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U.S. midterms: Ten questions investors should be asking

From gridlock and government spending to AI and bond yields, we explore what the 2026 U.S. midterms could mean for markets



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IN A NUTSHELL

- Predicting the midterm elections correctly does not guarantee the right portfolio decision. What matters is how the result compares with what the market has already priced in.
- Equities have often weakened ahead of elections and recovered afterwards, but individual cycles vary considerably, while high-yield spreads show little consistent independent election effect. Fundamentals and the wider macro backdrop typically matter more for markets.
- Recounts and legal challenges in tight electoral races are a near-term risk, but perhaps the biggest short-term market impact is likely to emerge beyond Congress, at the state and local level through regulation, for example of AI infrastructure.

Introduction

Washington pundits and policymakers have an old habit: declaring that an election sent a clear message, then spending months arguing about what it was. Markets tend to react rather more quickly.

On 3 November 2026, Americans will elect all 435 members of the House of Representatives and vote in 35 Senate races, including two special elections.[1] Voters will also choose 39 state and territorial governors, alongside members of numerous state legislatures and holders of many other state and local offices. By the time markets open on 4 November, investors will have to decide whether any of these results warrant a change in their expectations for growth, inflation, earnings or the U.S. dollar. With that in mind, we have structured our election outlook around ten questions investors should be asking.

1 / What is the market expecting from the 2026 midterms?

The starting point is not simply who wins, but what markets already expect. Current forecasts favor Democrats taking control of the House, although surprises remain possible. Even correctly predicting the political result does not necessarily lead to the right investment decision. What matters is whether the outcome is better or worse than investors had anticipated and how markets interpret the result.

The 2016 presidential election offers a useful reminder. Markets initially fell as Donald Trump's surprise victory became clear, but the decline had more than reversed by the end of the following trading day as investors turned their attention to the prospect of corporate tax cuts. Getting the politics right and getting the market right can be two different things.

[1] EPRS (October 2026). Understanding the 2026 United States midterm elections

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2 / Could the biggest surprises come from outside Washington?

Yes. Investors will naturally focus on control of the House and Senate, but some of the most interesting signals could come further down the ballot. Americans will also elect governors, state legislators and numerous local officials.

That matters economically. State and local officeholders can influence electricity supply, transmission lines, planning decisions and permits for data centers. A result that barely moves a broad equity index could therefore still matter significantly for individual companies awaiting project approvals.

3 / Can investors rely on the usual midterm patterns?

History can be a useful guide, but it should not be treated as a rule. The president's party has usually lost House seats at midterm elections, and 2026 currently looks consistent with that pattern.[2] But this election is unusual because President Trump is serving a second, non-consecutive term. That is rare within U.S. history – the only other example would be Grover Cleveland. Arguably, the closer modern parallel are presidents serving a second, consecutive term. Within this smaller subset of midterms, there is a much stronger effect known as the "six-year itch," with the president's party almost always losing support.[3]

Markets have patterns, too: U.S. equities have often weakened ahead of midterms and recovered afterwards. But these patterns tell us what happened previously, not what caused it. Investors should therefore treat historical precedents as useful reference points, rather than predictions.

4 / Would divided government be good for markets?

Not necessarily. Conventional Wall Street thinking tends to view divided government positively because political gridlock can make major legislative changes harder to achieve. But historical experience does not provide such a simple conclusion. Research[4] finds higher average excess equity returns under unified than divided government.

More importantly, fewer laws need not mean less political uncertainty. Congress would still need to agree to annual spending bills, leaving scope for disputes over government funding and potentially a government shutdown. A constrained White House could also rely more heavily on other policy tools. For investors, the relevant question in our view is therefore not simply whether Washington becomes gridlocked, but what policymakers do in response.

5 / Why could the midterms matter for AI and data centers?

Because the politics of AI is increasingly also about physical infrastructure. Data centers need electricity, grid connections and local infrastructure, and state and local governments can influence planning and permitting decisions.

If election results are interpreted as reflecting local concerns about data centers, local legislators could respond by scrutinizing permits more closely, asking developers to contribute more towards infrastructure or seeking to protect households from rising power costs. That could turn politics into an earnings issue for some beneficiaries of the AI buildout.

But investors also need to look at the other side of the equation. If AI begins to increase productivity more broadly, that economic impact could prove more important for equity valuations than the political debate surrounding data centers.

[2] Newsweek (October 9, 2026). Democrat chances of winning House, Senate hit new high
[3] Tufte, E. R. (1975) "Determinants of the Outcomes of Midterm Congressional Elections." American Political Science Review 69, no. 3, pp: 812–826; Erikson, R. S. (1988) "The Puzzle of Midterm Loss." The Journal of Politics 50, no. 4, pp: 1011–1029; Born, R. (1990) "Surge and Decline, Negative Voting, and the Midterm Loss Phenomenon: A Simultaneous Choice Analysis." American Journal of Political Science 34, no. 3, pp: 615–645.
[4] Morningstar (23 September 2026). Is gridlock in Washington actually good for stocks? Here's what historical market data say; Papamichalis, T., Ryu, D. and Wilson, M. I. (2025) "Divided Government and the Stock Market.

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6 / Does political gridlock mean greater fiscal discipline?

Again, not necessarily. A divided Washington could make it difficult to pass large new fiscal programs, but much of the existing federal spending would likely continue. Interest costs would continue to accumulate, while compromises over annual funding could preserve existing commitments or add spending without resolving the longer-term debt problem.

This distinction is particularly important for U.S. Treasuries. Investors will need to consider what the election means for future deficits, debt issuance and the yields required to attract buyers of government debt. Gridlock can make policy change harder. It cannot, by itself, fix the fiscal arithmetic.

7 / How should investors treat the first election-night results?

With caution. If control of the Senate depends on one or two very close contests, the apparent outcome could change as more ballots are counted. Exit polls are estimates, while close races can involve late-arriving ballots, recounts, litigation and differing state certification procedures.

Markets, however, do not necessarily wait for the final result. Previous research shows that equities, interest rates, oil and the U.S. dollar can move as the perceived probability of a political outcome changes. That makes it especially important to distinguish new information from election-night noise.

8 / How might election results affect the investment outlook?

Election results do not come with trading instructions. The chain that matters is: what had markets expected, what surprised them, how does that change political incentives and policy, and what does that eventually mean for earnings, inflation, interest rates and risk premia?

For 2026, that means looking beyond the simple question of which party controls Congress. Investors will need to consider the consequences for tariffs, fiscal policy, AI infrastructure and bond yields, while deciding which election-night developments represent lasting economic signals and which are primarily political noise. While the latter could certainly include recounts and legal challenges in tight races, it is worth keeping in mind that there is less at stake at midterms in general, than in presidential elections. Senate control could potentially come down to a single seat but even that would have limited investment implications. As a result, we would expect politics to return to business as usual, at least as far as markets are concerned. In other words, investors appear likely to focus on the decisions the newly elected officials promise to make, rather than who actually won.

9 / What should equity investors take away from the 2026 midterms?

For equity investors, the key is to distinguish between market-wide and company-specific effects. History offers some encouragement, but also an important warning. The S&P 500 has typically experienced some weakness in the months ahead of midterm elections before recovering in the following year.[5] Yet, returns over the 12 months following individual midterms have varied considerably, suggesting that the average is no particularly useful guide as to what comes next. Historical returns also differ depending on the political configuration: the most relevant comparison is under Republican presidents since 1953. For these admittedly small samples, average annual S&P 500 returns were positive for all combinations of control of Congress but much higher if Republicans also controlled at least one chamber than when a Republican president faced Congressional Democrats controlling both the House and the Senate.[6]

This reinforces a broader point: party control alone is a poor investment signal. An election result may dominate the headlines without materially changing the outlook for the broader equity market, where earnings, productivity, monetary policy and

[5] DWS CIO View (October 24, 2018). The Trump effect 2.0
[6] Deutsche Bank (October 5, 2026), "US-Zwischenwahlen 2026: Wie der Wahlausgang Politik und Märkte prägen könnte"

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valuations may remain more important. But the effects could be larger for individual companies and sectors if the result changes tariffs, regulation or the political environment surrounding AI infrastructure. The lesson is not to judge the political headline itself, but to ask whether it genuinely changes future corporate earnings or the valuation investors are willing to pay.

10 / What should bond investors take away from the 2026 midterms?

For bond investors, the election result is only the starting point. The bigger question is whether it changes expectations for growth, inflation, government borrowing and ultimately interest rates. Political uncertainty can also influence the extra compensation investors demand for holding longer-dated bonds. That means the implications may emerge gradually rather than on election night. Investors should therefore look beyond which party controls Congress and focus on whether the resulting policy mix changes the expected path of inflation, Treasury yields and the price of longer-term government debt.

Credit markets tell a similar story. Across the six midterms for which Bloomberg Global high-yield spread data are available since 2002, election outcomes show little consistent independent effect on spreads. Instead, post-election moves appear to have been driven more by the prevailing credit cycle and wider macroeconomic developments, such as the second round of Quantitative easing (QE) in 2010, the oil shock in 2014 and the Federal Reserve's tightening in 2018. With such a limited historical sample, the macroeconomic outlook and sector-specific risks may matter more, though in years to come, a larger sample might well reveal some interesting patterns.

Conclusion

Elections make headlines, but not every political shift changes the investment outlook. The lesson from these ten questions is simple: look beyond who wins and ask what, if anything, changes for growth, inflation, earnings and interest rates, shifting market expectations. History can be a useful guide, but it's not a rulebook. For investors, separating meaningful economic signals from political noise may ultimately matter more than correctly predicting the result.

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Glossary

AI infrastructure comprises the physical facilities and systems needed to develop and operate artificial intelligence, including data centers, electricity generation, power grids and network connections.

The credit cycle is the expansion and contraction of access to credit over time and is usually connected to the business cycle.

A data center is a facility containing computing equipment used to store, process and transmit digital information.

The Democratic Party (Democrats) is one of the two political parties in the United States. It is generally to the left of its main rival, the Republican Party.

Fiscal policy describes government spending policies that influence macroeconomic conditions. Through fiscal policy, the government attempts to improve unemployment rates, control inflation, stabilize business cycles and influence interest rates in an effort to control the economy.

A government shutdown occurs when funding legislation is not approved in time, requiring some government activities to stop temporarily.

High-yield bonds are issued by below-investment-grade-rated issuers and usually offer a relatively high yield.

The United States House of Representatives is a legislative chamber consisting of 435 Representatives, as well as non-voting delegates from Washington, D.C. and U.S. territories. Representatives are elected for two-year terms and each state's representation is based on population as measured in the previous Census.

Inflation is the rate at which the general level of prices for goods and services is rising and, subsequently, purchasing power is falling.

Interest rate is the proportion of a loan that is charged as interest to the borrower, typically expressed as an annual percentage of the loan outstanding.

Monetary policy focuses on controlling the supply of money with the ulterior motive of price stability, reducing unemployment, boosting growth, etc. (depending on the central bank's mandate).

Political gridlock is a situation in which disagreement between political parties makes it difficult to pass legislation.

Productivity measures how much economic output is produced for a given level of inputs (such as capital and labor).

Quantitative easing (QE) is an unconventional monetary-policy tool, in which a central bank conducts broad-based asset purchases.

The Republican Party (Republicans), also referred to as Grand Old Party (GOP), is one of the two major political parties in the United States. It is generally to the right of its main rival, the Democratic Party.

The risk premium is the expected return on an investment minus the return that would be earned on a risk-free investment.

The S&P 500 is an index that includes 500 leading U.S. companies capturing approximately 80% coverage of available U.S. market capitalization.

The spread is the difference between the quoted rates of return on two different investments, usually of different credit quality.

A tariff is a tax imposed by one country on the goods and services imported from another country.

Treasuries are U.S. government debt securities, including Treasury bills, notes, bonds, and inflation-protected securities.

The U.S. Federal Reserve, often referred to as "the Fed," is the central bank of the United States.

The United States Congress is the legislature of the federal government. It is comprised of the Senate and the House of Representatives, consisting of 435 Representatives and 100 Senators.

United States Senate is the upper chamber of the U.S. Congress, composed of 100 senators, two from each state, elected to staggered six-year terms.

Valuation attempts to quantify the attractiveness of an asset, for example through looking at a firm's stock price in relation to its earnings.

Yield refers to the income generated by an investment, such as interest or dividends, usually expressed as an annual percentage of its value.

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