

US midterm elections: Democrats win House, Republicans hold Senate as expected

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Summary

- As widely expected, the Democrats gained the majority in the House of Representatives, whereas the Republicans defended their majority in the Senate
- An impeachment of Donald Trump is highly unlikely as Democrats needed to gain both Houses of Congress
- However, Democrats can block, or at least delay, Republican initiatives from either the Trump administration or the Republican controlled Senate
- The House dominated by Democrats does not have the power to revert policy meaningfully
- No material impact on financial markets and therefore no change to current allocation

Infrastructure spending more or less likely?

Trump's promise to increase infrastructure spending was not implemented so far. Amongst Democrats, there is a lot of sympathy for higher infrastructure spending. However, one could also argue, that Democrats will avoid everything, which president Trump could sell as a success of his administration. If Democrats in the House would follow this obstructive policy, higher infrastructure spending might be less likely after the Democratic House win, although because the two parties do not necessarily agree on which type of infrastructure should be financed.

Further tax cuts for middle income earners

Democrats would favor tax cuts for the lower- and middle-income classes. However, they would like to finance this by higher taxes for the rich. As Trump is not following the traditional Republican agenda, Trump may approve that approach.

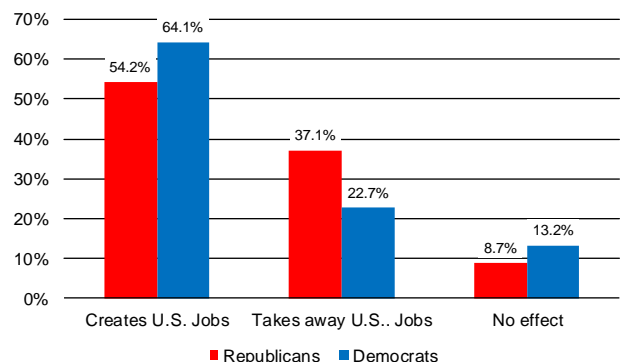
Impeachment

We think impeachment is highly unlikely. Democrats could initiate impeachment after gaining the majority in the House. However, impeachment is decided in the Senate, which is still under the control of Republicans.

Trade policy

Concerning trade policies, the Trump administration can act widely independently from the Congress. Traditionally, Democrats, because of their connections with the trade unions, were more protectionist than Republicans. However, since Trump took over the Presidency, the opinion of Republicans and Democrats on trade have changed. A higher percentage of Democrats than Republicans in primaries believe that "trade creates U.S. jobs" and the reverse is true for "trade destroys U.S. jobs".

Figure 1: Opinion on the effects of trade with other countries, by party primary



Source: The Primaries Project at Brookings

Concerning aggressive trade policy against China, both Republicans and Democrats support the view that China must open access to its markets and is using unfair investment practices. Therefore, we do not expect any change in Trump's trade policy.

Summary

The outcome of the U.S. midterm elections does not alter the growth and inflation outlook for the U.S. and the world economy. **There will be hardly any change in President Trump's trade and fiscal policy for 2019. The House dominated by Democrats does not have the power to revert policy meaningfully.** Furthermore, the path of deregulation will hardly be stopped or reversed.

We still live in a world with many unresolved political issues with a more important impact on global growth and asset class performance than the U.S. midterm elections. We are awaiting the Xi-Trump meeting later in November at the G20 meeting in Buenos Aires to get more visibility regarding trade tariffs. China is stimulating its economy and the Italian budget and details about the Brexit deal are still looming over European markets in particular. Furthermore, a first set of milder than expected sanctions on Iran were implemented on November 4.

Macroeconomic outlook and markets

We see a bipolar world, where the U.S. is growing and first signs of wage pressure should be felt in the coming months according to our proprietary model of the U.S. Phillips curve. However, productivity is improving too, reducing margin pressure for corporates in the U.S. On the other hand, China has to stimulate its economy and the eurozone is going through a (temporary?) slowdown.

U.S. interest rates are therefore rather skewed to the upside and the U.S. Federal Reserve is ready to continue on its hiking path. We are going through a phase of normalization: higher rates, smaller central bank balance sheets; i.e. tightening and no longer easing. Whether this will be a good scenario for equity markets is not clear yet going into 2019, it will heavily depend on earnings surprises and companies' guidance.

Positioning

We keep our neutral equity and slight underweight fixed income stance, which we put in place in late October after the sharp selloff by closing the equity underweight. We stick to our commodity overweight as a late cycle theme, which should profit from China's stimulus and political risks influencing the oil price such as Iran sanctions. For the time being, it is neither time to de-risk considerably nor to go aggressively overweight risky assets.

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