Research Note

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US Midterm Elections: What could be the impact on financial markets?

The November 3, 2026 US midterm elections will determine all 435 seats in the House of Representatives and 35 of the Senate's 100 seats. **In our view, the election is primarily likely to redistribute risks across sectors rather than alter the market's overall trajectory.** The key drivers for year-end remain earnings growth, financing requirements for Artificial Intelligence-related investments, inflation developments, Federal Reserve decisions and communication, as well as geopolitical developments, notably the conflicts in Ukraine and the Middle East and their implications for oil prices and global supply chains. While the election matters, its significance is less substantial than media attention suggests, and its most tangible effects are likely to be concentrated in a handful of clearly identifiable sectors rather than the broader market.

WHAT THE MARKET IS ALREADY PRICING IN

As the election approaches, forecasting models assign Democrats roughly a three-in-four chance of retaking the House of Representatives. Prediction markets point in the same direction, pricing in Democratic control of both chambers as the most likely outcome, at approximately two-thirds probability, followed by a divided Congress (Democratic House, Republican Senate) at slightly above one-quarter probability, and continued Republican control of both chambers at roughly one in ten.

However, estimates differ materially regarding the Senate, where races in Texas, Iowa, Maine and Ohio remain within the margin of error. Even a modest polling error could be sufficient to swing the upper chamber in either direction.

For investors, a Democratic House is therefore largely reflected in asset prices and should not come as a surprise. The remaining uncertainty lies with the Senate. The three possible configurations carry distinct implications:

- Democratic control of both chambers would strengthen congressional oversight of the executive branch and increase scrutiny of heavily regulated sectors, without enabling legislation opposed by the White House.
- A divided Congress would primarily result in legislative gridlock, a scenario that financial markets have historically welcomed.
- Continued Republican control of both chambers would represent the genuine surprise scenario. It would preserve the majority's ability to pass further tax measures, supporting cyclical stocks while likely creating headwinds for the bond market.

Past performances are not a reliable indicator of future performances.

A CONSTRAINED LEGISLATIVE BRANCH

Regardless of the outcome, the President retains veto power until the end of the term, while most legislation requires 60 votes in the Senate. Even with majorities in both chambers, Democrats would therefore be unable to enact their agenda unilaterally, whether related to tariff reductions or limitations on military action against Iran.

Their influence would primarily rest on three levers: congressional investigations and subpoena powers, budget approval, and the ability to block new legislative initiatives from the current majority.

This last point is the most relevant for markets. The budget reconciliation process, which allows fiscal and spending measures to pass by simple majority, has served as the legislative vehicle for the administration's key reforms. Several Republican officials have raised the possibility of a second reconciliation bill, although no consensus currently exists within their own party. Losing control of the House would effectively close this avenue until 2029.

The main economic consequence of a political shift would therefore be the suspension of new policy initiatives rather than any rollback of measures already enacted.

Historically, this type of configuration has not been detrimental to equities. Since 1938, the S&P 500 has advanced in the 12 months following 95% of midterm elections. However, this pattern primarily reflects prevailing economic conditions at the time rather than any mechanical election effect and should be interpreted within today's context.

FUNDAMENTALS REMAIN THE PRIMARY DRIVER

Markets enter the election period with solid fundamentals. The S&P 500 closed at 7,676.77 on October 26, less than 2% below its monthly record and up approximately 12.5% year-on-year. At the beginning of the earnings season, analysts' consensus projected earnings growth of around 30% year-on-year for the third quarter and a similar pace for full-year 2026. Unusually, earnings estimates were revised upward during the quarter rather than downward.

This growth is not being driven by excessive valuations. The forward twelve-month price-to-earnings ratio stood at around 19x in early October, slightly below its five-year average.

The primary vulnerability lies elsewhere, namely market concentration. Technology stocks account for approximately 40% of the index's market capitalization, and most recent earnings growth has been generated by a small group of large-cap companies benefiting from Artificial Intelligence investment. Their earnings releases on October 28 and 29, and especially their guidance regarding 2027 capital expenditure plans, are likely to have a greater influence on the index than the election outcome itself.

MACROECONOMICS MATTERS MORE THAN THE ELECTION

Inflation has resumed its upward trend. Consumer prices increased by 3.7% year-on-year in September and by 2.6% excluding food and energy. Energy prices accounted for most of the acceleration, but core inflation also surprised to the upside, which constitutes the more concerning signal for the Federal Reserve.

The Federal Reserve, chaired by Kevin Warsh, raised its policy rate in September to 3.75%-4.00% and remains in a tightening cycle. Markets expect a pause on October 28, followed by an additional rate hike on December 9. Given that the new Fed Chair has refrained from providing explicit forward guidance, the risk of policy surprises is higher than usual.

The 10-year Treasury yield is trading around 5%, a level that increases mortgage borrowing costs and weighs on rate-sensitive equities. This represents the primary channel through which the election could generate a genuine macroeconomic impact.

A Congress capable of approving additional unfunded tax cuts would likely sustain the risk premium demanded by investors on long-dated US government debt, whereas legislative gridlock would help contain it. In this respect, the most likely scenario appears relatively supportive for the bond market.

However, **the increase in long-term sovereign yields cannot be explained solely by cyclical and geopolitical factors and may also reflect more structural forces**, including elevated public financing needs, substantial funding requirements related to Artificial Intelligence, defence and infrastructure investment, as well as the gradual withdrawal of central bank support.

Despite higher borrowing costs, the US economy continues to display remarkable resilience. The key question is whether elevated long-term rates are merely temporary or signal a lasting normalization toward a higher cost of capital.

In a higher-rate environment, asset valuations become increasingly dependent on future cash flows and their ability to generate returns exceeding financing costs. Markets must therefore reassess risk premia, equity valuations and investment strategies that were built on the assumption of persistently low interest rates.

This issue is especially significant for capital-intensive, long-duration sectors, including infrastructure, energy transition and Artificial Intelligence. Should investors conclude that additional fiscal measures would lead to increased bond issuance and higher term premia, the resulting valuation headwinds could partially offset the expected improvement in earnings.

Oil prices, together with diesel prices, which are widely used in transportation, agriculture and construction, remain the primary channel through which geopolitics affects the US economy.

The conflict with Iran, which began in late February, significantly reduced traffic through the Strait of Hormuz, through which roughly one-fifth of global oil supply transited before the conflict. While alternative routes have helped restore a large portion of crude oil flows, refined-product shipments remain more disrupted and transportation costs have risen materially.

Brent crude nevertheless exceeded USD 100 per barrel in September and reached USD 114 on October 23 following renewed statements and indications of a possible escalation after the Israeli and US elections.

The evolution of the conflict will have a far more direct impact on inflation, interest rates and purchasing power than the composition of Congress. A Democratic-controlled Congress could

seek to constrain military operations through resolutions, although such attempts would likely face a presidential veto.

From a fiscal perspective, federal government funding currently extends only until December 11. This Congress has already experienced the longest government shutdown in history at the end of 2025, followed by a 76-day partial shutdown of the Department of Homeland Security in 2026. A new majority may prefer to wait until January before negotiating budget agreements, increasing the risk of another year-end shutdown similar to that of December 2018.

Historical experience suggests that such episodes disrupt economic data releases and public-sector contractors but generally have only a limited and temporary impact on economic growth. Budget-related political tensions could also re-emerge ahead of the next debt ceiling debate expected around mid-2027.

Finally, trade policy remains primarily under executive authority. Following the Supreme Court's February decision overturning tariffs imposed under the International Emergency Economic Powers Act (IEEPA), the administration relied on alternative legal mechanisms, initially through a temporary 10% surcharge and subsequently, since July, tariffs ranging from 10% to 12.5% targeting roughly sixty economies.

As a result, the effective average tariff rate declined to around 7% in August. Congress would be unable to overturn these measures without a veto-proof majority, which appears unattainable under any realistic scenario.

Meanwhile, refunds of tariffs previously collected under the IEEPA framework, amounting to approximately USD 166 billion, much of which has already been approved, represent a tangible source of liquidity support for importers regardless of the election outcome.

THE MOST EXPOSED SECTORS

Healthcare is the sector most directly affected. Democrats have made the restoration of enhanced Affordable Care Act subsidies their top legislative priority. The expiration of these subsidies has increased insurance premiums. Such a measure would benefit insurers operating in these markets but would require White House approval and would likely need to be incorporated into a broader budget compromise.

Pharmaceutical companies could face congressional investigations into pricing agreements negotiated with the administration. Increased scrutiny of vertical integration among large pharmaceutical groups could also emerge, with the objective of improving reimbursement levels and containing drug prices.

In the near term, the issue is primarily one of headline risk and volatility rather than regulatory change.

Utilities and AI-related infrastructure form the second key area of focus. Electricity costs have become an electoral issue, and several Democratic lawmakers have linked higher utility bills to the expansion of data centres. Stricter oversight of tariffs and grid-connection conditions could weigh on certain regulated utilities and delay project implementation. However, most

of these decisions fall under state and local regulatory authority, while large technology companies have already committed to multi-year investment programmes.

For large-cap technology companies themselves, the election is unlikely to materially alter the outlook.

Their trajectory will continue to depend on AI-related demand and the profitability of ongoing investments. A Democratic majority would intensify congressional oversight of competition, data usage and energy consumption. However, these issues already attract bipartisan attention, and no major legislative breakthrough appears likely before 2029.

Defence spending depends on appropriations votes.

The administration has requested an unprecedented USD 1.5 trillion defence budget. A Democratic House could seek to reduce its scope and attach conditions to funding for Middle East military operations. Nevertheless, support for defence remains broadly bipartisan, while infrastructure programmes appear less exposed. The likely outcome would therefore be slower budget growth rather than outright spending cuts.

For banks, deregulation is driven primarily by executive-appointed regulators, who would remain in office regardless of the election result.

However, Democrats could gain control of congressional financial services committees and use these positions to challenge or delay deregulatory measures, including adjustments to stress-testing requirements and capital rules. The ultimate impact would probably remain modest, apart from increased scrutiny of lending practices and housing-related issues.

Digital assets appear more exposed. The Clarity Act, intended to establish a regulatory framework for crypto-assets, failed in the Senate in mid-September, making passage before the end of the current legislature unlikely. A Democratic majority would further delay progress and could favour stricter oversight of the private equity industry, prediction markets and betting platforms, all of which are gaining popularity among US investors.

In the energy sector, Republicans remain committed to supporting domestic hydrocarbon production, whereas renewable energy would receive stronger political support under a Democratic victory, although without sufficient legislative authority to reverse existing measures.

The major permitting reform bill currently awaiting Senate approval, which aims to accelerate the deployment of oil, gas and electricity transmission infrastructure, could face delays under Democratic control.

Regardless of the election outcome, oil prices will primarily depend on whether the conflict with Iran continues or de-escalates.

Finally, consumer and retail sectors could benefit from discussions surrounding purchasing power, although meaningful tariff reductions remain unlikely without White House support. For these sectors, gasoline prices and tariff refunds are likely to matter more than the election itself.

KEY DATES TO WATCH

The coming weeks feature several critical events. The Federal Reserve's policy decision and earnings releases from major technology companies are scheduled for October 28 and 29, only days before the election.

On election night, House results should become clear relatively quickly, while several closely contested Senate races may take several additional days to resolve, prolonging uncertainty.

These events will be followed by the October inflation release on November 10, the Federal Reserve meeting on December 9, and the fiscal funding deadline on December 11.

The new Congress will take office in early January 2027.

CONCLUSION

The central scenario is already largely priced in by markets.

In our assessment, continued Republican control of both chambers would be mildly positive for financial markets, a divided Congress would be neutral, and full Democratic control would be mildly negative. Differences across these scenarios would likely remain limited and concentrated in the sectors discussed above, particularly healthcare, utilities, defence and digital assets.

Higher volatility around the election and the December 11 fiscal deadline is possible, although such episodes have historically tended to provide buying opportunities rather than trigger lasting trend changes.

What could alter our assessment has less to do with the election itself than with its broader macroeconomic environment: accelerating core inflation forcing the Federal Reserve to tighten further, a renewed surge in oil prices, or disappointment regarding Artificial Intelligence investment, particularly if financing conditions become more challenging. These are the variables we are monitoring most closely.

Written on 27 October 2026
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