

US Midterm Elections: Why They Matter for Markets

Beyond the political headlines, the election could influence spending, regulation, and market leadership for years to come.

What You Should Know

- **Divided government remains the most likely outcome, potentially reducing policy uncertainty.** With Democrats possibly taking Congress while Republicans retain the White House, fewer major legislative changes could create a more stable policy backdrop for strategic asset allocation and long-term financial planning.
- **Legislative gridlock could restrain fiscal expansion, with implications for growth and interest rates.** More limited federal spending may reduce upward pressure on Treasury yields and inflation, while creating a less supportive environment for economic growth and corporate earnings.
- **The results may signal longer-term sector opportunities and risks.** Shifts in voter priorities could shape the outlook for healthcare, infrastructure, defense, consumer protection, and AI regulation—creating potential winners and losers across public and private markets.
- **Global investors should consider the broader asset-allocation effects.** Changes in US fiscal policy, rates, inflation, and regulation could influence currency markets, global capital flows, and the relative attractiveness of US and non-US assets.

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As the US congressional elections approach, polls increasingly suggest that the Democrats will gain control of at least one house of Congress. Historically, during periods when opposing parties have controlled the legislative and executive branches of government, major shifts in policy have been few and markets have often responded favorably.

However, this doesn't mean that US and global investors have no reason to pay close attention to the upcoming election. Since the COVID-19 pandemic, the increasing importance of US fiscal policy for markets has made every election consequential for investors.

In addition, this year's midterms may also provide valuable insight into the longer-term direction of US policy on everything from interest rates to inflation to artificial intelligence. Those insights could help investors identify potential opportunities in an evolving environment.

Split or Sweep?

One possibility is that Republicans could retain the Senate while Democrats take control of the House of Representatives. This would limit the chances for new legislation and increase the potential for congressional oversight of the president. The House contest

includes approximately 29 competitive or toss-up seats, and a shift of roughly 4 to 5 seats could mean a change of control.

More recently, the possibility has risen that Democrats could win control of the Senate as well as the House. A Democratic sweep could bring increased focus on healthcare, affordability, consumer protection, and other Democratic campaign themes.

Legislative gridlock between a split- or Democrat-controlled Congress and a Republican president would likely limit additional spending. Treasury yields could face less upward pressure, although the same outcome might be less supportive of economic growth.

The prospect that a split- or Democrat-controlled Congress could be sworn in come January could prompt congressional Republicans to push to accomplish as many of their policy priorities as possible in a lame-duck session before the end of the year. These could include increased defense spending connected to the Iran war, more funding for agriculture, and changes to infrastructure spending. Together, these measures could form a package of new spending as large as half a percent of GDP.

Regardless of the election result, however, President Donald Trump will remain able to take executive action on trade, regulation, foreign policy, and more.



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Don't Forget the Debt

Politicians of both parties are campaigning more on worries about inflation and the economy than on the federal government's growing debt. However, the federal debt ceiling will need to be raised by next year. The manner in which that takes place matters for markets—and potentially for the government's credit rating.

Investors will be watching to see whether Republicans attempt to raise the ceiling during the year-end lame-duck session or whether Democrats will be able to use the issue as negotiating leverage next year after sweeping congressional elections.

While candidates of both parties are appealing to voters' concerns about inflation and affordability, the outcome of the election may have little influence on rising prices. That's because the current surge in inflation is being driven in part by energy supply issues resulting from the war in the Middle East. Unlike demand-driven inflation, the Federal Reserve's ability to fight supply-related inflation is limited, so affordability is likely to be an ongoing challenge for policymakers and consumers alike, regardless of who controls Congress.

Will AI Be Regulated?

Investors' expectations about the future of AI have become major drivers of both equity and fixed-income markets. However, voters are increasingly concerned about risks that AI may pose to many aspects of their lives, and politicians' campaigns have responded with calls to regulate what has, thus far, been a largely self-regulating industry. While the Trump administration is mostly opposed to government regulation of AI, the election outcome may lay the groundwork for future regulation.

Here are some possible scenarios:

- A Democratic sweep could bring greater scrutiny of data centers and other AI-related developments, especially because of concerns about affordability and safety.
- Regulation could be catalyzed by an accident or other event.
- If no immediate catalyst occurs, the 2028 election could feature candidates campaigning on AI regulation, with possible bipartisan support emerging in 2029.

- National security concerns may favor a lighter regulatory approach because policymakers view AI as strategic infrastructure and worry that regulation could slow innovation relative to China.

Why It Matters for Global Investors

Non-US investors should watch for a potential year-end spending package to emerge from Congress because it could influence US economic growth, interest rates, and inflation in ways that may have asset-allocation implications. If the election results don't lead to a year-end package, the US could experience half a percent of fiscal tightening next year—a notable shift from the post-COVID period.

Investors may also want to watch how an emerging split in the Democratic party between moderates and progressives plays out on election day. The results could signal whether the 2028 election will be contested over entitlement spending and healthcare reform or greater compromise on tax policy.



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Your financial professional can help you build a portfolio that's right for you despite political uncertainty.

Important Risks: Investing involves risk, including the possible loss of principal. • Fixed income security risks include credit, liquidity, call, duration, event and interest-rate risk. As interest rates rise, bond prices generally fall.

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