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WASHINGTON POLICY STRATEGY

Potomac Perspective

In this note, we forecast how the equity markets might react on Wednesday morning to the midterm election results (to the extent the outcome is known). The market may have a knee-jerk reaction followed by a later reassessment. Regardless of the outcome, however, our base case is for gridlock in the coming two years. We anticipate few major policy changes. We also give our final outlook for the election. The race for the Senate majority is still too close to call, but if we are forced to make a prediction, we expect a 50/50 Senate with Vice President Vance breaking the tie in favor of the Republicans. We also note that if the Senate majority is dependent on the Alaska race, then it could be several weeks before the outcome is known. The race for the House has been over for some time. The only question is the size of the Democrats' majority. We think it will be roughly in line with the post-World War II era during which the party not holding the White House has gained an average of 26 seats.

Anticipating the Market's Post-election Reaction – We believe that investors are expecting that Democrats will win the House but remain uncertain about control of the Senate. Thus, **the election results could trigger an immediate market reaction, particularly as the Senate outcome becomes clearer. However, the market's knee-jerk trade could reverse as investors recognize that gridlock remains the most likely policy outcome** in either case. The pattern could resemble the response to some Federal Open Market Committee meetings. Historically, markets move in one direction immediately after the Chair's press conference, then reverse course as investors digest the message and reassess its implications.

- Congress is likely to agree on little over the next two years. Even if Democrats win both chambers, we do not expect they will be able to block the Trump administration's regulatory agenda.
- Below, we outline potential initial sector reactions under each Senate outcome and distinguish those reactions from our policy assessment.
- **A definitive result may not be available Wednesday morning. Alaska's ranked-choice voting process could delay a Senate call for several weeks. In 2022, Senator Lisa Murkowski (Republican) was not declared the winner until November 23.**

Knee-jerk Winners and Losers if Democrats Win the Senate – Assuming that Democrats also win the House, investors could initially favor sectors perceived to benefit from Democratic priorities while selling those that are perceived to be targets of greater scrutiny or regulation. We would be cautious about reading the election results as indicative of looming policy changes.

- *Perceived Winners –*
  - *Clean Energy –* Investors might see a glimmer of hope that clean energy tax credits could be revived or extended. Government funding and debt ceiling standoffs may give Democrats opportunities to reverse some relevant provisions in the One Big Beautiful Bill Act. **Our take**: These pressure points could give Democrats the leverage that they would otherwise lack to boost the tax credits. The tax credits also have some GOP support, so they could be revived even in a split Congress.
  - *Healthcare* – Healthcare providers and insurers could rally on expectations that a Democratic Congress would reverse Medicaid cuts and would seek to restore Obamacare subsidies. **Our take**: The Medicaid cuts do not become

effective until 2027, so Congress could simply delay the implementation date. We see this as an easier option than restoring the Obamacare subsidies.

- *Consumer* – Consumer stocks could rally on the view that budget cuts impacting lower income households might be reversed. Our take: Restoring SNAP benefits and related programs will be difficult even if Democrats sweep the midterms. However, unless Republicans pass another reconciliation bill during the lame duck session, which includes additional spending cuts, we think the midterms would, at least, place a floor under the spending levels for programs targeted for lower-income workers.
- *Industrials/infrastructure* – Companies tied to the surface transportation bill could see a rally on Wednesday. Our take: The surface transportation law needs to be reauthorized. Companies tied to mass transportation could benefit from a Democratic win, while companies tied to highway construction and maintenance might see less funding than if Republicans remain in the majority.

- *Perceived Losers –*
  - *Pharmaceuticals –* Pharma stocks could face selling pressure due to concerns that Democrats might target drug prices as part of their focus on affordability. Our take: Drug price regulation is one area where there could be common ground between the White House and congressional Democrats.
  - *Data Centers and Artificial Intelligence* – Similar to pharma, investors may be concerned that a Democratic Congress will focus on affordability issues that could target data center development as well as AI. Our take: We are skeptical that Congress will intervene on either of these matters in a meaningful way. A lame duck session permitting agreement could include cost-allocation requirements and ratepayer protections. However, it could also create opportunities for new power generation. Without that combination of responsibilities and opportunities, we doubt Congress will pass a heavy-handed, cost-bearing bill. On AI, we think Congress is still in early days in the debate about regulation. Absent exogenous events that could force Congress to act, we are skeptical that Congress will pass anything more than symbolic legislation regarding AI during the next two years.
  - *Defense* – This sector might be perceived as a loser on the belief that Democrats could cut defense spending. Our take: The defense budget is likely to increase regardless of the election outcome. Democratic control could slow the rate of growth relative to Republican leadership, but a selloff based on expectations of spending cuts could be an overreaction.
  - *Banks and Financial Services* – The prospect of Senator Elizabeth Warren (Democrat-Massachusetts) as Chair of the Senate Banking Committee could weigh on the sector. Our take: The implications of a Warren chairmanship could be nuanced.
    - Democrats could revive President Trump's credit card interest rate cap proposal. In our view, the proposal's prospects would certainly get a boost from a Democratic sweep and investors would be justified in their concerns.
    - Warren would probably prioritize oversight of the banking regulators, especially regarding their agenda related to large banks. However, it is unlikely that Congress will block or roll back the Trump regulatory agenda, so investors should not overreact to the news. The Banking Committee, as well as other committees, could conduct investigations into the Trump administration's handling of the Jeffrey Epstein matter. The potential disclosure of new information could pose a risk for some large banks. Mid-sized banks could benefit as Democrats might push deposit insurance reform. Cryptocurrencies will also likely be another of Warren's priorities, but, as with banking regulation, policy changes are unlikely.

- **Critical Race for the Credit Card Industry** – Senator Roger Marshall (Republican-Kansas), a sponsor of the Credit Card Competition Act, is in a tight reelection campaign. If he were to lose, then that effort would be damaged (at least in the short term). The bill's other author, Senator Richard Durbin (Democrat-Illinois), is retiring. A Marshall loss could be positive for the credit card sector.

Knee-Jerk Reactions if Republicans Keep the Senate Majority – If Republicans defy the conventional wisdom and maintain their Senate majority, then we would expect a relief rally in the sectors that might react negatively to a Democratic victory. Democrats would still govern the House and gridlock would prevail. In this scenario, Senate Republicans would act as a check on both the Democrats and many of Trump's populist impulses.

- **Pharma** could still face some pressure from House Democrats, but passing drug price regulation will be difficult.
- **Defense** spending may rise more under a split Congress than under unified Democratic control, but budget realities will cap any increase.
- **AI** regulation is already a long shot, in our view. Under divided government, prospects for meaningful legislation will be low.
- Congress still needs to pass the **surface transportation bill**. In a split Congress, Democrats will push for more mass transportation funding while Republicans will push for more highway funding.
- **Banking** investors would be relieved if Warren does not become the Senate Banking Committee Chair. A divided Congress could open the door to another housing bill that includes small bank deregulation. Deposit insurance reform would be on the table, too. Chances of a credit card interest rate cap would decline if Republicans hold on to the Senate.

Updated Election Forecast – The race for the Senate majority remains a toss-up. Democrats have a pathway to win the Senate, but Republicans may hold on in some key races. On the House side, we have no doubt that Democrats will win the majority. The question is, "By how much?"

- **Senate** – Kalshi currently assigns Democrats a 72% chance of winning the Senate. We think that is too bullish regarding the Democrats' prospects. Democrats have momentum in some key races. However, the Democratic leads in several of these races are by razor-thin margins according to public polling. In addition, Trump won some of these states by double-digit margins in 2024. We question whether enough of these states will swing to the Democrats this year. Despite polls showing the Democratic candidate leading in Michigan, we think there is a decent chance that the state flips to the GOP. If we are right, then the hurdle for Democrats will be even higher.
  - **Our Best Guess –** In the tables below, we list 13 races (we added South Carolina) that we think will decide the majority in the Senate. While we rate several races as toss-ups, if we had to guess the winners, we think Democrats will gain three seats net, which will result in a 50/50 Senate in which Republicans will maintain the majority.
    - **Democratic Gains (4)** – Kansas, North Carolina, Ohio, and Texas.
    - **Republican Gain (1)** – Michigan.
    - **Notable Republican Holds: Alaska and Maine** – We believe that Republicans will retain the seats in Alaska and Maine, although we acknowledge that both races will be close and could swing to the Democrats.

- **Pathway to a Blue Tsunami** – Although we expect that Republicans will keep the Senate majority, we acknowledge that there is a pathway to a Blue Tsunami in which Democrats gain seven or possibly more seats.

Key Republican Seats						
State	**Republican**	**Democrat**	**RealClearPolitics Average (as of November 1, 2026)**	**Kalshi Odds for Incumbent Party (as of November 1, 2026)**	**2024 Presidential Results**	**Stifel Washington Policy Strategy Rating**
Alaska	Sullivan	Peltola	Peltola +1.2	31%	Trump +13	Toss-up
Iowa	Hinson	Turek	Hinson +0.5	56%	Trump +13	Toss-up
Kansas	Marshall	Hamilton	Hamilton +2.6	49%	Trump +16	Toss-up
Maine	Collins	Jackson	Jackson +1.7	32%	Harris +7	Toss-up
Nebraska	Ricketts	Osborn	Ricketts +6.0*	75%	Trump +20	Likely R
North Carolina	Whatley	Cooper	Cooper +10.7	3%	Trump +3	Likely D
Ohio	Husted	Brown	Brown +2.6	30%	Trump +11	Lean D
South Carolina	Graham Nordone	Andrews	Graham Nordone +2.7	70%	Trump +18	Likely R
Texas	Paxton	Talarico	Talarico +1.4	32%	Trump +14	Toss-up

Key Democratic Seats						
State	**Democrat**	**Republican**	**RealClearPolitics Average (as of November 1, 2026)**	**Kalshi Odds for Incumbent Party (as of November 1, 2026)**	**2024 Presidential Results**	**Stifel Washington Policy Strategy Rating**
Georgia	Ossoff	Collins	Ossoff +8.2	97%	Trump +2	Likely D
Michigan	El-Sayed	Rogers	El-Sayed +3.5	76%	Trump +1	Toss-up
Minnesota	Flanagan	Tafoya	Flanagan +5.8	90%	Harris +4	Likely D
New Hampshire	Pappas	Sununu	Pappas +6.7	92%	Harris +3	Likely D

- **House** – The race for the House majority has, in our view, been over for some time. Democrats need to gain only three seats net to retake the House, and they are well positioned to do so. The party that does not control the White House has gained

seats in 17 of 19 midterm elections since World War II. The average gain has been 26 seats. Due to Republican redistricting efforts in certain states, Democrats might not meet the historical average. However, we expect that they will win enough seats to flip the House. Currently, Kalshi shows a 93% probability that the Democrats will win the House. We agree with this assessment, which has been our view for quite some time.

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