# US midterms: a lame duck at home, but not abroad

For financial advisers and their retail clients. This is not a financial promotion.

Democrats have won control of both the House and the Senate. Markets cheered the result, but we think they have read it a little too optimistically. The President's domestic agenda has stalled, but his hands are far from tied abroad.

### Key takeaways

- **Lame duck at home, not abroad.** Congress can now block the President's domestic agenda, but foreign policy, the war with Iran and tariffs remain largely in his hands.
- **A rare reversal.** Since 1975, one party has controlled the White House and both chambers of Congress for only about a third of the time, and such periods rarely last beyond two years.
- **Oil has priced in too much good news.** De-escalation in Iran is more likely, but far from assured, and Congress's levers are slow.
- **The relief rally has already reversed.** Wednesday's gains were erased the next day as chip stocks sold off, and we expect markets to remain volatile.
- **The AI sell-off looks overdone.** Data-centre construction is more likely to move to more welcoming states than to stop.

## What happened

This was a sweep rather than the split Congress many had expected. Democrats gained at least seven Senate seats, including in states such as Kansas, Iowa, Texas and Ohio, and are on course for their largest House majority in nearly two decades. It is only the fifth time since the Second World War that one party has taken both chambers at a midterm election.

The cost of living, the war with Iran and, unusually, the spread of AI data centres were prominent issues. The new Congress takes office in January, so nothing changes in law before then.

## A lame duck at home

Democrats will hold a majority, but not a supermajority. Around 54 Senate seats falls short of the 60 normally needed to pass most legislation, and well short of the two-thirds needed to override a presidential veto. Neither side can legislate alone.

That leaves the President a lame duck domestically. He cannot stand for a third term, and he now faces a Congress able to block new legislation, shape the budget and launch investigations. It is a sharp change from the past two years, but not an unusual one. Since 1975, one party has held the White House and both chambers of Congress for only around 18 of 52



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**AREAS OF EXPERTISE**

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years, and five of the seven such periods lasted exactly two years. Full control is the exception, and it rarely survives a midterm.

There will be political noise, including investigations and talk of impeachment, but this kind of headline has historically had little lasting effect on markets.

## But not abroad: foreign policy and tariffs

Markets have been quick to assume that a weaker President at home means a more cautious one abroad. We are less sure. Foreign policy is where a US president has most freedom to act without Congress, and a President blocked at home has every incentive to look for results elsewhere.

Tariffs are a good example. The Supreme Court ruled in February that emergency powers could not be used to impose tariffs, but the administration has since relied on other trade laws, notably Sections 232 and 301. These need no new vote of Congress, and Democrats lack the two-thirds majorities needed to override a veto of any attempt to limit them. We expect tariff policy to remain unpredictable, with the courts, rather than Congress, the main check.

## Taxes and spending

The biggest change is what is now unlikely to happen. Further tax cuts or large stimulus payments are effectively off the table. At the same time, existing tax measures are unlikely to be reversed, as any repeal would face a presidential veto.

Democrats' priority is healthcare: restoring health-insurance subsidies, reversing Medicaid cuts and lowering drug prices. These are likely to become bargaining chips in budget talks rather than quick wins. For bond markets, less scope for unfunded spending is a positive, as it eases concerns about government borrowing.

## The war with Iran: oil has priced in too much good news

Before the conflict began in late February, Brent crude was around $70 a barrel. It spent much of the year near $110 and peaked above $116 at the end of October. It has since fallen to the mid-$90s, including a drop of around $8 on the day after the election, as the White House acknowledged the war had cost it votes.

We think that fall has run ahead of events. Congress can pass resolutions to end the war, but the President can veto them, as he has done before. Its main lever, funding, only comes into play from January and is politically difficult to use. The President has accepted that the war cost his party votes, but has also said he would make the same decision again. De-escalation is more likely than before the election, but it is far from assured, and the risk of further escalation remains.

Even with a deal, fuel prices are likely to take months to normalise. Energy feeds directly into inflation, including in the UK, so the path of oil matters for interest rates on both sides of the Atlantic. We would not assume the recent fall is the start of a straight line down.

## AI: the sell-off looks overdone

Data centres were on the ballot in dozens of local votes, and voters opposed them in 40 of 41 cases. Several newly elected governors campaigned on restricting or pausing construction, including in Texas and Ohio, two important data-centre markets.

At first, investors drew a sharp distinction. On Wednesday, chip makers fell, with the main US semiconductor index down around 3%, while the largest technology platforms rose, some to record highs. On Thursday that distinction broke down. The semiconductor index fell by around 10% at the time of writing, and the large platforms turned lower too, on fears that a Democratic Congress and Democratic state officials could tighten AI rules and slow data-centre construction.

The election did not start this debate. Chip shares had already fallen significantly over the past month on concerns that the AI trade had become overextended, with investors questioning when the enormous sums being spent on AI will pay back. The election has added political risk to an existing debate about valuations.

Even so, we think the selling has become indiscriminate. Companies have been sold regardless of their results: one major chip maker fell sharply days after reporting a record quarter and forecasting strong growth for 2027. Demand for

computing power has not changed because of the election; what is likely to change is where it is built. Developers are expected to favour states with more welcoming politics, such as Florida, whose newly elected governor is a vocal supporter of data-centre construction. That means delays and higher costs rather than a halt to investment that is global and funded by highly profitable companies. We expect volatility to persist, but companies with strong balance sheets and established earnings should prove the more resilient.

## How markets reacted

| Market | Wednesday 4 November | Thursday 5 November (intraday) |
|---|---|---|
| Dow Jones Industrial Average | Up 3%, its best day of 2026 | Down around 2% |
| S&P 500 | Up 1.6% | Down around 3% |
| Nasdaq Composite | Up 1.4% | Down around 5% |
| US semiconductor index | Down around 3% | Down around 10% |
| VIX volatility index | Down 20%, to around 17 | Up around two-thirds, to around 28 |
| Brent crude oil | Down nearly 9%, to around $95 | Up around 3%, to around $97 |
| US 10-year Treasury yield | Fell to about 4.9% | Edged lower, below 4.9% |
| Gold | Up around 3%, best day since August | Up around 1.5%, to a two-week high |

Source: CNBC, Yahoo Finance, Morningstar, Axios, Zacks, Kitco, 4–5 November 2026. Thursday figures are intraday at the time of writing. All figures are approximate and for illustration only.

## Equities: from relief to reversal

Wednesday's relief rally did not last. On Thursday, a renewed sell-off in AI and chip stocks erased the post-election gains. At the time of writing, the Nasdaq was down around 5%, on course for its worst day since the tariff sell-off of April 2025, and the main US semiconductor index was down around 10%. Even Wednesday's winners, including the largest technology platforms, turned lower. The VIX index, the market's 'fear gauge', jumped by around two-thirds, its biggest one-day rise in more than two years.

This time the trigger was the election itself, as investors worried that new AI rules and slower data-centre construction could hit the AI supply chain, with weak results from some chip companies adding to the pressure. The speed of the reversal shows how fragile sentiment is, and supports our view that Wednesday's rally had run ahead of the facts. Tariff policy is unchanged, US shares had already risen strongly this year, and oil is rising again on Iran risk.

Two days of sharp swings in opposite directions are a reminder not to read too much into any single session. We would not have chased Wednesday's rally, and we would not sell into falls driven by sentiment rather than fundamentals. For the AI supply chain in particular, the selling now looks indiscriminate to us. We expect markets to remain volatile in the near term.

## Bonds, interest rates, the dollar and gold

US government bonds rallied for a second day, with the 10-year yield falling below 4.9%, its lowest level since September, as investors priced in less fiscal expansion. Markets still expect the US Federal Reserve to raise interest rates in December, with futures pricing in around an 80% chance of a rise, so Friday's US jobs report will be closely watched.

Closer to home, the Bank of England raised interest rates on Thursday for the first time since 2023, by a quarter point to 4%. It now expects UK inflation to peak at around 5% next year, driven largely by higher energy prices linked to the Iran conflict, and the Governor has signalled that this may not be the last rise. It underlines how much the path of oil matters for UK investors.

The dollar fell to its lowest level since late September, and gold rose for a second day to a two-week high above $4,100 an ounce, helped by the weaker dollar and lower yields. For UK investors, a weaker dollar reduces the value of US investments in sterling terms unless the currency is hedged, and higher UK interest rates can add to that effect by supporting sterling.

## What this means for portfolios

Political events tend to drive short-term market moves, while long-term returns are shaped by earnings, inflation and interest rates. That matters now, after two days of sharp swings in opposite directions. In our view, markets have been too optimistic on oil and too pessimistic on parts of the AI supply chain.

Diversification across regions, asset classes and investment styles can help portfolios cope with this kind of rotation, where some areas of a market fall as others rise. We do not change our views in response to an election result alone, and the outcome sits comfortably with the tactical asset allocation views we set in October.

Within equities, we are positive on the US and Japan and neutral elsewhere. Our US view is a medium-term one, and short-term swings in either direction do not change it. In bonds, we favour UK government bonds and are negative on corporate bonds, both investment grade and high yield. We are also negative on commodities and diversified real assets, conservative alternatives and UK cash.

**FE Investments tactical asset allocation views, October 2026**

| Equities | |
|---|---|
| US | Positive |
| Europe | Neutral |
| Japan | Positive |
| UK | Neutral |
| Emerging markets | Neutral |
| Asia Pacific ex Japan | Neutral |
| **Government bonds** | |
| Global government bonds | Neutral |
| UK government bonds | Positive |
| UK index-linked | Neutral |

| Corporate and EM bonds | |
|---|---|
| Global investment grade | Negative |
| Global high yield | Negative |
| EM government bonds (US$) | Neutral |
| **Cash and real assets** | |
| Commodities / diversified real assets | Negative |
| Infrastructure | Neutral |
| Conservative alternatives | Negative |
| UK cash | Negative |

Views as at October 2026 and subject to change without notice.

## What we are watching

- **January:** the new Congress is sworn in and its priorities become clearer.
- **Iran:** any ceasefire, the reopening of the Strait of Hormuz and votes on war powers.
- **Tariffs:** new Section 232 and 301 actions, and the court challenges against them.
- **Budget talks:** government funding deadlines are where Congress has most leverage.
- **AI:** where new data centres are sited, technology companies' spending plans and results from the largest AI chip maker on 17 November.
- **Interest rates:** Friday's US jobs report, the Fed's December decision and whether the Bank of England raises rates again.

**Important information**

This is not a financial promotion and is not intended as a recommendation to buy or sell any particular asset class, security or strategy.

All information is correct as at 5 November 2026 unless otherwise stated. Where individuals or FE Investments Ltd have expressed opinions, they are based on current market conditions, they may differ from those of other investment professionals and are subject to change without notice.

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