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US Equity Strategy

Midterm Election Perspective

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CITI'S TAKE

Current polling supports a consensus view toward a House flip. The Senate is a toss-up, but we would not be surprised by a Democratic sweep. Generally, we do not expect a meaningful impact on S&P 500 fundamentals in any outcome over the intermediate term. Rather, we expect incremental sector influences to be more likely, particularly in a Dem sweep. The AI influence is likely to remain the dominant one headed into '27. Consumer Discretionary has been the worst-performing sector in the current term and aligns with falling issue-specific approval ratings.

Midterm Outcome Largely a Fundamental Non-Event — We view the midterms as a fundamental non-event for S&P 500 fundamentals across likely outcomes. Prediction markets and polls point to a House flip toward Democrats, with the Senate a toss-up. Market response should be minimal as this outcome may already be priced in. Historically, equities mildly underperform ahead of midterms with a small pickup in implied vol peaking 3–4 weeks prior, reversing course post-election.

Weak Approval Signals Dem Gains Likely — President Trump's net approval sits below his first-term pace and trails Obama in '14 and Bush in '06, both of which saw chambers flip in the midterms. Approvals are weakest on inflation (–42%), the economy (–27%), and foreign policy (–22%)—difficult areas to reverse in limited time. Diesel prices at all-time highs and a –28% approval on the Iran conflict do not paint a constructive picture.

Sector Implications Skew Toward a Dem Sweep — We expect nuanced sector reactions, most notably under a Dem sweep. Relative performance correlations to party-control odds suggest Semis prefer GOP control, likely tied to AI legislation risk, though we see slim odds of legislation derailing the AI trade given President Trump's veto and anti-regulation stance. Consumer Discretionary has been the worst performer since end-'24, aligning with polling trends amid tariff and gasoline headwinds. Energy led on the Iran situation, a political negative. Financials earn a mixed deregulation grade. HC could benefit.

Dem Sweep Carries Incremental Downside via '28 Read-Through — A Dem sweep may begin to price '28 policy risk, mainly higher corporate taxes and AI infrastructure guardrails. This scenario hands key committees to Democrats, a marginal negative in our view for the AI trade and previous deregulation beneficiaries. Two years of market-negative legislation could reach President Trump's desk for veto, creating a policy backlog ready to advance quickly post-'28.

Offsets Could Turn a Dem Sweep Market-Positive — We caution a Dem sweep is not entirely market-negative. We have argued that the S&P 500 would be higher absent tariffs and the Iran conflict—both headwinds built up under the current Administration. To the degree a Dem sweep curtails or diminishes Executive tariff and war powers, we see potential for a positive market response. We highlight that the '18–'19 case study reinforces that midterms were a relative sideshow versus the Fed.

See Appendix A-1 for Analyst Certification, Important Disclosures and Research Analyst Affiliations.

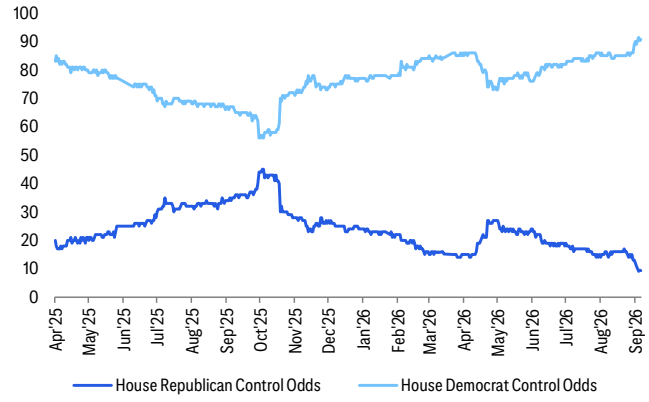
Midterm Implications

We are of the view that the midterms will be, for the most part, a fundamental non-event based on historical connections as well as the higher likelihood of a split Congress. Further, the overall market response should be minimal as this outcome has been well-telegraphed in the prediction markets and polls, limiting the surprise factor for equities. We do not see the rationale to expect monumentally different policy outcomes over the next two years in either of the likely midterm election outcomes, particularly when assessing the probability of policy with sufficient magnitude to impact equity fundamentals.

That said, we do think that, should the Senate go Democrat, there will be nuanced reactions per sector/thematic influences. And, as we point out in this note, there is an open debate as to how investors are thinking of pro-market politics.

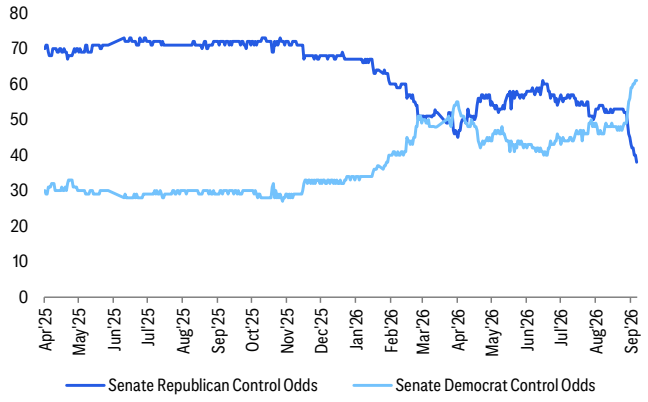
Currently, prediction markets are pricing a high chance that the Democrats flip the House. The Senate is closer to a toss-up, yet with recent momentum favoring the Dems. This is aligned with polling averages, and at this point there should be no surprise to equity markets if the Dems at least flip the House.

Figure 1. House Control Odds (Kalshi)



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Source: Citi Research, Bloomberg

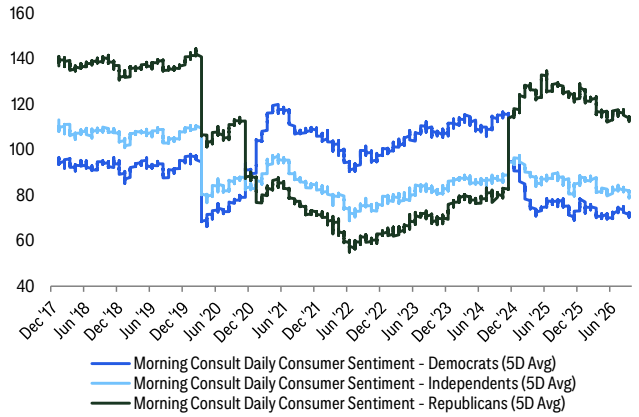
Figure 2. Senate Control Odds (Kalshi)



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We can see in the consumer confidence data that sentiment has weakened across party affiliations since the beginning of President Trump's second term. Interestingly, consumer sentiment for Republicans and Independents was relatively stable leading up to the '18 midterms where the Dems flipped the House and the GOP was able to hold onto the Senate. Consumer confidence data here points to possible midterm underperformance for the GOP relative to '18.

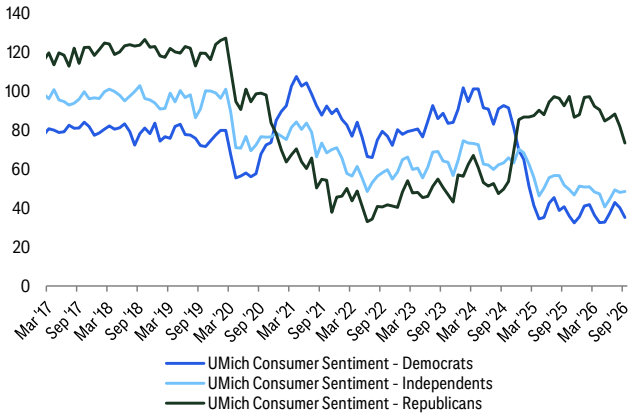
Figure 3. Consumer Sentiment by Party (MorningConsult)



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Source: Citi Research, Bloomberg

Figure 4. Consumer Sentiment by Party (UMich)

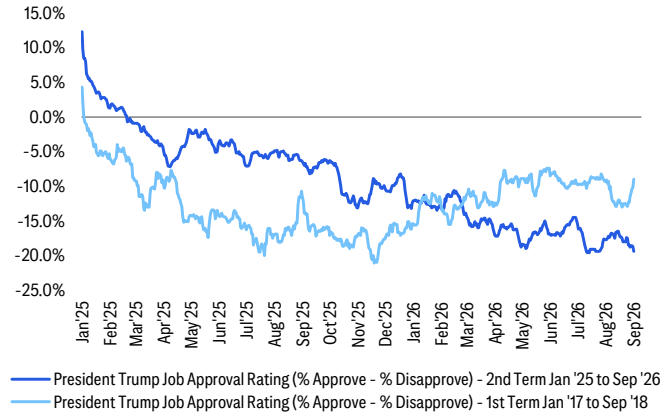


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If we look at President Trump's approval ratings relative to his first term, the data tells a similar story. The President's net job approval rating has diminished since the onset of his second term, underperforming relative to where his approval ratings were at this point in '18. It seems prudent to expect the Dems to gain ground in the midterms unless sentiment on key issues can reverse course quickly. Here, President Trump's approvals are weakest on inflation (–42%), the economy (–27%), and foreign policy (–22%)—difficult areas to change voter sentiment in such a short period of time remaining (Figure 6).

Figure 5. President Trump Approval Rating 1st vs. 2nd Term

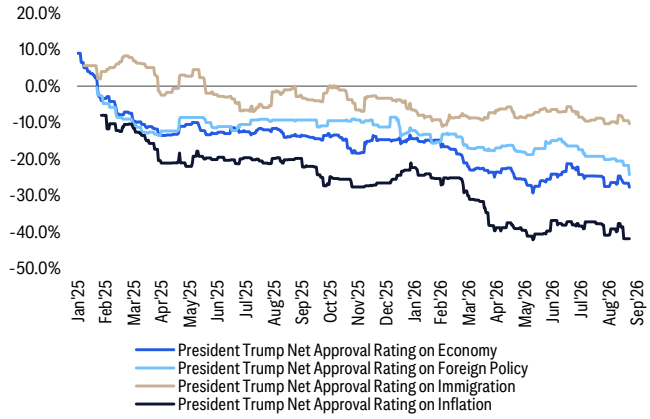


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RealClearPolitics Poll Avg, Net Approval (% Approve - % Disapprove)

Source: Citi Research, Bloomberg

Figure 6. President Trump Issue-Specific Approval Ratings



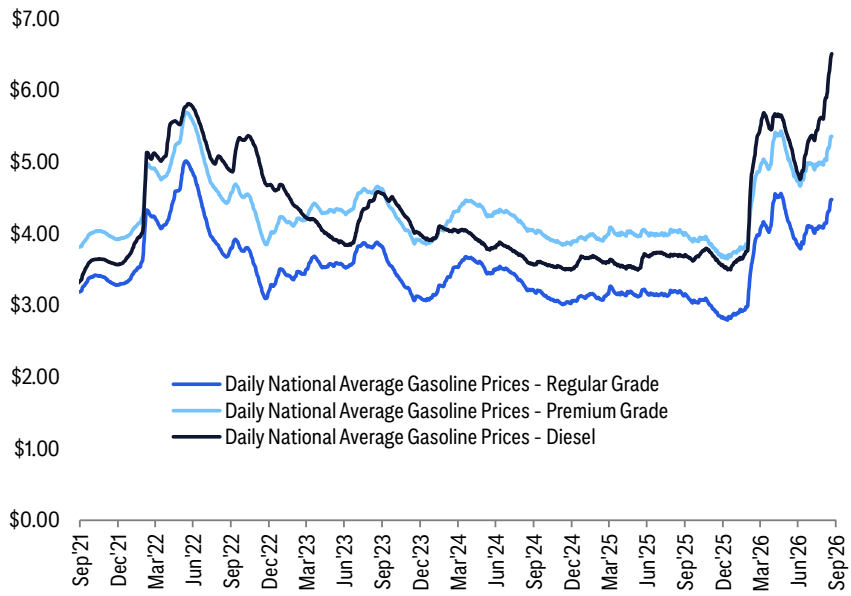
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RealClearPolitics Poll Avg, Net Approval (% Approve - % Disapprove)

Source: Citi Research, Bloomberg

A resolution of the Iran conflict over the next few weeks could still presumably swing some momentum towards the GOP, but time is running out. Diesel prices at the pump reaching all-time highs as the Administration's handling of the Iran conflict falls to a net approval rating of –28% does not paint a constructive picture. A Dem sweep via a strong showing in the midterms invites contemplation on what it could mean for the remainder of President Trump's term and how Republicans in Congress might strategize their campaigns in relation to the President in preparation for '28.

Figure 7. Gas Prices at the Pump



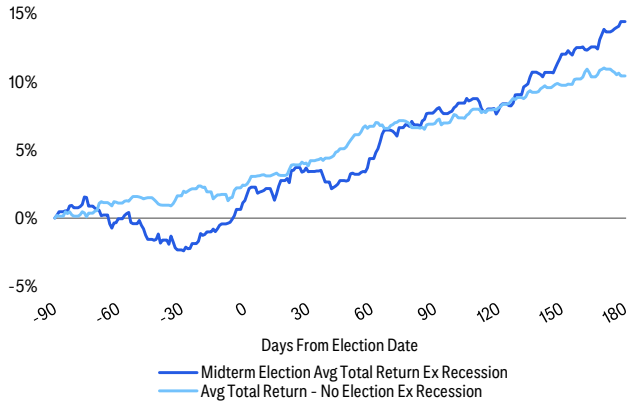
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Source: Citi Research, Bloomberg

It is not abnormal for a President's approval ratings to decline in the second term as political capital is spent. President Trump's approval rating at this time is marginally below where President Obama was in '14 and President Bush was in '06. In both cases, the opposing party ended up in control of both chambers post-midterms, and the incumbent party losing ground in midterms overall is a normal outcome. Given this backdrop and how the polls and prediction markets have telegraphed the changing sentiment, it should not be a large surprise to markets if we do see a Democratic sweep this time around.

Typically, midterm elections are not a significant market-moving event. On average, there is a small pickup in implied vol as equities mildly underperform non-election years in the leadup to midterms. This headwind peaks ~3–4 weeks ahead of the midterms, and then the alleviation of this event vol tends to push equities a bit higher to converge with the non-election-year return pattern within a few weeks post-election.

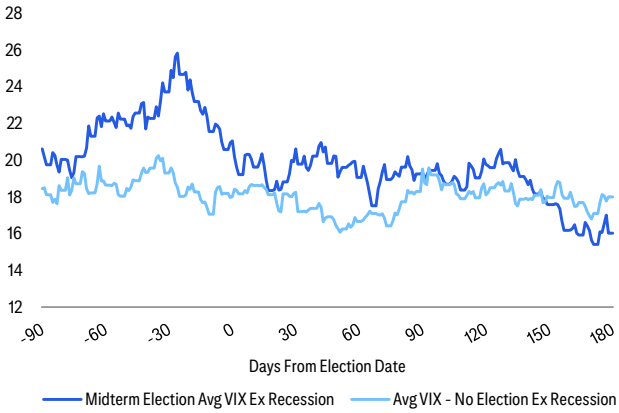
Figure 8. S&P 500 Performance Midterms (Last 60 Years Ex-Recessions)



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Source: Citi Research, Bloomberg

Figure 9. Implied Volatility (VIX) around Midterms (Since 1990 Ex-Recessions)



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Source: Citi Research, Bloomberg

While the data above may be helpful context, we caution these are small sample sizes with only 16 midterm periods over the last 60 years. Most of these periods are not comparable to the setup today; there have only been three instances where there has been a Republican President alongside GOP control of the House and Senate heading into the midterms: President Bush in '02 (GOP held on to the House and Senate), Bush in '06 (House and Senate flipped Dem), and President Trump in '18 (House flipped Dem). Given the small sample size, we think it is worth focusing on how the market has traded this year as party-control odds have changed, as well as what happened in '18–'19 alongside a very similar setup to today.

Interestingly, looking at relative performance correlations this year at the industry group level to House and Senate party control odds, a few trends stand out. The caveat here is that this analysis is likely to produce some questionable correlations. Semis would seem to prefer the GOP holding on to the House and Senate, likely tied to the prospects of AI legislation in the event of a Democratic sweep. In our view, the prospect of Congressional legislation that derails the AI trade is slim in any midterm outcome given President Trump's veto power and clear stance against regulation in this space. Also standing out is the market preference for Democratic control in Insurance, HCES, and Pharma, which may be tied to the belief that a Democratic sweep could restore some lost healthcare coverage, but this could also be a questionable correlation.

Figure 10. 1M Relative Performance Correlations to House and Senate Control Odds (Industry Group Level)

1M Relative Performance Corr to 1M Chg Party Control Odds	Senate R	Senate D	House R	House D
Media & Entertainment	0.04	-0.04	0.09	-0.06
Telecommunications Services	-0.51	0.52	-0.38	0.36
Automobiles & Components	0.21	-0.21	0.32	-0.32
Consumer Durables & Apparel	-0.11	0.15	-0.12	0.11
Consumer Services	-0.18	0.20	-0.32	0.30
Retailing	-0.09	0.05	-0.09	0.11
Food & Staples Retailing	-0.44	0.44	-0.34	0.34
Food Beverage & Tobacco	-0.24	0.24	-0.29	0.27
Household & Personal Products	-0.19	0.19	-0.36	0.35
Energy	-0.51	0.52	-0.39	0.37
Banks	0.03	-0.01	-0.31	0.30
Diversified Financials	-0.10	0.15	-0.34	0.34
Insurance	-0.28	0.31	-0.57	0.57
Health Care Equipment & Services	-0.10	0.12	-0.47	0.46
Pharmaceuticals Biotechnology & Life Sciences	-0.10	0.10	-0.50	0.48
Capital Goods	-0.07	0.07	-0.14	0.11
Commercial & Professional Services	-0.27	0.30	-0.36	0.36
Transportation	-0.05	0.05	-0.32	0.30
Semiconductors & Semiconductor Equipment	0.42	-0.44	0.56	-0.55
Software & Services	-0.01	0.01	0.20	-0.20
Technology Hardware & Equipment	0.14	-0.14	0.14	-0.14
Materials	-0.32	0.33	-0.39	0.38
Real Estate	-0.38	0.38	-0.38	0.38
Utilities	-0.34	0.36	-0.20	0.18

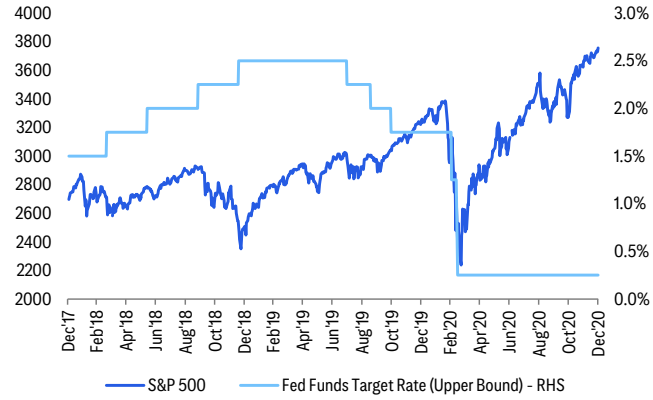
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The '18–'19 case study might be a cleaner way to assess market impact. Democrats flipped the House in the '18 midterms, and with that we saw more focus from President Trump on executive orders, mainly pursuing more aggressive tariff policy with China. Even here, however, it is worth pointing out that the midterms were, in our view, a relative sideshow in comparison to the main market driver at the time, which was the Fed hiking cycle and subsequent pivot. Yes, on the margin, the incremental tariffs created a headwind, yet the more important factor was the Fed.

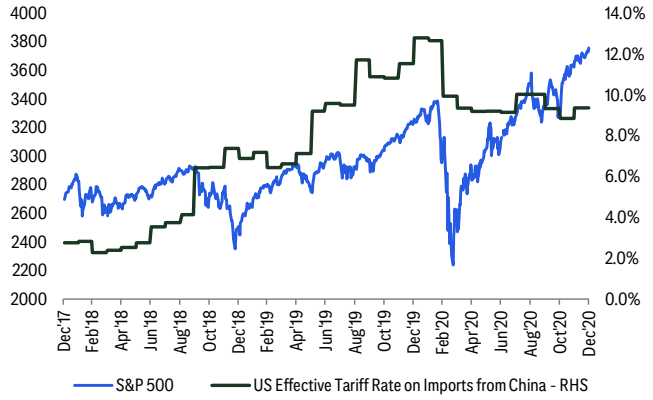


Figure 11. 2018–2019 Case Study – Fed Funds Rate



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Source: Citi Research, Bloomberg

Figure 12. 2018–2019 Case Study – Tariffs



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Below we show sector and industry group level total returns throughout President Trump's first and second terms at this point heading into the midterms. We also show these returns from this point before the midterms through the end of the following calendar year in President Trump's first term. What stands out here is that in the post-midterm period in the first term, we saw healthy index-level returns yet significant underperformance of cyclical industry groups, with tariffs and a restrictive Fed presenting a headwind for the bulk of this period. The growth cohort outperformed, yet the outperformance of rate-sensitive defensive industry groups in an overall risk-on backdrop for equities does stand out. Presumably here, the Fed reversing course from a tightening to an easing bias in the second half of 2019 was a tailwind for this portion of the market.

Looking at Sector/Industry Group returns thus far in the second term and the comparable period through President Trump's first term, one can develop a "report card" of how the related policies have influenced price action.

First, we would argue that the AI trade influencing markets over the past three years has been largely independent of President Trump's policy initiatives. So, Tech and Media performance mostly stands alone. Second, Consumer Discretionary has been the worst-performing sector since inauguration in Jan '25. If there is one sector that aligns with polling trends, it is probably this. The ongoing flow of trade/tariff, oil/gasoline headwinds and related uncertainty seem to mostly show up here. Third, Energy has been the best-performing sector during the second term. Unfortunately, this is more of a political negative than positive as it reflects the ongoing Iran situation. Fourth, notwithstanding the deregulatory promise headed into the current presidential term, Financials performance would suggest a mixed grade.

All in all, S&P 500 performance during the first half of each of the two President Trump terms has been remarkably similar, but the path there has been starkly different.

Figure 13. Sector and Industry Group Level Total Returns, President Trump's 1st Term vs. 2nd Term

Total Returns by Sector & Industry Group	Jan '17 - Sep '18	Jan '25 - Sep '26	Sep '18 - Dec '19
Communication Services	-1.1%	41.4%	16.4%
Media & Entertainment	8.5%	44.3%	15.8%
Telecommunications Services	-1.1%	11.3%	18.7%
Consumer Discretionary	42.9%	0.6%	7.6%
Automobiles & Components	2.1%	-7.3%	3.7%
Consumer Durables & Apparel	27.2%	-22.4%	7.4%
Consumer Services	31.2%	-1.1%	25.1%
Retailing	76.3%	7.0%	3.5%
Consumer Staples	10.2%	12.7%	18.5%
Food & Staples Retailing	24.1%	9.9%	17.5%
Food Beverage & Tobacco	5.3%	25.1%	12.0%
Household & Personal Products	8.9%	-5.5%	35.6%
Energy	6.9%	41.3%	-14.1%
Financials	28.0%	14.2%	10.1%
Banks	29.5%	34.5%	12.5%
Diversified Financials	31.5%	8.4%	6.7%
Insurance	18.2%	4.7%	12.3%
Health Care	39.2%	24.3%	11.3%
Health Care Equipment & Services	52.0%	-5.5%	13.4%
Pharmaceuticals Biotechnology & Life Sciences	31.1%	47.6%	9.6%
Industrials	26.9%	26.1%	5.1%
Capital Goods	24.9%	36.7%	5.6%
Commercial & Professional Services	24.8%	-13.9%	22.2%
Transportation	34.3%	16.7%	-1.6%
Information Technology	60.4%	59.1%	25.3%
Semiconductors & Semiconductor Equipment	48.8%	102.8%	26.1%
Software & Services	58.1%	10.1%	25.7%
Technology Hardware & Equipment	74.3%	68.4%	24.7%
Materials	22.5%	16.4%	4.4%
Real Estate	13.8%	11.9%	22.2%
Utilities	15.9%	8.2%	27.2%
S&P 500	33.3%	32.3%	13.1%

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Source: Citi Research, Bloomberg

We presume that an outcome where the Democrats flip the House and the GOP holds onto the Senate would be closer to a non-event. In this scenario, it is still not likely in our view that we see legislation over the next two years that is meaningful enough to impact equity fundamentals. President Trump will still have veto power, and the setup would point to policy gridlock and continued focus on executive orders—not too dissimilar from the status quo.

If the Dems sweep, there could be incremental downside pressure on equities as the market looks for read-throughs to '28, which we believe holds much more significance in terms of policy impacts on equity fundamentals. The Administration in '28 will be forced to address the Social Security funding gap, and we do anticipate higher corporate taxes to be a main feature of the Dems' solution. Given the six-year term for Senate seats and narrow party-line margins here, each Senate seat picked up in this election does improve the odds of a given party sweeping in '28.

So, with a Democratic sweep, we do see the rationale to price in a larger probability of higher corporate tax rates in out-year estimates, lowering index fair value today. We could also see the rationale on the margin to price more stringent regulations/guardrails on the AI infrastructure buildout in out-year estimates. This scenario would also turn control of key committees over to the Dems, which would be a net negative on the margin for the AI trade and deregulatory initiatives from the current Administration. Here, think two years of potentially market-negative legislation passing through the House and Senate, landing on the President's desk for veto. This would not create policy headwinds near-term yet would create a backlog of finalized legislation ready to roll through quickly should the Dems sweep in '28. We focus on the Dem sweep here as our work on the Dem policy platform heading into '24 highlighted the downside risk to index earnings from tax policy proposals that we expect carry over in broad strokes to '28.

A Dem sweep is not entirely market-negative as there are offsets here. Recall that heading into the '24 elections, we were vocal in our view that a second term for President Trump with GOP control of the House and Senate would not be a market-positive outcome. Our view was that tariff policy would weigh on equity fundamentals, and TCJA extension would bring little in the way of net new tax cuts, with the lion's share of the bill's cost eaten up by extension of expiring tax cuts. Both of these calls have played out, while the Iran conflict has been an additional market negative from the current Administration. Simply put, our view is that the S&P 500 would be higher today in the absence of tariffs and conflict in the Middle East. To the degree that a Dem sweep could curtail tariff and war powers from the Executive branch, or at least diminish the magnitude of these efforts, we could certainly see the possibility of a market-positive response.