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The Midterms Delivered a Big Shift. What Comes Next?

A new Democratic majority could change the direction of policy in Washington, with implications stretching from the AI buildout to the economy and the 2028 election.



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What You Should Know

- Affordability helped drive the vote, but candidate quality mattered, too. Democrats made gains across demographic groups and in traditionally Republican territory, with moderate candidates performing particularly well.
- A Democratic Congress will have more power to challenge the Trump administration than to enact sweeping legislation. Divided government raises the likelihood of gridlock, while giving Democrats greater influence over funding, investigations, presidential appointments, and other policy priorities.
- The election introduced a new variable for the AI boom. Growing state and local resistance to data centers could slow development, raise costs, and create additional uncertainty for companies tied to the AI buildout.
- The political implications extend well beyond Election Day. A crowded lame-duck agenda comes first, while the durability of Democrats' gains and both parties' ability to build winning coalitions will help shape the run-up to 2028.

The American people spoke, and they were loud. Democrats made major gains in the 2026 midterms, taking control of both the House and Senate in an outcome few expected just months, or even weeks, ago. With some final results still pending, the political landscape looks markedly different than it did heading into Election Day.

Here's where the count stands as of November 6:

- **The House** – Democrats needed a net gain of three seats to reach the 218 needed for a majority. They're on track to win 40 to 45 additional seats, bringing their total to nearly 260, which could give Democrats their largest House majority since 2008.
- **The Senate** – Democrats needed to hold their seats and pick up four. They've won seven Republican-held seats, including South Carolina, North Carolina, Texas, Kansas, Maine, Ohio, and Iowa. Democrats also currently lead in Mississippi and Alaska. If those leads hold, Democrats would have a 56-44 majority, their largest since 2008.
- **The Governors** – Democrats are trending toward holding 28 of the 50 governorships. Several state legislatures also flipped to full Democratic control, including Arizona, Michigan, Wisconsin, Minnesota, and Nevada.

Three key indicators we were watching ahead of the election all pointed to sizable Democratic gains: presidential approval averaged 38%, independent voters favored Democrats 58% to 38%, and when asked which party voters preferred for Congress, Democrats held a 9-point average advantage. Even so, the final outcome was far larger than those indicators suggested.

What Drove the Democratic Gains?

Affordability appears to have been a major driver of the results. With inflation hovering around 3.7%, the Federal Reserve (Fed) moving back toward tighter monetary policy, and September job growth coming in at just 29,000, economic concerns remained front and center for voters.[1] Exit polls also pointed to dissatisfaction with the administration on issues such as immigration and the war in Iran.

Several groups that shifted toward Republicans in 2024 moved sharply toward Democrats, including Hispanic voters, Gen Z, and independents. But recent elections have shown how quickly these groups can move between parties, making it too early to assume those shifts are permanent.

Candidate quality mattered, too. Democrats won well beyond their traditional strongholds, aided by candidates such as Annie Andrews, Roy Cooper, and James Talarico, who ran more locally focused campaigns. Moderate Democrats also outperformed more progressive candidates in several states, suggesting the new majority may enter 2027 with a more centrist tilt and potentially more openness to bipartisan deals.

What Divided Government Means for Policy

Divided government is back. Democrats will control both chambers of Congress, but President Donald Trump still holds the veto pen, and even a 56-seat Senate majority falls short of the 60 votes generally needed to advance most legislation past a filibuster. That sets the stage for legislative gridlock, but hardly makes Congress powerless.

Beginning in January, Democrats will control government funding bills (the appropriations process), congressional committees and investigations, and the Senate approval process for presidential appointments, giving them considerable leverage over the administration. They're also expected to make affordability a legislative focus, with healthcare, tariffs, consumer protections, and limitations on presidential war powers among the early priorities. Some areas could offer room for compromise with the White House, but oversight, investigations, funding battles, and confirmations may ultimately define the next two years.

The biggest practical impact may come through hearings, investigations, and budget negotiations rather than standalone legislation. For markets, the bigger questions may be where divided government creates policy stability and where funding, trade, or regulatory fights introduce new uncertainty.

- **Where Compromise Is Possible** – Drug pricing and housing could offer opportunities for bipartisan action, while larger issues such as Social Security and immigration remain longer-shot possibilities. AI legislation may also be on the agenda, although meaningful action appears less likely.
- **Confirmations and Oversight** – A Democratic Senate will have substantial leverage over presidential appointments requiring Senate approval, including nominees to the Fed, which could mitigate some concerns about Fed independence. Democrats will also control congressional committees and investigations, increasing scrutiny of the administration and private-sector industries.

> “A divided Washington doesn't necessarily mean a powerless Congress.

- **Fiscal Policy** – The 2027 debt-ceiling debate could become a significant source of market uncertainty, particularly if Democrats use it to seek concessions on healthcare, tariffs, or the Iran war. Past debt-ceiling standoffs have created bouts of market volatility, and a prolonged fight in 2027 could do the same. Brinkmanship could intensify approaching the "X date," when the Treasury is projected to exhaust its ability to keep paying the government's bills. Either way, deficits are expected to remain above 6%, while Treasury yields could decline over the next year as easing inflation outweighs fiscal concerns.
- **Foreign Policy** – A Democratic Congress could increase oversight, push for additional Ukraine aid, challenge the president's use of military force, and use funding negotiations as leverage. But Trump retains considerable executive authority over foreign policy, including export controls, sanctions, immigration enforcement, and tariffs. The result could be a more constrained presidency in 2027 and 2028, but hardly a powerless one.

A New Risk for the AI Buildout

The election also introduced a new risk for the AI buildout: growing state and local resistance to data centers. Of the 41 data-center measures on ballots November 3, voters favored greater restrictions in all but one, including measures involving bans, moratoriums, and additional development requirements.[2] Several newly elected Democratic governors also campaigned on restricting data-center development in states with significant planned capacity.

Markets were quick to react. AI and semiconductor stocks sold off sharply following the election, with the Nasdaq Composite Index falling 5.52% on November 5 and shares of many companies tied to the AI buildout falling even further.[3] But the election wasn't the only pressure on the sector. The AI trade was already facing questions about high interest rates, heavy capital spending, and whether future returns would justify the scale of investment. The election added another layer of uncertainty around how quickly planned data-center capacity can actually come online.

We don't think this is simply election-year rhetoric. Concerns about electricity costs, water use, and development have increasingly made data centers a local political issue, and state and local governments have considerable influence through permitting, zoning, and tax incentives. More restrictions could raise costs for the large technology companies building data centers at scale (hyperscalers), put greater pressure on smaller AI and cloud-computing companies, and delay or cancel some projects.

> "The election adds a layer of uncertainty around how quickly the AI buildout can move.

What's Left on Congress' 2026 Lame-Duck Agenda

The current Republican majority has only a few legislative weeks left before the new Congress takes over in January. During this lame-duck session (the period between the election and the start of the new Congress), several key priorities remain:

- **Government Funding** – The current continuing resolution, a temporary measure that keeps the government funded, expires December 11. Congress will need to approve fiscal 2027 funding or another short-term extension to avoid a government shutdown.
- **Defense** – Congress still needs to pass the annual National Defense Authorization Act (NDAA), which sets defense policy and authorizes Pentagon programs. Although the bill traditionally receives bipartisan support, this year's negotiations are complicated by debates over $1.14 trillion in proposed defense funding, a separate $350 billion Republican reconciliation package, and as much as $200 billion in emergency spending for the Iran war.

- **Energy Permitting** – The Bipartisan American Jobs and Affordability Act aims to speed up the permitting process for energy infrastructure projects, including power generation and transmission. The Senate is expected to take up the bill during the lame-duck session, but its path through the House remains uncertain.
- **Other Unfinished Business** – Congress also faces several expiring or unfinished programs, including the Farm Bill, which covers agriculture programs and food assistance; federal surface transportation programs; and potential legislation establishing rules for digital assets and crypto markets.

What the 2026 Midterms Could Mean for 2028

It's too early to draw firm conclusions about 2028, but the size of Democrats' new majority could make it harder for Republicans to quickly regain control of Congress. The Senate map will overlap with several presidential battlegrounds, with seats up in Arizona, Georgia, Nevada, North Carolina, Pennsylvania, and Wisconsin. Democrats' strong showing in those states this year gives them reason for optimism, but two years is a long time in politics.

The bigger question is whether Republicans can rebuild the coalition that powered their 2024 victory and whether Democrats can hold onto the voters who helped deliver this year's gains. Still, it's important not to over-read the results of a single election. The balance of power has shifted sharply, but with a Democratic Congress and Republican White House, the next two years are still more likely to be defined by negotiation, oversight, and funding battles than sweeping legislative change. The political landscape changed dramatically on Election Day, but the realities of governing changed far less.

Talk to your financial professional to help make sure your portfolio is prepared for whatever happens in Washington, D.C.

About the Author:

James R. (JT) Taylor serves as Chief Political Strategist and Macro Policy Sector Head at Hedgeye Potomac Research. JT has extensive experience in both government and business in Washington, D.C., with a career spanning the legislative and executive branches as well as the financial-services industry. Prior to joining Potomac Research Group, he ran Pelorus Research, the US public-markets division of the Holdingham Group based in the United Kingdom. He previously led a policy research team as Managing Director at DeMatteo Monness. From 2002-2009, he was Managing Partner of Kemp Partners, a Washington, D.C.-based strategic consulting, business development, and marketing firm he founded with former Housing and Urban Development Secretary Jack Kemp in 2002. At Kemp Partners, he oversaw day-to-day operations and business development while managing client relationships in both the corporate arena and financial-service industries.

[1] Yahoo Finance, "Inflation Jumps to 3.7% and Drags an October Hike Back Into Play," 10/14/26.

[2] Ballotpedia, "The Daily Brew," 11/6/26.

[3] CNBC, "Dow Drops 1,800 Points; Nasdaq Tumbles into Correction Territory on AI Tech Wreck," 11/5/26.

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