

35 percent. How low can you go?

"The President of the Commission, Mr. Delors, said at a press conference the other day that he wanted the European Parliament to be the democratic body of the Community, he wanted the Commission to be the Executive and he wanted the Council of Ministers to be the Senate. No. No. No."

Margaret Thatcher, Houses of Parliament, 30th October 1990.

Opening with a quote from Margaret Thatcher is unusual in these politically moribund times, but as the European elections approach on 22nd May, there is a sense that people across Europe are waking up to what the EU is really all about and debating whether a federal super state is really what they've signed up for. In a document gravely titled the Solemn Declaration on European Union, the stated aim of the EU is "Ever closer union". To many, this may be taken to mean ties of an economic nature, such as free trade. Or politically, perhaps no more than a conglomeration of individual sovereign states with some vague notion of shared values and ambitions. But what we have looming on the horizon, and what the eurozone definitely has, is something just short of what Margaret Thatcher predicted 24 years ago. Amid the never ending soap opera that is the EU/eurozone, the ambition of the European Commission, the

executive body, is to push for even more centralised power in Brussels involving powers being surrendered by national parliaments and sovereign central banks towards the European Central Bank.

The most visible and tangible example of this is the Euro currency. Some will remember its predecessor, the ECU (European Currency Unit), a soft currency of which Margaret Thatcher was deeply sceptical. Back then, there was an idea that the ECU would trade alongside the national currencies of the French Franc, German Mark and Dutch Guilder, for example, but allowing for pan-European accounting and pricing in ECUs. The basket of sovereign currencies, which included Sterling of course, was an exchange rate mechanism where central banks would endeavour to maintain FX rates within specified bands whilst maintaining some independence. We all know how that ended.

Beyond that, many people across the European Union, and particularly the eurozone, are relatively unaware of how the EU and the Euro really work. Indeed, in the wake of the first Greek debt crisis with riots breaking out and central Athens in flames, one high ranking EU official was quoted as saying that it was a good thing that Greeks were unaware that the Euro was to blame for the country's ills. Greeks have overwhelmingly wanted to stay in the Euro before, during and after the crisis.

The ignorance or indifference of the voting public also blights European elections. The turnout in 2009 was down to 43% compared to 62% in the first elections in 1979. But ask how many people actually know who Herman van Rumpoy is (Nigel Farage famously didn't) or that he is President of the European Council and represents the heads of Governments of EU member states. What about Jose Manuel Barroso, President of the European Commission? And what is that? Some may be surprised to know that it's the executive branch of the EU in charge of legislature and, therefore, the most powerful office in the EU.

But if you're voting on the 22nd May, you won't be seeing these names or voting on these posts. Barroso was appointed by the European Council as a result of the nomination of the most powerful party within it, the European People's Party, or EPP. A successful vote for your local MEP only gets them membership of a 751 strong European Parliament that has no power to pass any laws unlike, say, the UK House of Commons. That's done by the unelected executive, the European Commission.

The mathematics of winning the European elections hinge on how many turn out to vote and this year and it may break the record for the lowest level of interest across the EU. Those with the strongest sentiment against the EU are more likely to vote than the silent status quo – hence the vote may be skewed towards eurosceptic parties that will subsequently fail to feature so strongly in national elections when people are more concerned with voting on the state of the economy.

Insofar as any political body influences the economy, and therefore markets, we don't see the Euro elections having a material impact one way or another. If we are just talking about the UK, then UKIP was always the favourite to win among EU followers assuming they could get their act together to overtake a rather benign approach to the whole thing by Labour with Conservatives trailing in with the pro-Europe Lib Dems. If at some point in the future the UK were to get an in/out referendum that would really shake things up but nobody is thinking about that this side of a Scottish independence vote let alone the general election.

At the EU level, we do not think that markets are even concerned about a new left-leaning European Commission President in the guise of the widely tipped Martin Schultz given that his incumbent, Jose Manuel Barroso is a self confessed Maoist. Mr. Schultz already chairs Euro parliament debates anyway.

For stock and bond markets, we are more interested in the policies being pushed by the sovereign states of UK, France and Germany and the ECB's Mario Draghi, who is more closely watched than any of the domestic politicians. He has a problem with the legal structure of the ECB and cannot act with the independence of the US Federal Reserve when it comes to policy intervention with things like QE. Mr. Draghi has paid the market a lot of lip service to defend the euro, and keep European Union together, with his "whatever it takes" statement (hence the strength of the Euro) but the time has come for the ECB to deliver with negative interest rates and real plans for QE, both of which Germany objects to, or markets may call his bluff.

It has been a difficult second quarter for many investors because many expected the simple economics of supply and demand to kick in as central banks, notably the Federal Reserve, wound down their bond buying programs. One would imagine that the biggest buyer of bonds shutting down would naturally see the price of bonds fall and, therefore, yields rise. But the opposite has happened. In part this is down to a quite serious fall in inflation across the eurozone which would keep interest rates, and bond yields, lower for longer – even in Germany. UK Gilts are not wholly immune to falling yields and the differential, or spread between, UK and German whilst wider than before, has acted as a pull for lower Gilt yields.

There is also the uncomfortable notion that central bank support for bonds acted like a free bet for investors to take on more risk. If the Federal Reserve, say, is underwriting the stability of markets and making it clear that rates will stay low, one might feel more comfortable about buying debt in emerging economies. If that goes, it's not hard to see why a return to safe haven assets actually pushes bonds up rather than down due to less buying by the central bank.

Ultimately, lower interest rates are good for equities of any hue. Genuine growth stocks look even better in low interest rate environments because of the higher value of discounted future earnings. Our conviction towards equities is as strong today as our opening 2014 Outlook report in January. It may be a rocky summer but we believe equity returns will reward the brave.

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