

Market and Economic Insights

Strategy Spotlight

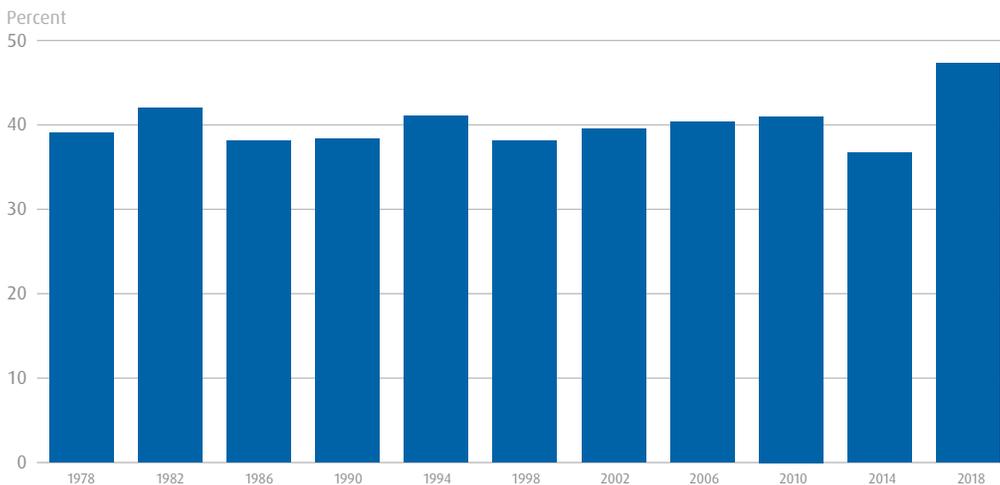


Midterm recap: Split Congress could lead to gridlock

In what appeared to be the [most likely outcome](#) of the 2018 midterm elections, we have a split Congress. Though there are a number of seats yet to be called, Democrats have clinched the 218 seats needed to take control of the House, and Republicans have secured at least 51 Senate seats and will likely increase their majority.

With respect to policy, we expect gridlock over the next two years, with Democrats aiming to frustrate President Trump’s agenda. That being said, there is a scenario (though we think relatively modest probability) where President Trump could tack back toward the center and work on issues like infrastructure and immigration. However, Democrats may be wary of giving Trump any wins ahead of the 2020 Presidential election campaign.

U.S. historical midterm turnout



Source: United States Elections Project. Voter turnout in 2018 is a preliminary estimate and subject to change.

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Market implications

We believe that the markets have, for the most part, priced in this scenario. For equity markets, we expect modest strength as some uncertainty is removed from the market and with the expectation that not much will get done from a policy perspective over the next two years. Earnings growth remains strong and the economic backdrop is solid, supporting our view to be overweight U.S. equities.

Meanwhile, we feel bond yields will likely drift modestly higher, driven by strengthening wage inflation and strong economic growth. The potential for an infrastructure package and/or a minimum wage bill would drive inflation higher and bond yields along with it. However, as we note above, this is a relatively unlikely scenario.

A Fed policy mistake remains the risk that we're most concerned about. A question following the midterm election is whether President Trump will feel emboldened to continue to question the Fed's normalization process. However, we feel that this will have little impact on the Fed's reaction function.

An eye on 2020

Our expectation is that a split Congress will likely be a stalemate for the next two years as both political parties begin positioning themselves for 2020 elections. We expect the Democrats in the House to further push for investigations into President Trump and stall many of his agenda items, though they have little ability to repeal enacted legislation. The Democratic field for the 2020 presidential election is extremely deep and we will be watching closely to see how the race develops and who may be poised to face President Trump in the next election.

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