August 24, 2026

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Potomac Perspective

The dog days of August may be providing a glimpse of what investors should expect following the midterm elections. The resulting gridlock is likely to mean that Congress will be limited in what it can pass. Instead, we expect the regulatory agencies and the Federal Reserve to be the venues where the policy action takes place.

- The relative quiet of summer underscores where the policy action will be gravitating towards in the coming months and years. Congress has been out of town on the campaign trail, so there have been few headlines emanating from Capitol Hill. However, that does not mean there have been no developments regarding economic policy. The Trump administration has engaged in several policy actions, and we expect that to be the case in the coming two years – especially in 2027.
- Our base case is that the midterm elections will produce divided government and gridlock. In this scenario, Congress will struggle to pass legislation that moves the needle on the economy. Policy action will be limited to the administration and the Federal Reserve.
- Following Treasury's announcement of increased buyback activity, Secretary Scott Bessent said that the department has a "big toolkit." The administration might need to use it if Congress is unable to pass legislation. We also expect that the regulatory agencies will be busy implementing President Trump's agenda during his last two years in office. The Securities and Exchange Commission (SEC), the banking regulators (including the Consumer Financial Protection Bureau) are likely to be active in coming years.
- Despite the low odds that Congress will enact far reaching legislation in 2027 and 2028, there will still be a flurry of activity on Capitol Hill as the two parties position themselves ahead of the 2028 presidential election. We expect that Congress will debate legislation to regulate artificial intelligence, data centers, and social media. However, we are skeptical that it will be able to pass impactful policy changes. The housing bill passed earlier this year demonstrates our point. The ROAD to 21st Century Housing Act passed Congress with broad bipartisan support but will have only a limited impact on the housing market.
    - Currently, the only way to pass meaningful legislation is to have a unified government with sufficient majorities in the House and Senate that can withstand defections among members of the majority party. We do not expect that these conditions will exist in 2027.
- There could be a handful of exceptions to our outlook. One such exception could be the highway transportation bill which needs to be reauthorized. Still, we think that legislation will simply extend current policy rather than fundamentally changing it.
- Under our base case, lengthy government shutdowns are expected to become more likely, but the economic and market impact will probably be limited. Historically, equity markets have experienced varying performance during past government shutdown periods; future market performance may differ. Certain businesses that are impacted by regulatory action should bear in mind the risk of shutdowns. For example, we think that there could be a shutdown in December that could temporarily close the SEC. We believe companies planning on a late year IPO should be mindful of this, as they consider the timing of a potential offering.

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