FROM THE OFFICE OF THE CIO

2026 Midterms: A Political Shift, Not an Investment Thesis

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Key takeaways

- **Politics changed, but our investment outlook did not:** Divided government shifts the balance of power in Washington, but economic and market fundamentals remain the primary drivers of our outlook.
- **Stay invested and stay disciplined:** Investors should avoid making long-term portfolio changes based on political preferences. Instead, they should remain focused on financial goals, diversification, and appropriate risk.
- **Stay proactive on tax and estate planning:** Current tax rules remain largely intact, but opportunities can still emerge from changing markets, state tax developments and individual circumstances. Flexibility and proactive planning remain important.

The 2026 midterm elections delivered a more decisive political outcome than expected, but the results do not change our fundamental investment view. Democrats won control of both the House and Senate, ending two years of unified Republican government and setting up divided government for the final two years of President Trump's second term.

The surprise was the number of seats in Congress that the Democrats gained. Democrats flipped seven Republican-held Senate seats in Iowa, Kansas, Maine, North Carolina, Ohio, South Carolina, and Texas. This result gives Democrats considerably more leverage than markets anticipated, changing the balance of power in Washington.

A Democratic Congress will have greater ability to challenge the administration's fiscal, economic, and geopolitical agenda, while President Trump retains the veto. That combination should make sweeping legislation more difficult and put greater emphasis on negotiations over spending, taxes, and the federal budget. For the next two years, the central question is how a president with substantial executive branch authority governs with diminished political capital.

Elections change policymakers and policy priorities, but successful long-term investing still depends on earnings, economic growth, valuations, interest rates, and the ability to stay invested through periods of uncertainty.

A broad repudiation, but not yet a realignment

Democratic gains across traditional battlegrounds and deep into Republican-leaning territory suggest that dissatisfaction with the administration extended well beyond the usual opposition coalition. Affordability, the cost of energy, the Iran conflict and questions about government accountability and corruption appear to have been important factors. Cultural issues that helped mobilize Trump's 2024 coalition appeared less persuasive in the face of other more pressing concerns. But a midterm wave is not the same as a durable partisan realignment. Voters can reject an incumbent party without embracing the opposition's entire program and Democrats, as a party, still only poll equal to or slightly below the president in most polls. Democrats now face the harder task of demonstrating that their electoral coalition can support a coherent governing agenda.

Divided government changes the balance of leverage

Democratic control of Congress creates immediate constraints on the administration's legislative ambitions. Congressional leaders can set committee agendas, initiate investigations, scrutinize federal spending and, in the Senate, influence nominations. The White House retains the veto and considerable discretion in trade, regulation and foreign affairs. The result may be negotiation on a limited set of shared priorities — or a period of confrontation in which the administration relies more heavily on executive action. Neither outcome should be assumed in advance.

The economic agenda becomes a political negotiation

Affordability was central to the campaign and will remain central to the governing debate. But agreement on the problem does not imply agreement on solutions. Tax legislation, federal spending, housing policy and the deficit will require difficult choices, particularly with the parties controlling different branches of government. Major changes to individual or estate taxation would require legislation, making sweeping revisions harder to enact without bipartisan support. Meanwhile, the country's long-term fiscal challenges persist regardless of the election result. The political debate will increasingly concern which priorities can attract a governing majority, not merely which proposals command partisan enthusiasm.

Foreign policy faces a new domestic test

The Iran war demonstrates how quickly foreign policy can become domestic politics. Energy prices, shipping disruptions and the human and fiscal costs of conflict affect public perceptions of economic management and geopolitical strategy. The election may increase pressure for diplomacy and give Congress a stronger platform to examine the administration's objectives. But presidential discretion in national security remains substantial, and electoral losses do not guarantee a change in strategy. The same tension between executive ambition and congressional scrutiny will shape debates over Ukraine, other key alliances and tariffs.

Political capital may be the lasting story

Political capital is not simply an approval rating. It is the practical ability to persuade legislators, institutions, businesses and foreign governments that cooperation will produce durable results. An election can change those calculations even before a single new member is sworn in. Possible scenarios could include Republican officeholders reassessing the risks of aligning closely with the president; Democratic leaders testing the limits of a new mandate; and international partners considering which American commitments are likely to endure beyond 2028.

The administration retains formal power, but its capacity to shape events may be more contested. The next two years will test whether divided government produces restraint, constructive bargaining or prolonged institutional conflict. The defining issue is not only who holds formal authority, but who can convert that authority into lasting results.

Does the result change our outlook?

The election outcome does not materially change our view, but the size of the Democratic victory increases the

potential for changes at the margin. Our outlook already anticipated divided government, which generally limits the prospects for major fiscal legislation because neither party can enact its agenda independently. The larger-than-expected Democratic majorities do not change that basic constraint.

The near-term policy window is the lame duck session before the new Congress takes office. With Republicans losing congressional control, lawmakers may have stronger incentives to address outstanding fiscal priorities while they still can. After that, divided government raises the bar for major tax and spending legislation while increasing the risk of confrontations over appropriations and other fiscal deadlines. For investors, this distinction matters.

The election may change the path of policy, but it does not necessarily change the direction of the economy or markets. Corporate earnings, inflation, interest rates, and economic growth remain more important to our outlook than the party controlling Congress.

Markets tend to move past elections

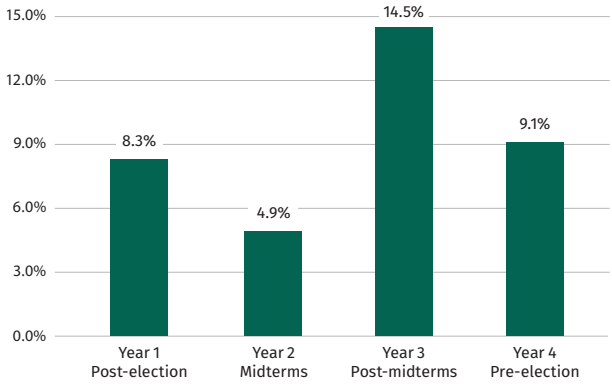
Election uncertainty can affect markets in the short run, but history offers little evidence that one political outcome consistently produces better investment returns than another. Midterm years have historically been more challenging for equities as uncertainty around taxes, regulation, and government spending rises ahead of Election Day. Once the elections are over, uncertainty fades and investors typically return their attention to fundamentals.

The 2026 experience has already been somewhat different. Stocks have remained resilient despite higher oil prices, questions surrounding the scale of artificial intelligence investment, and elevated interest rates. Strong corporate earnings and continued AI capital spending have provided important offsets. Those forces, not the election, have been the primary drivers of markets in 2026.

There is also a broader lesson from the presidential cycle. While historical patterns are not a guarantee of future results, since 1950, the S&P 500 has averaged 4.9% in the 12 months before midterm elections compared with 14.5% in the 12 months after, with gains occurring in 95% of post-midterm periods. (See Figure 1.) Importantly, this pattern has not depended on whether Democrats or Republicans prevailed. Historically, markets have responded more consistently to the resolution of political uncertainty than to the election outcome itself.

Figure 1: Stock Market Returns and the Election Cycle

Average S&P 500 Index 12-month returns, November to November, 1950-present



Sources: Haver Analytics and Fidelity Investments.

What should investors do now?

Election results can create a powerful temptation to reposition portfolios, particularly when the outcome conflicts with an investor's political preferences. History provides little support for making long-term investment decisions on that basis.

Our approach is to stick to the fundamentals of a sound financial plan. Reassess whether risk tolerance or financial goals have changed, rebalance allocations that have drifted from long-term targets, and maintain diversification across asset classes.

For investors, the larger risk is not which party controls Washington. It is allowing political conviction to override investment discipline. Elections change policymakers and policy priorities, but successful long-term investing still depends on earnings, economic growth, valuations, interest rates, and the ability to stay invested through periods of uncertainty.

What we are watching

With the election decided, our attention shifts from who controls Washington to what Washington does. Three developments will help clarify the outlook: the final margins and leadership choices in Congress; whether the White House pursues compromise or confrontation; and whether Democrats can move from electoral opposition to a credible agenda on affordability, governing competence and executive branch oversight.

The lame duck session is the first test, followed by negotiations next year over taxes, federal spending, and appropriations. Those debates could create periods of market volatility and, over time, alter the fiscal outlook. For now, however, the election changes the policy path more than it changes our portfolio view.

What the election means for tax and estate planning

The same logic applies to tax planning: the election changed the politics of taxes far more than the law. The One Big Beautiful Bill Act made most of the 2017 provisions permanent, including the $15 million per-person estate and gift exemption (indexed), the 20% pass-through deduction and 100% bonus depreciation. Repealing any of them requires a presidential signature. Beyond the lame duck session, a Democratic Congress cannot enact tax law over a veto, and a narrow deal on the state and local tax deduction cap is the one plausible exception. The next real opening is January 2029, when the exemption, top bracket and small business stock exclusion could become campaign targets.

Where the risk actually sits

Near-term risk is in the states and at Treasury, not in Congress. California voters rejected a wealth tax and moved to bar future ones, which suggests the next round of state fights will be about rates and residency, not net worth. Treasury and the IRS can also tighten rules on valuation and grantor trust reporting without a vote.

Corporate earnings, inflation, interest rates, and economic growth remain more important to our outlook than the party controlling Congress.

Moves in markets lead to moves in planning

In the recent past, legislative deadlines have been the primary driver for wealth transfer. With none ahead, opportunistic transfer will be driven by volatility in the market. Typically, the strategy is to transfer assets when values are temporarily low and hold when they are high, using structures built to adjust, such as short-term grantor retained annuity trusts, substitution powers and formula gifts made in tranches. Unused exemption is an option on a future dislocation, but it needs a date by which it gets used.

What it means for your 2026 return

The election does not change the tax rules already in place for 2026. The law favors people who own businesses and real estate over those who earn wages and portfolio income. For high earners in high-tax states, the SALT deduction falls back toward $10,000, itemized deductions are worth 35 cents on the dollar rather than 37, and charitable giving must clear a 0.5% of income floor. Owners benefit from the pass-through entity tax election, permanent bonus depreciation and the business income deduction.

Before year end

As year end approaches, consider reviewing key tax and estate planning opportunities with your advisors, including charitable giving, annual exclusion gifts, pass-through entity tax considerations, and broader wealth transfer planning. If you are considering a change in residency, consult with your tax and legal counsel to understand the applicable requirements and ensure your planning and documentation are appropriately aligned.

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Richard Anderson, *CFA®, is a Senior Portfolio Strategist with Citizens Private Wealth. A member of the firm's investment strategy group, his responsibilities include macroeconomic research and asset allocation recommendations, strategy communication, manager selection and portfolio construction.*

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As a Managing Director at Citizens Private Wealth, ***Joe Roberts*** *heads the firm's Family Office for high- and ultra-high-net-worth clients. He oversees a coordinated set of specialty services — estate and financial planning, trust, tax planning, insurance, bill pay, philanthropy and institutional — delivered across Citizens Private Wealth, Citizens Wealth Management and Citizens Private Bank, bringing an integrated family-office experience to clients.*

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