

2018 MIDTERM ELECTIONS: DIVIDED CONGRESS



As predicted in the polls and widely expected in the marketplace, the highly-anticipated midterm election results revealed that the Democrats were indeed able to take control of the House of Representatives, while the Republicans retained control of the Senate. However, the power of Trump is still alive and well as the Republicans made significant gains in the Senate, especially where the President campaigned. In this gridlock scenario, President Trump's party loses full control of Congress - which will make it increasingly difficult to pass major legislation and will leave President Trump without the congressional support to move his agenda forward. In other words, the order for policy over the coming two years will largely be one of the status quo.

Specifically, both tax and healthcare reform will be highly unlikely. Republicans are likely to have difficulty passing a second tranche of tax cuts that Trump has previously floated, while there's little chance of repealing and replacing the Affordable Care Act (ACA). However, an area of compromise (and potential upside surprise) could be on the infrastructure side, where both Trump and the Democrats appear to support an increase in federal infrastructure spending that could potentially move forward in 2019 and provide a small boost to growth in the coming years. Importantly, these results will have little bearing on the trade front and Trump's protectionist agenda, where the Democrats and Republicans are actually more aligned on their views. However, an upside scenario does exist where Trump seeks a deal with Chinese President Xi at the G20 Summit later this month. Finally, the Democrats have pledged to check the President's power and are expected to attempt to frustrate and stymie the President's agenda through a flurry of investigations and subpoenas against Trump and his aides, suggesting that political angst in Washington is surely to remain front-and-center going forward.

MARKET RESPONSE: NEGLIGIBLE

As this gridlock scenario was the base case leading up to the midterms (and largely priced-in), we are seeing little in the way of meaningful financial market impact.

▶ GLOBAL EQUITIES

Equity markets are mainly higher as the passage of the midterms has removed an element of uncertainty from the marketplace. Moreover, a lot of nervousness had already been swept out of valuations in the October equity rout.

▶ INTEREST RATES

As a divided government has removed the prospect for further fiscal stimulus (tax cuts), treasury yields have declined and the yield curve has flattened substantially – though the path of least resistance for interest rates remains gradually higher over time.

▶ US DOLLAR

This divided Congress outcome has yielded some consolidation in the greenback, owing mainly to reduced expectations for expansive fiscal stimulus and the corresponding pullback in treasury yields.

INVESTMENT STRATEGY IMPLICATIONS: STATUS QUO

Going forward, we expect that legislative gridlock will mean status quo for both the economy and the financial markets (as nothing gets done or undone). Furthermore, a divided congress suggests that Democrats will be unable to roll back existing tax cuts or reinstate financial regulations, while a split government with more checks and balances is likely to be supportive for the markets in general. With the midterm elections behind us, investors are likely to shift their attention back to the macroeconomic landscape at hand:

▶ GLOBAL GROWTH TRAJECTORY

Healthy and broad based, signs of recession remain elusive

▶ CENTRAL BANK OUTLOOK

Onward and upward with monetary policy normalization, albeit gradually

▶ US-CHINA TRADE RELATIONS

Risks pertaining to protectionism linger-on, suggesting that volatility is surely to prevail in the near-term

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