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# U.S. midterm elections: Reaction and analysis

By Matt Miller, political economist

While we don't know the full outcome of the U.S. midterm elections just yet, here are my initial thoughts on the political, policy and market-related implications.

**Outcome**

- Expect legislative gridlock for at least the next two years as Republicans are almost sure to (barely) control the House of Representatives. Senate control is still unknown, and there's a chance we won't know until the December 6 Georgia Senate runoff.
- A narrow GOP margin of control in the House gives the farther right wing of its caucus more power. Despite a better-than-expected showing among Democrats, I still expect a struggle between the progressive and centrist wings over what direction the Democratic Party should take as we head into the 2024 presidential election.
- Donald Trump's potential return to the presidency seems less likely. Trump-backed candidates underperformed more mainstream GOP candidates. Meanwhile, Governor Ron DeSantis' extraordinary landslide victory in Florida has been embraced overnight by GOP stalwarts as pointing the way to the future.

**Policy**

- Republican control of the House, no matter how narrow, is the salient policy point for investors because it means the end of the affirmative legislative phase of Biden’s presidency. That likely means no tax increases and no large, progressive spending packages will gain enough votes for approval.
- That said, I expect defense spending to rise because Republicans and Democrats have a shared interest in it, substantively and politically. Both parties feel that we're in a more dangerous world given Russia’s invasion of Ukraine and the eroding relationship between the U.S. and China.
- There is going to be competition to be “tougher on China” as we head toward 2024. That may lead to political incentives aligning both sides to push new measures on export controls and restrictions. There also may be restrictions of outbound investment.
- If the GOP ekes out control of the Senate, it could bring more aggressive “messaging” legislation on China, tax cuts, the border and immigration — perhaps more. Biden will veto many of these measures, drawing battle lines for 2024.
- If Republicans end up controlling both chambers, a more centrist GOP Senate will likely provide some moderating effect on the debt ceiling showdown likely to come around October 2023.
- I also think tax cuts for the middle class could result from a compromise deal because Biden and Democrats may not want to be seen as opposing tax relief for everyday folks. It may even involve an initial Biden veto to excise possible tax cuts for “the rich” from any GOP package.

**Markets**

- Market volatility is generally higher in midterm election years, especially in the weeks leading up to Election Day. Since 1970, midterm years have had a median standard deviation of returns of nearly 16%, based on the S&P 500 Index, compared with 13% in all other years.
- The silver lining for investors is that markets have tended to rebound strongly in subsequent months. Since 1950, the average one-year return of the S&P 500 Index following a midterm election was 15%. That’s more than twice the return of all other years during a similar period. Of course, every cycle is different, and elections are just one of many factors influencing market returns. This time around, investors will need to weigh the impacts of a potential global recession and rising geopolitical tensions.

As always, my comments are meant to be analysis, not advocacy. My role on the investment team is to make sure folks have a cleareyed understanding of what I think is likely to happen on political and policy matters, and then consider the relevant investment implications.