors to be mindful of the Eurozone election cycle and its potential to impact the prospects for companies across the financial services sector, in our view.

Exhibit 5: Financials funds saw significant post-election inflows
Cumulative flows into sector-specific equity products, USD mn



Source: Lipper, Goldman Sachs Global Investment Research.

Exhibit 6: The UK referendum spurred sharp relative price moves in Banks
USD:GBP exchange rate (RHS), HSBC share price and MSCI Europe banks index



Source: Lipper, Goldman Sachs Global Investment Research.

Rating and pricing information

Allianz SE (B/N, €170.25), Ashmore Group (B/N, 347.00p), Azimut Holding (B/N, €17.12), Banca Generali (B/N, €24.93), Big Yellow (B/N, 766.00p), BNP Paribas (B/N, €62.00), Bolsas y Mercados Espanoles (S/N, €32.67), CaixaBank SA (B/N, €3.93), Colonial Inmobiliaria (B/N, €6.77), Entra Holding (B/N, Nkr96.50), Eurocommercial (S/N, €34.19), Euronext Group (B/N, €42.85), Foncière des Régions (B/N, €78.96), Gecina (B/N, €126.05), Grand City Properties (N/N, €17.37), Helvetia Holding (B/N, SFr549.50), Hispania Activos Inmobiliarios SA (B/N, €13.95), Icade (B/N, €68.23), KBC Group (B/N, €62.04), Klepierre (B/N, €34.60), LEG Immobilien AG (N/N, €77.10), Man Group (B/N, 149.20p), Mercialys (S/N, €17.12), Munich Re (B/N, €182.40), Nordea (B/N, Skr103.40), Partners Group (S/N, SFr574.50), Prudential Plc (B/N, 1,640.50p), RSA Insurance Group (B/N, 573.00p), Saga Group (B/N, 208.00p), Secure Income REIT Plc (B/N, 345.75p), St. James's Place Plc (B/N, 1,086.00p), Swiss Re (B/N, SFr88.90), UniCredit (B/N, €13.64) and Zurich Insurance Group (B/N, SFr264.60)

Disclosure Appendix

Reg AC

We, Jernej Omahen, Chris Turner, CFA, Johnny Vo, Jean-Francois Neuez and Julian Livingston-Booth, hereby certify that all of the views expressed in this report accurately reflect our personal views about the subject company or companies and its or their securities. We also certify that no part of our compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

Unless otherwise stated, the individuals listed on the cover page of this report are analysts in Goldman Sachs' Global Investment Research division.

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Growth is a composite of next year's estimate over current year's estimate, e.g. EPS, EBITDA, Revenue. **Return** is a year one prospective aggregate of various return on capital measures, e.g. CROCI, ROACE, and ROE. **Multiple** Multiple is a composite of one-year forward valuation ratios, e.g. P/E, dividend yield, EV/FCF, EV/EBITDA, EV/DACF, Price/Book. **Integrated IP score** is a composite of Growth, Return and Multiple scores.

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Disclosures

Coverage group(s) of stocks by primary analyst(s)

Jernej Omahen: Europe-Pan-Euro Banks. Chris Turner, CFA: Europe-Diversified Financials. Johnny Vo: Europe-Insurance. Jean-Francois Neuez: Europe-Pan-Euro Banks. Julian Livingston-Booth: Europe-Real Estate.

Europe-Diversified Financials: Aberdeen Asset Management, Amundi, Anima Holding SpA, Ashmore Group, Azimut Holding, Banca Generali, Banca Mediolanum SpA, Bolsas y Mercados Espanoles, CMC Markets Plc, Deutsche Boerse AG, Euronext Group, London Stock Exchange, Man Group, NEX Group, Partners Group, Schroders.

Europe-Insurance: Admiral Group, Allianz SE, Assicurazioni Generali, Aviva Plc, AXA, Baloise, Delta Lloyd, Direct Line Group, Gjensidige Forsikring ASA, Hannover Ruckversicherung, Hastings Group, Helvetia Holding, Legal & General Group, Munich Re, Old Mutual Plc, Prudential Plc, RSA Insurance Group, Saga Group, Sampo, SCOR, St. James's Place Plc, Standard Life Plc, Swiss Re, Topdanmark A/S, Tryg A/S, Zurich Insurance Group.

Europe-Pan-Euro Banks: ABN Amro Group, Alpha Bank, Arrow Global Group, Banca Monte dei Paschi di Siena, Banca Popolare Emilia Romagna, Banco BPI, Banco BPM SpA, Banco Comercial Portugues, Banco Popular Espanol, Banco Sabadell, Banco Santander, Bank of Ireland, Bank of Piraeus, Bank Pekao, Bank Zachodni WBK, Bankia, Bankinter, Barclays Plc, BBVA, BNP Paribas, CaixaBank SA, Commerzbank AG, Credit Agricole SA, Credit Suisse, CYBG Plc, Danske Bank, Deutsche Bank, DNB, EFG International, Erste Bank, Eurobank Ergasias SA, HSBC, ING Groep NV, Intesa Sanpaolo, Investor AB, Julius Baer Group, KBC Group, Komercni Banka, Lloyds Banking Group, Metro Bank Plc, Moneta Money Bank AS, National Bank of Greece, Natixis, Nordea, OTP Bank Plc, PKO BP, Provident Financial, Raiffeisen Bank International, Resurs Holding, Royal Bank of Scotland, SEB, Shawbrook Group, Societe Generale, Standard Chartered, Svenska Handelsbanken, Swedbank, UBI Banca, UBS Group, UniCredit, Van Lanschot NV, Virgin Money Holdings, Vontobel.

Europe-Real Estate: Aroundtown Property Holdings, Beni Stabili, Big Yellow, British Land, CA Immo, Castellum, Citycon, Cofinimmo, Colonial Inmobiliaria, Derwent London, Deutsche Wohnen AG, Entra Holding, Eurocommercial, Fabege AB, Foncière des Régions, Gecina, Grand City Properties, Great Portland Estates, Hammerson, Hispania Activos Inmobiliarios SA, Hufvudstaden, Icade, Intu Properties, Kaufman & Broad SA, Klepierre, Land Securities, LEG Immobilien AG, Mercialys, Merlin Properties Socimi SA, PSP Swiss Property, Secure Income REIT Plc, SEGRO Plc, Shaftesbury, Unibail-Rodamco, Vonovia, Wereldhave.

Distribution of ratings/investment banking relationships

Goldman Sachs Investment Research global Equity coverage universe

Rating Distribution	Investment Banking Relationships

	Buy	Hold	Sell	Buy	Hold	Sell
Global	33%	53%	14%	63%	57%	50%

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