



## "That's another fine mess you've gotten me into!"

In the wake of the last Italian election, we released an article highlighting the volatile nature of Italian politics. Since then, and true to form, Italy has managed to deliver another bout of political chaos which now marks the longest period of uncertainty for Italian politics since WW2. We will endeavour to explain where we are on this roller coaster and our position for clients.

The coalition of the Five Star and the Justice League may have the majority vote from the people, but they still need to have cabinet approved by the Head of State, President Sergio Mattarella. On Sunday, he vetoed the latest submission for a new finance minister from the populist coalition claiming the candidate is a staunch Eurosceptic who has openly talked about plans for Italy to abandon the Euro. Whilst this Presidential veto

prompted congratulations from the French Prime Minister, there were calls for the President to be impeached in Italy. In response to the chaos, the President this week appointed Carlo Cottarelli, a former IMF official, to the task of forming a caretaker government to keep the Italian government functioning until a more permanent solution can be agreed.



Now, any new government, even a caretaker government, needs the backing of parliament. At this point, the largest force in Italian politics is the Five Star and Justice League coalition who will need to give their backing to any alternative government proposed. Essentially, the chances of the populist coalition approving the signing in of a caretaker government and thus approving their own demise is slimmer than Italy winning this year's world cup.

So, where does that leave our Italian friends? Either a fresh round of Italian elections will take place after June or the populist leaders of both Five Star and the Justice League will once again try to form a government that the President can sign off on. That's where we are right now.

There is a very real possibility that this will result in an even larger majority for the populist parties in any subsequent round of elections. If populism takes a clear majority in another election, there will be no real way to keep a lid on the implementation of very radical changes to Italian monetary and fiscal policy. Indeed, many commentators believe the simple act of another round of elections is a de-facto referendum on Italy remaining in the Eurozone.

The second fear for markets is that the Five Star and Justice League's manifesto hints at slashing taxes and increasing public spending, which will only further burden an already debt-laden economy which lacks any serious GDP growth. This scenario dramatically raises the probability of another Eurozone debt crisis which, given the anti-EU views of the new populist party in Italy, could throw an Italian exit from the Eurozone into sharp focus.

How this will unfold is unknown, but the hope is that fresh talks between the President and the Five Star and Justice League can end with some constructive agreements, enabling a government to form that suits both the people and the pro-EU centralists in Italy. This will most likely hinge on securing some commitments to remaining in the euro over the longer term. Indeed, as of this morning, this scenario already seems to be playing

out. However, if Italian politics has taught us anything, it's that anything can happen.

In response to the developing situation, TAM has reduced its client's exposure to the euro currency to limit any negative short-term effects on portfolios should the Italian situation deteriorate. We do however believe that cooler heads will ultimately prevail for Italy which should allow European markets to get back on an even keel. The growth fundamentals continue to exist in the Eurozone and we continue to maintain our exposure to continental European equities through investing in a diverse sub set of equity opportunities that should be able to weather any short-term volatility arising from the Italian debacle.

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