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US Equity Strategy

Mid Term Matters

CITI'S TAKE

Mid-term polls suggest a higher probability of a Blue sweep. We expect that this is mostly embedded in current US equity market sentiment. In turn, we need to consider two possibilities. One is that Republicans outperform and retain Senate control (polls within margin of error in key states). A second is that Democrats gain a higher number of Senate seats than expected, perhaps 53+. In the former, we expect a tailwind for equities into year end. In the latter, '28 election consternation could lead to incremental valuation pressure in anticipation of higher corporate taxes.

Scott T Chronert[AC]

Patrick Galvin, CFA

Margin of Error — While probabilities increasingly favor a Blue sweep, several tightly contested Senate races leave open some possibility of Republican control of the Senate or, conversely, a greater than expected Democratic foothold in the Senate. Equity market reaction is likely positive in the former case and negative in the latter.

Approval Ratings and Precedents — Mid-term flips in the House and Senate control are fairly normal, the magnitude of which ties back to approval ratings for the incumbent party heading into the election. Approvals & generic ballot polls imply a significant Dem pickup. Bush in '06 seems the closest analogy.

Beyond Congress — Other governorships and state specific issues will be influenced by the magnitude of Blue wave, or lack thereof if the Dems underperform poll expectations. The AI buildout is likely to be a key determinant here. Investors need to be wary that single state dynamics (e.g., Texas) could influence the AI trade with each of relative losers and winners.

Election Playbook — Our preferred mid-term call to favor Health Care relative to Financials/Banks has mostly played out. Should Republicans retain the Senate, we expect a tactical tailwind. In the event Democrats gain an outsized Senate majority, we expect incremental pressure on equities. Budget, debt ceiling, deficit funding and tax rates all become important issues to prepare for headed into '27.

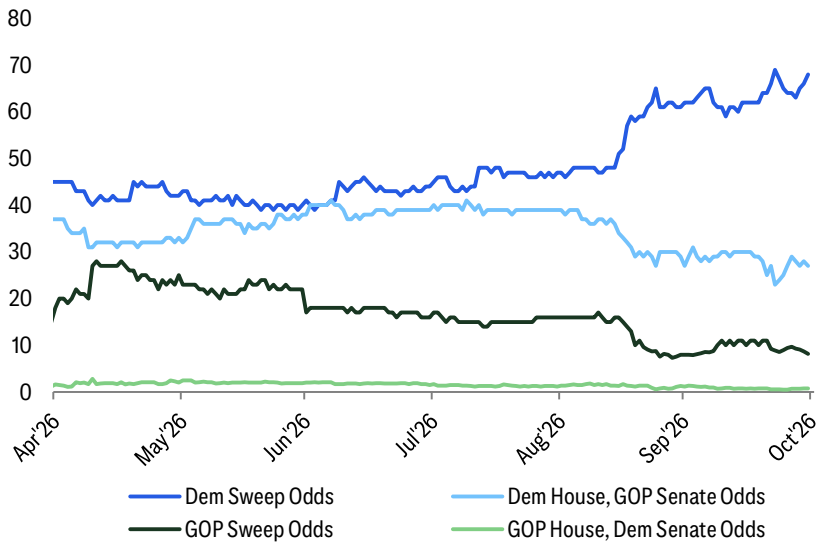
See Appendix A-1 for Analyst Certification, Important Disclosures and Research Analyst Affiliations.

Election Uncertainty and Implications

In our earlier Mid Term Elections note (Mid Term Election Perspective) we concluded that immediate fundamental impacts would be limited while acknowledging a Blue sweep bias and some sector influence as requiring more focus. As we close in on next week's election, there is lingering uncertainty to be navigated that could have both short and long term consequences for US equity price action.

Currently, the odds of a Dem sweep are highest and have been mostly increasing since early September. Figure 1. Yet, a scenario where the GOP holds the Senate is still possible. Our focus here will be on the recent momentum in polls/prediction markets pointing to one outcome or the other and the market implications. While the near-term policy impacts are important, we are also eying the midterm outcome implications for the '28 election where the equity fundamental impacts are more significant.

Figure 1. Midterm Election Outcome Odds (Kalshi)



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Source: Citi Research, Bloomberg

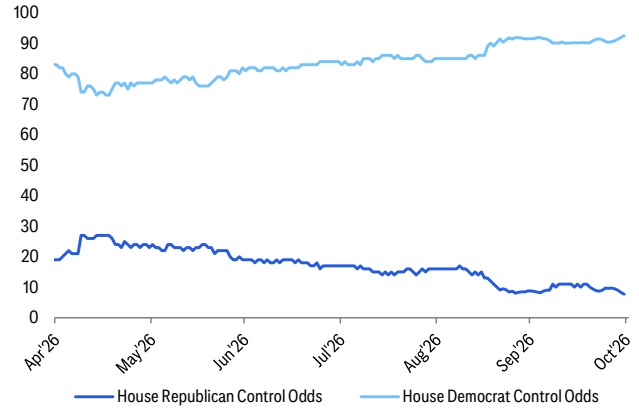
Control of the House

The House is assumed to flip to the Democrats. While largely anticipated, this should be no surprise to markets given the incumbent party typically loses House seats through the midterms and the GOP currently holds a narrow majority. While the House flipping to the Dems is well telegraphed, the important factor will be how many seats the Dems pick up here. A narrow majority for the Dems would force representatives to vote alongside party lines for the next two years. A larger Dem majority in the House would give flexibility for some members to break from party lines on key issues that are important to their respective districts, improving the chance that these seats can be held in '28. Essentially, a larger midterm Dem pickup in the House marginally increases the chance of a Blue sweep in '28 all else equal.

Figures 2-4 provide some context. President Trump's approval rating has steadily deteriorated through his current term, now at the bottom end relative to the last 20yrs for a President heading into the midterms. Generic ballot polls are favoring the Dems by a large margin at this point, but not too dissimilar to the generic polls in '18. Historically, wider generic ballot margins and higher magnitude net

disapprovals have coincided with the incumbent party losing more ground in the midterms. The current combination sets up for the Blue sweep narrative akin to the Bush '06 outcome.

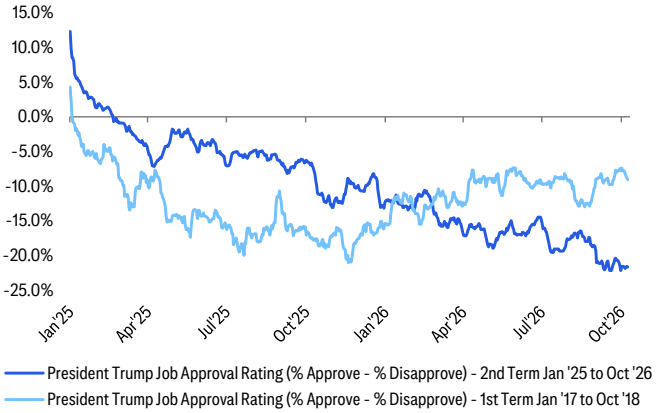
Figure 2. House Control Odds (Kalshi)



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Source: Citi Research, Bloomberg

Figure 3. President Trump Approval Rating 1st vs. 2nd Term

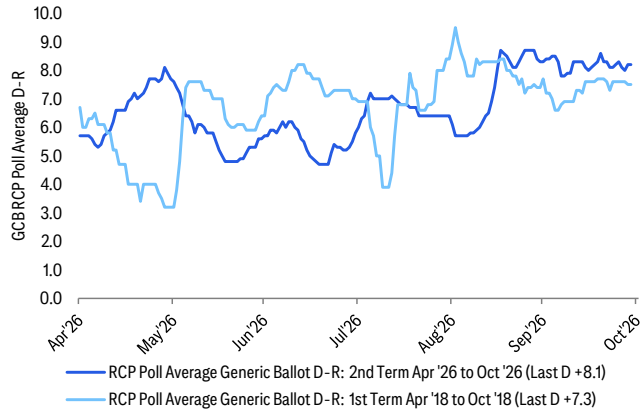


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RealClearPolitics Poll Avg, Net Approval (% Approve - % Disapprove)

Source: Citi Research, Bloomberg

Figure 4. Generic Ballot RCP Polling Avg, 1st vs. 2nd Term



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RealClearPolitics Generic Congressional Ballot D-R Poll Average

Source: Citi Research, Bloomberg

Figure 5. Past Midterm House Results

Midterm Year	President	President Net Approval Rating	Generic Ballot	House Result
2006	Bush (R)	-16.4%	D +11.5	Dem 233 (+31)
2010	Obama (D)	-4.3%	R +9.4	GOP 242 (+63)
2014	Obama (D)	-11.6%	R +2.4	GOP 247 (+13)
2018	Trump (R)	-9.7%	D +7.3	Dem 235 (+41)
2022	Biden (D)	-12.3%	R +2.5	GOP 222 (+9)
2026	Trump (R)	-21.7%	D +8.1	?

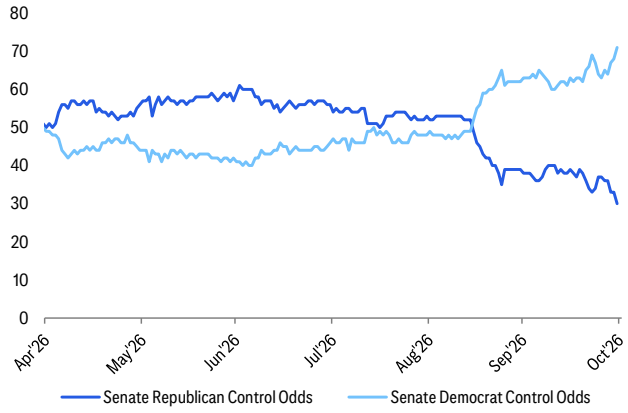
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Source: Citi Research, Bloomberg

Control of the Senate

Here the probability of the Dems flipping the Senate has increased over the last few months, picking up momentum in the last week as early voting commenced. Yet, this result is by no means a certainty as the polls are within the margin of error for several key Senate races. There is still a realistic path for the GOP to retain control of the Senate, yet in our view, a Blue sweep is increasingly embedded in current equity market sentiment.

Figure 6. Senate Control Odds (Kalshi)



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Source: Citi Research, Bloomberg

Figure 7. Past Midterm Senate Results

Midterm Year	President	President Net Approval Rating	Generic Ballot	Senate Result
2006	Bush (R)	-16.4%	D +11.5	Dem 51 (+6)
2010	Obama (D)	-4.3%	R +9.4	Dem 53 (-6)
2014	Obama (D)	-11.6%	R +2.4	GOP 54 (+9)
2018	Trump (R)	-9.7%	D +7.3	GOP 53 (+2)
2022	Biden (D)	-12.3%	R +2.5	Dem 51 (+1)
2026	Trump (R)	-21.7%	D +8.1	?

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Source: Citi Research, Bloomberg

Currently, the Dems still hold the edge in the polls and prediction markets for several toss up Senate races. If results end as the polls/prediction markets suggest in these battlegrounds the Dems would hold 53 Senate seats. Importantly, these seats are for 6yr terms so the margin of victory is significant as to implications for Senate control in '28. In '28, the Dem seats up for re-election are mostly in safe Dem territory so a midterm result of 53+ seats for the Dems does meaningfully increase the probability of a Dem sweep in '28 all else equal. Figure 8.

Figure 8. Key Senate Races

Senate Seats (RCP Category)	Democrat	Republican
Seats Safe or Not Up	42	42
Seats Likely Safe	3	1
Seats Lean to Party	2	1
Toss Ups (Current Party Edge)	6	3
Total Seats (No Toss Ups)	53	47

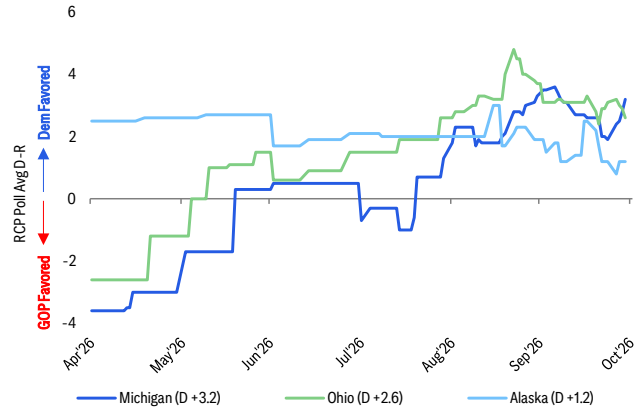
Key Senate Races	RCP Category	Current RCP Poll Avg	Current Kalshi Odds	Category No Toss Ups
New Mexico	Likely Dem	D +16.5%	98.3% D	D
North Carolina	Likely Dem	D +10.7%	96.9% D	D
Georgia	Likely Dem	D +8.2%	96.8% D	D
New Hampshire	Leans Dem	D +6.7%	91.7% D	D
Minnesota	Leans Dem	D +5.1%	90.1% D	D
Florida	Leans GOP	R +6.2%	90.4% R	R
Montana	Likely GOP	R +12.0%	91.9% R	R
South Carolina	Toss Up	R +2.7%	73.0% R	R
Nebraska	Toss Up	R +2.0%	72.0% R	R
Alaska	Toss Up	D +1.2%	69.0% D	D
Michigan	Toss Up	D +3.2%	74.0% D	D
Iowa	Toss Up	R +0.7%	56.0% R	R
Kansas	Toss Up	D +2.6%	53.0% D	D
Ohio	Toss Up	D +2.6%	70.0% D	D
Maine	Toss Up	D +1.4%	67.0% D	D
Texas	Toss Up	D +1.8%	72.0% D	D

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Source: Citi Research, Bloomberg

Recent momentum in the polls varies state to state. Given the number of toss up races within the margin of error, a small aggregate polling bias could result in a

group of toss up races moving to one party or the other. This leaves the door open for a wide range of Senate outcomes from GOP retaining control to a material Dem majority. Momentum in the prediction markets has favored the Dems of late, particularly as early voting data began rolling in this week.

Figure 9. RCP Senate Race Poll Avg D-R (MI/OH/AK)

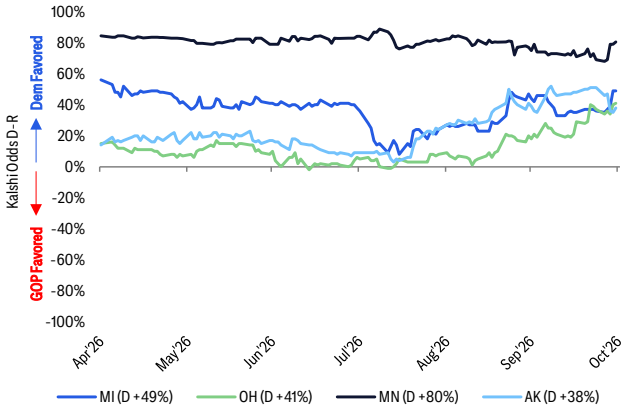


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RealClearPolitics Democrat – Republican Candidate Poll Average

Source: Citi Research, Bloomberg

Figure 10. Senate Race Odds D-R (MI/OH/MN/AK)

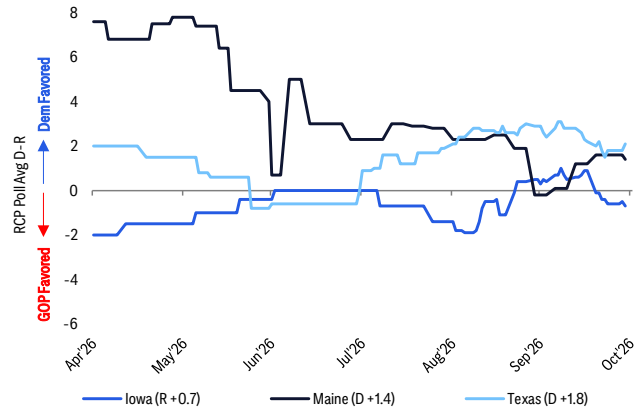


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Kalshi Democrat – Republican Candidate Odds

Source: Citi Research, Bloomberg

Figure 11. RCP Senate Race Poll Avg D-R (IA/ME/TX)

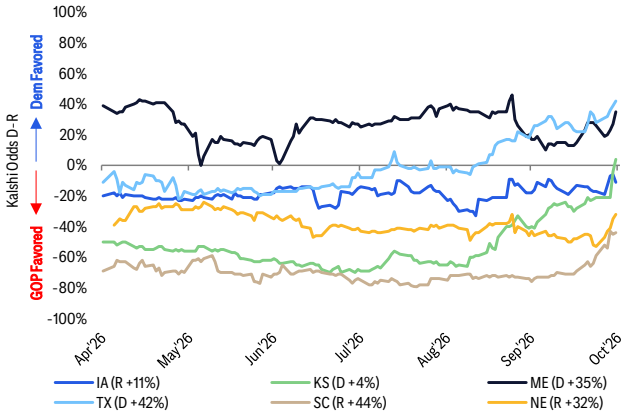


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RealClearPolitics Democrat – Republican Candidate Poll Average

Source: Citi Research, Bloomberg

Figure 12. Senate Race Odds D-R (IA/KS/ME/TX/SC/NE)



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Kalshi Democrat* – Republican Candidate Odds (*Independent for NE)

Source: Citi Research, Bloomberg

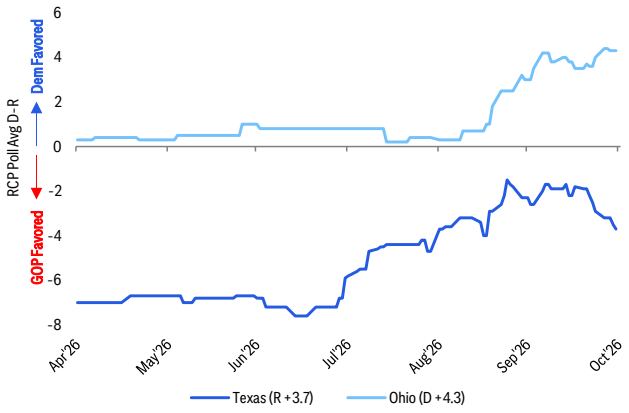
Net net, this implies that the market is discounting a higher probability of a Dem sweep. This implies that a surprise GOP hold of the Senate could set up for a market rally into year end. On the other hand, if the Dems end up with 53+ Senate seats, we need to factor in the implications as to how the equity markets begin to discount the '28 elections. Simply, the stronger the Democratic majority in the Senate, the greater the chances of incremental equity market pressure both short and longer term, which we discuss below.

Governor Races, Local Elections, & Datacenter Buildout Implications

Key Governor races are also important in terms of the potential spillover impact to the Senate races as well as state level policy implications for the datacenter buildout. Texas Governor Abbott (R) has carried a consistent advantage in the

polls, while Paxton's (R) polling has been less favorable in the Senate race. While a split ticket outcome is possible, the spillover risk has put TX in play for the Dems. In Ohio, Ramaswamy's (R) recent decline in the polls may improve the odds that the OH Senate seat also goes Dem. Prediction markets indicate a Dem pickup in at least a few Governor races, which may increase angst for the AI trade as State level legislation pushes down the path of more datacenter opposition. In aggregate, Dems picking up a large number of seats in the House would also imply a similar shift in local elections. Here, we anticipate more hurdles at the local level (zoning/permitting) that on the margin may constrain incremental compute capacity. We are less worried about the longer term fundamental read through here given the net impact would be an elongated supply pathway to bringing compute online rather than cancellations of planned capacity in aggregate. We also note that the market concerns regarding financing pressures to pay for the buildout would be eased in this scenario.

Figure 13. RCP Governor Race Poll Avg D-R (TX & OH)

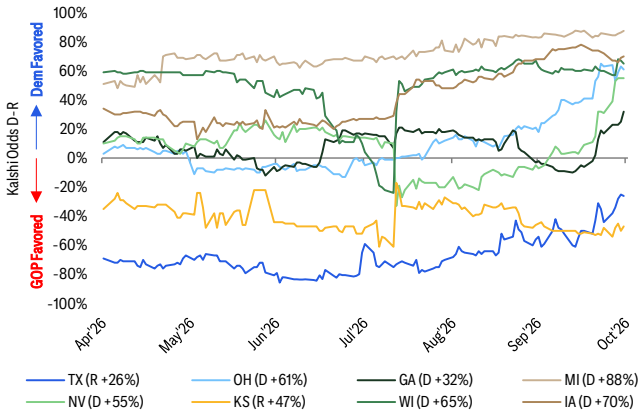


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RealClearPolitics Democrat – Republican Candidate Poll Average

Source: Citi Research, Bloomberg

Figure 14. Governor Race Odds D-R



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Kalshi Democrat – Republican Candidate Odds

Source: Citi Research, Bloomberg

Midterms Market Impact

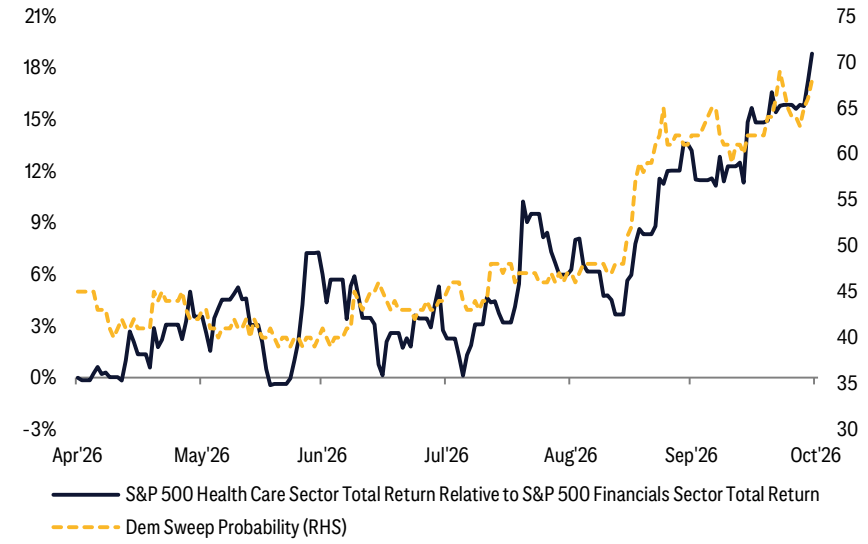
The long HC vs Financials/Banks pair we suggested in our previous mid-term note has largely played out and, if the GOP holds on to the Senate, Fins likely rally. HC just needs the House to flip Dem to open the door for incremental HC spend, potentially reversing some OBBBA cuts through a negotiated budget process in a split Congress. A Senate result favoring the GOP is incrementally a more important trading impetus for Fins given Senate Committee leadership can influence the regulatory sentiment and holds approval power over Fed appointment to fill Powell's seat at the end of his term.

Longer term, the mid-terms outcome is likely to influence how markets handicap a myriad of issues. For '27, budget and debt ceiling are likely to retu
spotlight, particularly as a Democratic majority works to increas
spending while Republicans push for an increase in Defense spe
there are two sides to this as higher deficit concerns are offset b
of increased fiscal stimulus.

The '28 election is still a ways out but markets are likely to start
higher corporate taxes, aligned with Democratic priorities in the

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Figure 15. S&P 500 Healthcare vs. Financials & Dem Sweep Odds (Kalshi)



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Source: Citi Research, Bloomberg

In summary, mid-term election results are unlikely to have an immediate fundamental impact. Rather, sentiment swings in anticipation of policy are more likely. We see potential for a market rally if GOP holds the Senate and would not rule out this outcome just yet given how many Senate races are within the margin of error. A Dem sweep would be a marginal market headwind but where the magnitude is important, as is the outcome in TX. If the Dems take 235+ seats in the House and 53+ seats in the Senate we likely need to weigh a more serious probability of higher corp taxes/Dem sweep in '28.