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Listeners of the Potomac Perspective podcast know that baseball is a favorite topic on the podcast. Recently, it has seemed that the New York Yankees and congressional Republicans were on similar paths – insurmountable leads that have dwindled. Republicans are still likely to flip the House but not by the margins previously expected. The Senate has always been a tougher task for Republicans and remains a toss-up. This note looks at some potential policy ramifications following the election and at the political outlook for November.

In recent weeks, additional states have held primaries and there have been several special elections to fill current vacancies in Congress. These primaries and special elections have clarified the political environment heading into the November midterms. Chances of a “red wave” and a Republican sweep have diminished but are not completely gone. Democrats’ chances of keeping the Senate are slightly better than 50/50 but several Democrats remain vulnerable. Despite a rough few weeks, Republicans remain favored to win the House but by a smaller margin than previously expected, which has implications for 2023. Obviously, with two months to go, the situation remains fluid.

Here is our view of what the midterms could mean for policy and the markets followed by our take on the state of the election.

If the GOP Wins – The following is an overview of what to expect if Republicans win either the House or Senate. The GOP’s chances of winning the House are better than winning the Senate, but a sweep of both chambers has limited incremental implications. Gridlock is the likely outcome of a Republican win in either chamber. Winning the Senate would give Republicans the ability to block judicial and administrative nominations but would not have a material impact on legislation given President Joe Biden’s veto authority.

House Republican leaders have signaled their intent to investigate the Biden administration on numerous fronts – border security, energy and climate policy, China, the withdrawal from Afghanistan, as well as the Department of Justice and the Federal Bureau of Investigation (including the search of Mar a Lago and the investigation of Hunter Biden) to name a few. Investigations could be a dominant theme in a Republican Congress.

In addition to investigations of the executive branch, congressional Republicans will likely hold hearings on the social media industry, technology, and national security, as well as woke capitalism. Investors should expect significant pushback from Republicans against environmental, social, and governance (ESG) policies – both as mandated by government regulators and as self-imposed by the private sector. Republican chaired House committees will have CEOs of companies that actively engage in social policy testify and defend their positions. Although much of this will be smoke, there will be significant heat at the state level where Republican governors, state treasurers, and comptrollers will use political levers to punish firms that refuse to do business with a state’s key industry (e.g. banks that refuse to lend to energy companies could be blocked from participating in municipal bond offerings).

The hearings and investigations mentioned above will probably occupy most of Congress’s attention and leave little time for legislating on numerous issues. Legislating could be limited to “must pass” items such as government funding bills. Even then, Republican leaders will face resistance within their ranks against cooperating with the Biden administration. The House Freedom Caucus, a group of conservative Republicans, has already warned the GOP leadership against agreeing to a long-term spending bill

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during the lame duck session of Congress. The Freedom Caucus votes as a unit, which gives the group significant leverage to block legislation it opposes – even legislation supported by the GOP’s leadership. This can make the House almost unmanageable for Republican leaders.

If Congress fails to pass an omnibus appropriations bill in 2022, 2023 could see a series of short-term continuing resolutions (CRs) that fund the government at FY2022 levels. This, in turn, delays increases in defense spending or additional highway construction spending above last year’s levels. It also increases the risk of government shutdowns. Relatedly, Congress will need to raise the debt ceiling at some point in 2023 (if it is not raised by the end of 2022). The Freedom Caucus might withhold its support of a debt ceiling hike, which would leave Republican leaders in the unenviable position of looking to the Democrats to help raise the debt ceiling. Although Congress will likely raise the debt ceiling in 2023, Republican divisions could make a default seem more likely than is currently priced in and lead to market volatility.

If Democrats Hang On – If Democrats defy both expectations and history and retain the House and Senate, then the party will probably revisit items that were in early versions of Build Back Better but were dropped from the Inflation Reduction Act. Tax hikes on wealthy individuals (including marginal income tax rates and capital gains tax rates) and on trusts and estates could be back on the table. Also, Democrats might try to pass additional climate spending proposals and an expanded child tax credit. If Democrats somehow sweep Congress and gain two Senate seats, they might try to end the filibuster, which could make future legislating easier (for both parties).

The biggest unknown emanating from a potential Democratic win is the future of the Democratic leadership. It is widely assumed that if Democrats lose the House, then House Speaker Nancy Pelosi will probably step aside. However, will Speaker Pelosi remain as Speaker if Democrats prevail? If Pelosi retires as Speaker following a Democratic win, who will succeed her? A new generation of Democrats would probably be in line for the leadership and Representative Hakeem Jeffries (D-NY) seems to be the frontrunner to succeed Pelosi as House Democratic leader but there are significant questions about Jeffries’ (and others’) leadership style and effectiveness. Pelosi has succeeded in keeping House Democrats mostly united. Her successor might have a tougher time in maintaining unity among Democrats.

Election Status – As of a few weeks ago, Republicans looked like a lock to win the House. In the past two months, the Supreme Court decision in the Dobbs case, lower gas prices, and a pair of legislative wins have bolstered Democrats’ prospects for the midterm elections. During that time, a series of primary and special elections have given a clearer picture of what November might look like. Democratic turnout in primaries such as Florida is similar to 2018 (a good Democratic year) and a recent NBC News poll showed that Democrats had closed the enthusiasm gap. According to NBC, 66% of Democratic voters have a high level of interest in the midterms. This is only two points behind Republican voters and closer than the eight point gap NBC showed a few months ago. In addition, Republicans have underperformed in special elections to fill vacant House seats in Minnesota and New York. Democrats won a special election in NY-19 despite expectations that Republicans would win the race, and Republicans won in MN-1 but only by four points in a district that President Donald Trump carried by ten points in 2020. These are not signs of a red wave.

Republicans continue to enjoy political advantages and the recent Democratic surge could subside by Election Day. President Biden’s student debt forgiveness program might play well with parts of his base, but it could also backfire and alienate voters who have paid off the student loans and voters who did not attend and have no student loans to pay off. Also, Republican ads that put the focus back on Democratic vulnerabilities (the economy, crime, border security, etc.) are starting to ramp up and could reverse recent polling trends.

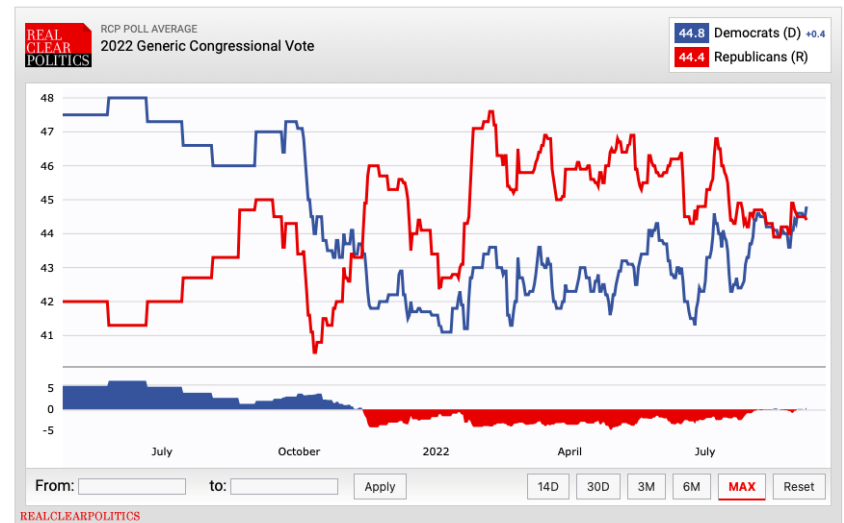
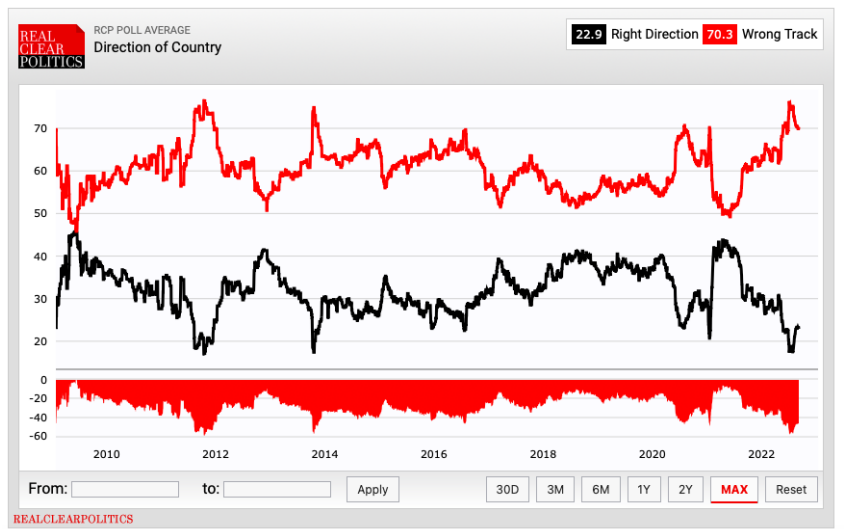
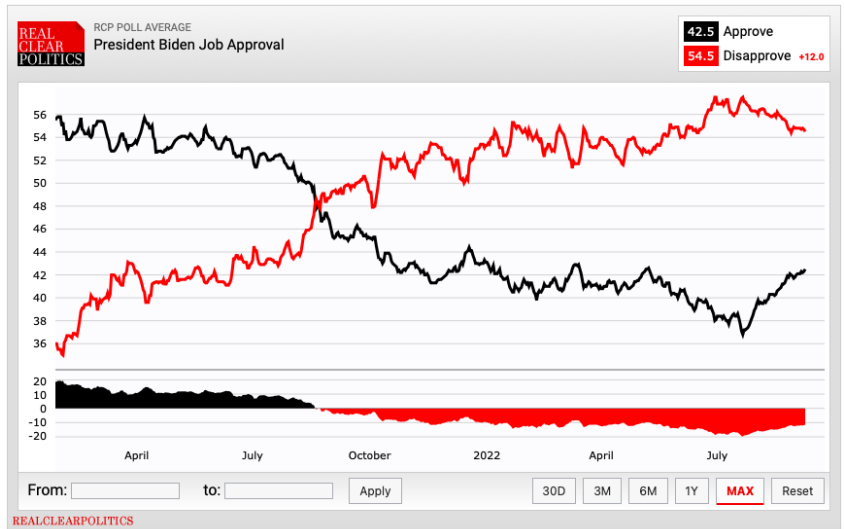
The biggest question is how much will former President Donald Trump be in the media in the coming weeks? If he remains in the headlines, then Republican attempts to refocus the election on the Biden administration could fall flat. If Mr. Trump can remain quiet and reduce his press exposure, then the political focus can switch back to Democrats, which should boost Republican prospects.

Republicans remain favored to flip the House. The average gain for the minority party in a midterm election is 27 House seats and Republicans need only a gain of five to flip the House (note: the GOP unexpectedly gained 13 seats in 2020 which could cap its 2022 upside). The Real Clear Politics poll average shows that President Biden’s job approval number has recovered from its low point but is still weak, which leaves Democrats vulnerable.

Also, the RCP poll on the direction of the country shows an exceptionally high number of voters think the country is on the wrong track, which is bad news for Democrats.

While the gap in the generic poll has closed, Republicans often outperform the poll, so Democrats probably need to lead by several points in order to retain the House.

Republicans always faced challenges to win the Senate. Democrats are only defending 14 seats and many of those seats are in reliable Democratic states. On the flip side, Republicans are defending 21 seats including four in states where the incumbent Republican senator is retiring, thus making the race more competitive than it would be otherwise. The GOP has limited opportunities and is playing defense in several key states.



Nine key races will likely decide control of the Senate. Republicans need a net gain of one to win the majority. The following is a list of these races and our current view of the races:

Key seats currently held by Democrats:

- **Arizona:** Sen. Mark Kelly (D) v. Blake Masters (R) (lean Democrat).
- **Georgia:** Sen. Raphael Warnock (D) v. Hershel Walker (R) (toss-up).
- **Nevada:** Sen. Catherine Cortez-Masto (D) v. former Nevada Attorney General Adam Laxalt (R) (toss-up).
- **New Hampshire:** Sen. Maggie Hassan (D) v. TBD (primary on September 13, 2022) (likely Democrat).

Key seats currently held by Republicans:

- **Missouri:** Missouri Attorney General Eric Schmitt (R) v. Trudy Busch Valentine (D) (likely Republican).
- **North Carolina:** Rep. Ted Budd (R) v. former Chief Justice of the NC Supreme Court Cheri Beasley (D) (lean Republican).
- **Ohio:** J.D. Vance (R) v. Rep. Tim Ryan (D) (lean Republican)
- **Pennsylvania:** Dr. Mehmet Oz (R) v. Lieutenant Governor John Fetterman (D) (toss-up).
- **Wisconsin:** Sen. Ron Johnson (R) v. Lieutenant Governor Mandela Barnes (D) (toss-up).

If the political winds shift back in the Republicans' favor, the GOP could have a chance at flipping Colorado and possibly Washington but both states look like longshots right now.

Too many Senate races remain toss-ups so possible outcomes range from a Republican net gain of one or two seats to a Democratic net gain of one or two seats.

Based on the recent trends in primary and special election voting and polling trends, we handicap election outcomes as follows:

House	Senate	Probability
Republican	Democrat	55%
Republican	Republican	20%
Democrat	Democrat	20%
Democrat	Republican	<5%

Source: Stifel Washington Policy Strategy

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