

Mitch on the Markets

5 Important Midterm Election Takeaways



By Mitch Zacks
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It comes as a great relief to many – including the markets – that the midterm elections are almost over. I say ‘almost over’ because there are still key races in states like Florida and Georgia being contested, and there are still a few House races yet to be called. Whatever happens with those races in the next week or two, the bottom line is that Democrats needed 23 seats to regain control of the House and secured closer to 40, while Republicans have maintained control of the Senate and perhaps even added a couple of seats in the process.¹

What does the outcome of the 2018 midterms mean for the markets and the economy? I’ve got 5 takeaways that you won’t want to miss.

1. Markets Historically Favor Gridlocked Congress – Not all gridlock scenarios are created equal (historically), but history tells us that the market has delivered consistently positive returns in times when the party

that controls Congress is different than the party that is in the presidency. The general thinking/rationale is that following a midterm election, a president tends to lose power, particularly if Congress is split.² This means that the probability of enacting meaningful, business-oriented legislation for either party is lowered significantly, which creates a certainty that the markets like, in my view. While we’ve seen this scenario play out many times in the modern history of the United States, I would also caution that there are not quite enough data points to deem it statistically significant.

2. Don’t Expect a Mitigating Presence on China – Even with power redistributed a bit in Congress, there is not a whole lot that Democrats or Republicans will be able to do to help ease political and trade tensions with China. The China issue is largely in the hands of the executive branch, and to date there has not been much to signal that a new trade deal is in the offing. In about two weeks, President Trump will meet with Chinese President Xi Jinping at the G20 summit in Buenos Aires, and market watchers will be eyeing the meeting intensely for details about what

the next steps are in resolving the issues.³

3. Will Infrastructure Emerge as a Positive Surprise? There are few policy objectives that Republicans and Democrats seem to agree on, but infrastructure may be one of them. Even before the midterm elections there were signs of bipartisanship in the infrastructure realm. In early October, legislation called the America's Water Infrastructure Act of 2018 passed with broad support from both parties. The new law authorizes water resource projects and policies nationwide to be administered by the US Army Corps of Engineers; it provides federal funding for water infrastructure projects; aims to expand the country's water storage capabilities; and, seeks to upgrade wastewater, drinking and irrigation systems. Because of the deficit effects of the tax cut, it seems that the trillion plus dollar infrastructure projects that Trump wants are far off the table – but there could be smaller deals that provide a boost.⁴

4. A Potential Downside to Bipartisanship – Both Democrats and Republicans have joined in a chorus criticizing the U.S.'s biggest tech companies for a range of issues from privacy protection to censorship. On many of these issues, Democrats and Republicans have different attitudes about what is wrong with the Google, Facebook, and Twitters of the world, but they agree that the era of free reign in tech needs to come to a close. Many

lawmakers have stopped short of embracing new European regulations that have come into effect recently, but they do agree that legislation is needed. Investors should watch in the coming year or two how far these regulations could go, and what it could mean for tech earnings.⁵

5. Brace for More Ugliness – Democrats' control of the House means that they regain subpoena and investigative powers, which could by extension mean causing the administration all sorts of headaches and battles to engage in. President Trump mentioned taking a "warlike posture" with no legislative cooperation if Democrats go down these paths, and it remains to be seen what the House Democrats will actually do with these powers. What's more, the Mueller report is due to be released in the not-too-distant future, which could provide more ammo for the Democrats.⁶

Bottom Line for Investors

While it seems like a lot is at stake following these midterm elections, I think the bottom line remains that the economy can function just fine – or perhaps even better – when it knows that there shouldn't be too much threat of interference from the federal government. The trade and tech regulation issues likely remain the top causes of real headwinds, in my view, as those are areas where we could still see unfavorable market-oriented outcomes.

Taken together, we still believe the

probability of a recession in the next six months is low, but the above factors could continue to make the investment environment volatile and uneasy. But, don't let that shake you – in my view, it is best to stay steady and focus on the long-term.

About Mitch Zacks

Mitch is a Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

¹ Axios, November 13, 2018.

<https://www.axios.com/newsletters/axios-am>

² Strategas, Quarterly Review in Charts Mon. Oct. 1, 2018

³ The Wall Street Journal, November 13, 2018.

<https://www.wsj.com/articles/a-china-trade-deal-or-a-new-cold-war-1542110401>

⁴ CNN, October 23, 2018.

<https://www.cnn.com/2018/10/23/politics/america-water-infrastructure-act-donald-trump-signing/index.html>

⁵ Bloomberg, September 18, 2018.

<https://www.bloomberg.com/news/articles/2018-09-13/new-social-media-rules-can-get-majority-in-congress-warner-says>

⁶ The New York Times, November 7, 2018,

<https://www.nytimes.com/2018/11/07/us/politics/trump-midterms-house-senate.html>

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