



A quick take on the midterms: Gridlock

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Q: What do you think the election outcome means for equities, the money markets and fixed income?

Stephen Auth, chief investment officer for global equities: As we review the outcome of last night's historical midterm elections (the largest midterm voter turnout in the history of the country), our view is this was probably as close as equity investors could have gotten to threading the needle toward a positive outcome. With the Republicans' Senate majority now strengthened and Democrats' House majority narrow enough that an overly radical agenda from that chamber is ruled out, investors have the following to cheer for: 1) two key pillars of President Trump's pro-growth agenda, corporate tax cuts and deregulation (albeit now most likely as an executive branch action), remain solidly in place; 2) the perceived threat to inflation and the bond market of an unexpected Republican sweep has passed; and 3) major policy uncertainty risk for stocks has now been lifted.

To be sure, risks remain, China and the Fed key among them. But having survived the worst possible tail events from these midterms, stock investors have cause for relief—and a relief rally.

Deborah Cunningham, chief investment officer for global money markets: From an economic perspective, divided governance suggests mixed results. While the U.S. economy should continue to outperform the rest of the world, growth probably has peaked, although there is no recession in sight. We would anticipate inflation to continue to trend modestly higher on tariffs and trade disputes, with disagreements on these issues more likely in a divided Congress. We also expect wage inflation to keep trending higher as the worker skills that are available aren't necessarily meeting the requirements of many of the new jobs that are available.

From a money markets perspective, we expect to see modestly higher short-term interest rates, probably in the 3+% neighborhood, with good growth and opportunity in liquidity products in a slightly increasing market.

Robert Ostrowski, chief investment officer for global fixed income: Last night was as expected: no macro surprise and no real new information. The margins on the House and Senate races give something for each side to spin as victory. Maybe the pollsters were the real winners. Prepare for gridlock, which is generally constructive for the fixed-income markets as it reduces the tail risk to either end of the pre-election forecast (a "Blue Wave" capturing all of Congress or a "Red Fort" with Republicans holding off the Dems' charge.)

In the short term, we'd expect a relief trade that really started five days ago to continue, with generally moderate movements up in both risk assets and interest rates/bond yields. The focus now shifts to fundamentals and the normal cycle of macro events; up next are the G20 meeting in a few weeks, Federal Reserve policy and the ongoing trade war. Wildcards include the standoff between the European Union and Italy over the new populist Italian government's 2019 budget plans that call for increased spending, and the upcoming Brexit deadlines. Looking further, it will be interesting to see if President Trump and the House Democrats can work together on infrastructure and trade initiatives.



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