Commentary

Midterm election 2026: What matters for investors now

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The magnitude of the Democratic victories in both the Senate and gubernatorial races was surprising and exceeded what many market participants appeared to be pricing. While the outcome is politically significant, investors should resist the temptation to view it as an immediate economic regime change.

History suggests markets have typically looked through midterm election results relatively quickly. Since 1938, the S&P 500 has never been lower 12 months after a midterm election, with an average gain of nearly 15% over the subsequent year. Historically, markets have tended to shift their focus back to the fundamentals that ultimately drive asset prices: economic growth, inflation, corporate earnings, interest rates and monetary policy.

That shift may happen quickly this cycle as well.

While the election changes the balance of power in Washington, it does not dramatically alter the economic backdrop overnight. A Democratic Congress can more effectively block legislation it opposes, but it cannot unilaterally enact a broad policy agenda under a Republican president. The result is divided government, which traditionally limits major legislative changes and can provide a degree of policy stability.

However, investors should be careful not to assume all gridlock is positive. Markets generally welcome divided government when it reduces uncertainty. They become less enthusiastic when it leads to debt ceiling standoffs, budget disputes, funding battles, investigations or prolonged political confrontation. The next 12 to 18 months may be less about which party won and more about how Congress and the White House navigate those issues.

The election may matter more in Austin than in Washington

One of the more underappreciated implications of this election is its potential impact on AI infrastructure.

Over the past two years, investors have debated the likely AI winners. The next debate may center on who pays for the infrastructure required to support AI.

The AI story is evolving from a semiconductor story into an electricity story.

While much of the focus has been on control of Congress, governors, utility commissions, grid operators and local regulators may ultimately have a greater influence on the pace and economics of AI infrastructure development. Data centers require massive amounts of power, water, transmission capacity, tax incentives and permitting approvals, most of which are influenced at the state and local level rather than in Washington.

Now a blue state, Texas sits at the center of this theme. Its business-friendly environment, available land and power infrastructure have made it one of the most attractive markets for hyperscale data-center development. However, the scale of planned investment is beginning to test the limits of existing power generation and transmission capacity.

Virginia offers a useful example of the risks. Northern Virginia's explosive data-center growth has already sparked political and community backlash. Rising concerns around electricity demand, grid costs, land use and taxpayer subsidies ultimately contributed to higher taxes and fees on data-center development, prompting several planned projects, including Amazon facilities, to be delayed, reevaluated or relocated.

At the federal level, the future of 100% expensing for capital equipment could become part of broader tax and budget negotiations. At the local level, a growing not-in-my-backyard, or NIMBY, movement is increasing scrutiny around

power consumption, water usage, tax incentives and the infrastructure costs associated with large-scale data-center projects.

The election is unlikely to change demand for AI. What it could change is how quickly infrastructure is approved, where it is built and who ultimately bears the cost.

Put simply, investors may be moving from a race to build better AI models to a race to build enough infrastructure to power them.

Sector implications

We believe the market impact is likely to be felt more at the sector level than at the broad index level.

Healthcare may be a relative beneficiary, particularly hospitals, Medicaid-exposed providers and life-sciences companies tied to research funding. At the same time, increased health care spending and coverage expansion could be accompanied by renewed pressure on drug pricing and Medicare Advantage reimbursement.

Financials may face a more challenging regulatory backdrop, particularly in consumer finance and payments. However, the sector's long-term earnings power will remain driven far more by interest rates, credit quality, loan growth and capital-markets activity than by election outcomes.

Energy presents a more nuanced picture. A Democratic Congress may favor preservation or expansion of renewable-energy incentives while applying greater scrutiny to traditional energy development. Yet commodity fundamentals, global supply dynamics and geopolitical risks will likely remain the dominant drivers of energy markets in the near term.

Defense spending is unlikely to experience a dramatic shift. A more probable outcome is a continued negotiation between Republican priorities around defense and Democratic priorities around health care, research funding and social programs. The composition of spending may evolve more than the overall level.

What investors should focus on

While the election will command most of the headlines in the near term, we believe investors should focus on several issues that will likely prove more important to long-term portfolio outcomes:

- The trajectory of inflation and interest rates
- Federal Reserve policy
- Corporate earnings growth
- The sustainability of the AI investment cycle
- Fiscal policy and debt-ceiling negotiations
- Continued competition for capital across the economy

The election has resolved one source of uncertainty, but it has not changed the broader investment environment. Inflation remains above prepandemic norms, interest rates remain elevated, government borrowing needs remain substantial and businesses continue investing aggressively in AI and infrastructure.

Ultimately, elections influence markets, but they rarely remain the primary market driver for long. Investors would be well served to recognize the policy implications while keeping their attention focused on the fundamental forces that are likely to shape returns over the coming year.

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