

# 2022 U.S. mid-term elections: Possible outcomes and impact



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Record inflation, rising interest rates, domestic policy disputes, the war in Ukraine (and the European Union's subsequent embargo on Russian oil imports) and a sharply divided electorate all make for a fascinating backdrop to this year's midterm elections.

I recently spoke with Daniel Clifton, partner and head of policy research at Strategas Securities, to discuss the factors that could impact investors during the run-up to the midterms. Clifton evaluates financial market implications of policy and political development, and he's been ranked as a top Washington policy analyst in each of the past 13 years.

Following is a summary of our conversation.

## **Volatility in politics, too**

Clifton pointed out that economic volatility has translated into political volatility since the 2008 financial crisis. In the eight federal elections since the crisis, voters have removed the party in power in seven of them. According to Strategas, the U.S. hasn't seen that level of electoral volatility since the years immediately following World War II. That's because citizens are voting with their wallets.

"We tried all Republican, we tried all Democrat, we mixed it up, we rolled the dice under Trump, and none of these combinations have been able to get economic growth back to that 3% level that we had before the financial crisis," Clifton said. "We've been growing at 2% instead of 3%, the U.S. economy is about \$4 trillion smaller because of that slower growth rate, and voters just know inherently that their standard of living is not growing as much, and they keep throwing out the existing Congress."

Historically, Clifton said, midterm elections have been referendums on the incumbent president and tended to swing against the party in the White House. That is, after the first two years of a president's term, voters tend to remove their party from power in Congress. The average number of seats a first-term president's party loses in the House in their first midterm election is 29. The margin is likely to be much slimmer this time around.

This year, 34 of the 100 Senate seats are up for grabs, and all of 435 House seats are in play. Republicans need to gain just four seats to take the House, which Clifton notes is a small number for a midterm election. With the Senate evenly split, either party needs to pick up just one seat to gain control of the upper chamber.

"We looked at over 100 years of data and we can only find two presidents who have ever gained seats in their first midterm election, both due to extraordinary circumstances," Clifton said. "FDR during the Great Depression and George W. Bush following the attacks on 9/11. That's a pretty big headwind the Democrats are going into this election with."

President Joe Biden's approval ratings have suffered due to multiple factors—most recently, the spike in gasoline prices—and Republicans performed well in the 2021 elections in Virginia and New Jersey. But while earlier this year Republicans appeared to be positioned for a substantial win on election night, Clifton said the electorate has undergone a historic shift that has essentially neutralized the GOP advantage of a few months ago. What changed? Gas prices fell from \$5 a gallon to \$4 on average nationally, and the Supreme Court overturned *Roe v. Wade*, leaving abortion rights to the states.

"When that happened, the entire political system began to change," Clifton said. "We can look at voter registration files since July 1, and we're seeing a historic increase in the number of women voters relative to men voters, which we think is in direct response to that Supreme Court decision. Then we had a series of special elections in current Congressional districts, which are much better than polling. What you saw is the 13-point Republican advantage has essentially come back down to neutral over the last 30 to 60 days. A lot of those results look like the 2020 election results, which is very similar to a split Congress or split House of Representatives."

## **Legislative implications**

As of early September, Strategas' model indicated that Republicans are in line to win 18 seats in the House. While Clifton still expects the House to flip, Republicans look more



likely to hold a razor-thin majority. Democrats, meanwhile, are favored to win the Senate, according to Strategas' modeling. The key race is in Pennsylvania, which is leaning toward Democratic candidate John Fetterman. If that seat flips, Republicans will need to win two seats to take control of the Senate, which Clifton said would be challenging given the current dynamics.

"Right now, we're planning for a razor-thin democratic Senate and a razor-thin Republican House," Clifton said. "That's going to be a very difficult environment to be able to pass public policy change."

Still, there are some policy initiatives that could be resolved, particularly as we move closer to the 2024 general election. "Once we get to September or October of 2023, members of Congress are going to start worrying about their own reelection in 2024," Clifton said. "If you look at the Senate map in 2024, you have a lot of Democrats that are up for reelection in traditional Republican or swing states. I believe that if you get this combination within the 15 months after the election, you'll likely get some sort of energy permitting reform that would allow for better signing-off of pipelines, particularly with a Republican House. If you have that split scenario, that's something that can get done ahead of the election.

"And contrary to what people say, you get a lot done right before an election," Clifton continued. "Hopefully, the divisive fiscal issues can get resolved in a lame-duck session of Congress, but I wouldn't be surprised if you see some modest changes in energy, and maybe even on tax, given that you have some expiring tax provisions."

Clifton added that many policy changes will largely be determined by how successful the Federal Reserve is in controlling inflation. "If you start to see meaningful inflation reduction, you'll start to see new fiscal proposals come through. Right now, there's a hesitation on expanding the fiscal environment because the fiscal environment exacerbated our inflation issues during the pandemic. If all of a sudden you see inflation coming down meaningfully at the end of 2023, there's going to be lots of ideas to spend more money again."

And there are a few areas where Republicans and Democrats are aligned, allowing for compromise in some agenda items even in a gridlocked environment.

"There's going to be a bid for defense spending in light of what's going on in Ukraine and China right now," Clifton said. "I think you're going to get that regardless of which party wins. One area where we just saw pretty incredible bipartisanship was the [CHIPS Act](#). This was the idea of bringing [semiconductor production] home. In light of a lot of the geopolitical turmoil, we do not want risks to the supply chain. That's the most bipartisan idea that's going on in Washington. There are a lot of differences between Donald Trump and Joe Biden, but on China policy and on tech policy, they're very much aligned. And that tells you that it's becoming the official policy of the U.S. government when you see no real difference between two very different presidents."

### Market implications

One historical indicator that should bring investors hope is how the S&P 500 performs after a midterm election year. Clifton noted that the index tends to be volatile in midterm election years, and this year has been no different. As of September 9, the S&P was down about 15% year to date. After midterm elections has been a much different story. The last time the S&P declined in the 12 months following a midterm election was in 1946.

"Presidents love new fiscal policy the first year, which means the Fed has to tighten in the second year—and boy, are we tightening," Clifton said. "This is the most the Fed has tightened in a midterm election year since 1978. There's no guarantee, but what we think happens is the Fed tightens during silly season in midterm election year. But as those start to fade—inflation begins to come under control, silly season goes away, politicians start worrying about their own reelection in 2024—the stock market picks up a better economic policy, and they begin to embrace that economic policy. This pattern has worked for a long period of time. In the third or fourth quarter of next year, I think you're going to see much better economic and political processes."

We discussed much more during our conversation, including why Clifton expects record voter turnout for a midterm election, how the election results could impact U.S. relations with China and Russia, what it could mean for the 2024 presidential election, and why substantial changes to estate tax laws are unlikely.

[Click here to listen to a recording of the full event.](#)



## Disclosure

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