MULTI-ASSET

Assessing a Divided Congress and Market Fundamentals

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Tuesday's US midterm elections shifted US Congress to split control. Yet, Franklin Templeton Multi-Asset Solutions CIO Ed Perks says this expected alteration in the balance of power is unlikely to change his US economic outlook or lead to major changes in US policy. He also explains why he looks at multiple fundamental factors when assessing markets, rather than political outcomes alone.

While there had been a lot of noise around the US midterm elections on November 6, when looking at the potential impact to markets, we don't think the Congressional results are likely a cause for concern.

As many commentators predicted, the United States now has a split Congress. The Democrats gained control of the House of Representatives and the Republicans maintained control of the Senate.

US Economic Outlook

In our view, a divided Congress is not likely to have a material impact on our economic outlook. We continue to expect positive global economic growth led by a US economy that appears to be in relatively good health.

Although it's possible that US growth could slow as the boost from fiscal expansion fades, we think the effects will be minor because markets have largely priced in this outcome.

Possible Changes to US Policy

In general, we think a divided Congress will likely leave the overall direction of policy unchanged. We don't foresee major changes to current tax, spending or trade policies.

That said, we could see some pressure on policy-sensitive stocks. For example, if House Democrats push for revisions to health care legislation, we could see some volatility in the health care sector.

These days, it has become seemingly more difficult for both parties to achieve consensus on even the most bipartisan economic issues. One of these is infrastructure. It's unclear to us what a split Congress would mean for infrastructure modernisation. For example, House Democrats might not want to hand President Trump a victory on infrastructure ahead of the next presidential election.

A split Congress could lead to further policy paralysis in Washington.

Taking a Broader View

Our experience tells us a single factor doesn't influence markets in isolation—at least not in the long term. We focus on multiple fundamental factors when assessing markets, rather than political outcomes alone.

After reaching a series of record highs in 2018, US stocks have been volatile in recent months for several reasons. As we mentioned in a previous article, intensifying US-China trade tensions, higher US interest rates and rising inflation are just some of the factors that have led to recent market shifts.

In our view, recent market volatility is not particularly surprising given last year's relative stability. In addition, our research shows the market tends to be volatile during US midterm election years.

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