

What the Midterm Election Can and Cannot Change

Why the Votes That Matter Most for Investors May Come After November 3

by John E. Chapman

In our Midyear Update in July, I wrote that the consensus expected a divided Congress coming from the midterm elections, that we would not “trade” the election, and that we would keep liquidity available so that policy driven volatility could become an opportunity rather than a threat. I also repeated a line from our January Outlook report that I still believe is the right starting point:

“Elections shape sentiment, but earnings, growth, and monetary policy shape returns.”

Four weeks before Election Day, two of those three statements hold firmly. The third needs revising, because the consensus has moved. In July, the base case was a Democratic House and a Republican Senate. Today, prediction markets put the odds of Democrats winning the House above 90% and of Democrats winning the Senate near two in three, with a Democratic sweep of both chambers priced at roughly 62%. The generic ballot has widened to a Democratic lead of seven to nine points, and recent polling shows Democratic candidates competitive or ahead in Senate races in Texas, Ohio, and Alaska that few expected to be in play this year. It is important to note that none of this is settled, and polling has been wrong before.

My purpose this month is not to forecast the result. Rather, it is to explain why we believe the investment consequences of this election are narrower than the headlines suggest in some respects and more important than the headlines suggest in others.

Our first observation: a “sweep” is not a trifecta

Much of the coverage treats a Democratic sweep as a dramatic change in economic policy. We think that misreads the arithmetic. President Trump remains in office through January 2029, and any bill that reaches his desk is subject to a veto that neither party will have the votes to override. Budget reconciliation, the tool that allowed last year’s tax legislation to pass with a simple majority, still requires a presidential signature.

The practical result is that whether Democrats win one chamber or both, fiscal policy goes on autopilot for the next two years. There will be no second large tax package and no new stimulus program. In fact, the realistic range of fiscal outcomes narrows after this election rather than widens. What the difference between a split Congress and a Democratic Congress does change is oversight, confirmations, and the debt ceiling, and that is where we are focusing our attention.

Why we think the Senate matters more than the House

The House will draw the headlines on election night. For investors, we believe the Senate is the more consequential chamber, because the Senate confirms nominees to key government roles. Federal Reserve governors, Treasury officials, and financial regulators all require Senate approval.

That matters more than usual right now. In September the Federal Reserve raised rates by a quarter point to a range of 3.75% to 4.00%, its first increase since 2023, and the decision was unanimous. Within weeks, the President publicly described the Board as “very hostile” and “very political,” said he would have voted against it, and repeated his wish for rates of 1% or lower. Jerome Powell’s term as a governor ends in January 2028, and the Supreme Court blocked the attempted removal of Governor Lisa Cook in June. The composition of the Board is a live question, and the Senate holds the gate.

Here is the view that we believe sets our reading apart. History is often cited to show that markets do poorly when a Republican president loses control of Congress. We would treat that history with caution, because it blends very different economic eras. More importantly, in this cycle the bond market’s chief concerns are fiscal discipline and the credibility of the Federal Reserve.

A Congress that cannot pass large deficit financed legislation, and a Senate that would require broad agreement before reshaping the Fed, both speak to those concerns directly. We think it is entirely possible that the outcome conventional wisdom calls “unfavorable” proves neutral or even modestly constructive for long term interest rates.

The fiscal dates we are focused on

Last month I wrote that the Treasury had tried to reassure the long end of the bond market and that bond traders had declined to be reassured. September confirmed that. The 10-year Treasury yield rose more than half a percentage point during the month to about 5.27%, its largest monthly increase since 2022 and its largest quarterly rise since 2009. That level sits nearly a full point above the Congressional Budget Office's long run assumptions, and at that gap, analysts estimate roughly \$3.5 trillion would be added to federal debt over the coming decade through higher interest costs alone. This is anything but a trivial matter.

This said, the most important fiscal event of 2027 is not on the ballot in the upcoming midterm election. Congress raised the debt ceiling to \$41.1 trillion in July 2025, and current projections have the Treasury reaching that limit sometime between early and midsummer 2027. In other words, the debt ceiling is likely to arrive at roughly the same moment as the new Congress arrives.

We expect the ultimate outcome to be an increase or suspension, as it always has been, but we also expect the path to successfully raising the debt ceiling will test a potentially vulnerable Treasury market.

There is another notable challenge coming even before the debt ceiling question. The temporary funding measure Congress passed in September runs only through December 11, which means the first fiscal deadline arrives in a lame duck session, after the election, with lawmakers who may already know they are leaving. We think investors are underestimating how much of the election's consequence will be felt in the bond market in the months after November 3 rather than in the stock market on the morning after.

What consumer confidence is and is not telling us

The Conference Board's consumer confidence index fell to 81.9 in September, its lowest reading since April 2014, and the University of Michigan's sentiment index stood at 48.1, near historic lows. Expectations for inflation over the next twelve months jumped to 4.6%. Respondents pointed out gasoline prices, grocery prices, and mortgage rates, which are now above 7%, with Brent crude back above \$100 per barrel.

Our interpretation of this survey's results has two parts. First, households have reported low confidence levels for most of this cycle while continuing to spend. We weigh what consumers do more heavily than what they say. Second, and this is the point we consider underappreciated, survey sentiment has become highly partisan, and the party that wins an election typically sees its supporters' confidence jump soon afterward. We would expect some rebound in measured confidence after November, and we would caution against mistaking it for an improvement in the economy.

What has genuinely changed this year is that discontent now crosses party lines: Republican sentiment has fallen about 20% since January and Democratic sentiment about 13%. The cause is prices, not politics, and only lower energy costs and a steadier labor market will address it. September's hiring of just 29,000 jobs, with unemployment rising to 4.2%, is a reminder that this low hire, low fire labor market can soften quietly even while layoffs remain rare.

There is one fiscal detail that bears directly on the consumer. Reductions to Medicaid and food assistance enacted to help fund last year's tax legislation are scheduled to take effect after the election. Combined with no prospect of new stimulus, that implies a modest fiscal headwind for lower income households in 2027. At the same time tariff refunds from the February Supreme Court decision, which have helped corporate cash flow this year, will wind down.

What the election cycle does and does not promise for markets

Investors often hear that the twelve months following a midterm election have been among the strongest of the four-year presidential cycle, with positive returns in every such period since at least 1950. That record is real, and we take some comfort in it. However, we believe it is important to understand why it has occurred. Midterm years have historically been weak, averaging returns of about 7.5%, and the subsequent strength has largely been a recovery from that weakness as uncertainty lifted.

This year does not fit the pattern. Stocks were up roughly 12% through September, one of the best starts to a midterm year on record, with relatively few large daily swings. There has been no midterm drawdown to recover from, so the familiar statistic about the rally from the midterm low starts from a different place this time. And unlike many past cycles, the Federal Reserve is tightening rather than easing.

Our conclusion is that the post-election tailwind is likely real but smaller than the historical averages imply. Our view is that oil prices, bond yields, and earnings will matter far more than the composition of Congress. Options markets are currently pricing a move of less than 1% in the S&P 500 on the day after the election. We think that is a reasonable estimate for the stock market and too sanguine as a description of the months that follow for the bond market.

On sectors, a Democratic House would bring more oversight of technology, healthcare, and banking. We expect that to produce headlines and episodic volatility rather than a lasting change in fundamentals. Tariff policy also remains largely in executive hands. House Democrats have said limiting tariffs would be an early priority, but with a presidential veto in place, we expect trade policy to continue to be set by the White House, and possibly to rely even more heavily on executive tools if the legislative path closes.

What we are doing about it

First, what we are not doing is repositioning portfolios around an election outcome, and the evidence for that discipline is unusually clear. One study found that \$100,000 invested in the S&P 500 from 2013 to the start of 2026 grew to roughly \$398,000 when left fully invested, but to roughly \$214,000 or \$186,000 for investors who moved to cash whenever their preferred party was out of power.

What we are doing is preparing for the sequence ahead. With the 10-year Treasury above 5% and high-quality corporate bonds yielding in the mid 5% range, we believe intermediate maturity, high-quality fixed income offers some of the most attractive income available in nearly two decades, and we are adding to it deliberately rather than reaching for yield at the long end, where debt ceiling and fiscal risk will concentrate.

We continue to favor quality companies that fund their own growth, which matters more when capital markets may become less hospitable. We continue to hold real assets and a modest gold allocation. In fairness, gold fell more than 4% in September, a reminder that insurance does not pay off every month. But a year in which fiscal governance and the independence of the Federal Reserve are both on the agenda is precisely the environment it is meant for.

Bottom line: we are keeping liquidity available for the unusually challenging calendar from the October 28 Federal Reserve meeting through the election, the December 11 funding deadline, and the debt ceiling in 2027.

Conclusion

The election will change the tone in Washington, the volume of oversight, and the politics of confirmations. It is much less likely to change fiscal policy, trade policy, or the direction of the Federal Reserve in the near term. In our view, the most important votes for investors will be cast after November 3, on government funding, on the debt ceiling, and on the people who will sit on the Federal Reserve Board, and those votes will register first in the bond market.

Our framework is grounded in years of experience and is largely unchanged from January. Elections shape sentiment; earnings, growth, and monetary policy shape returns. We would add one refinement this year: fiscal credibility now shapes the price of money that every other asset depends upon, and that is the part of this election we are watching most closely.

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