THE IMPACT OF THE MID-TERM ELECTIONS

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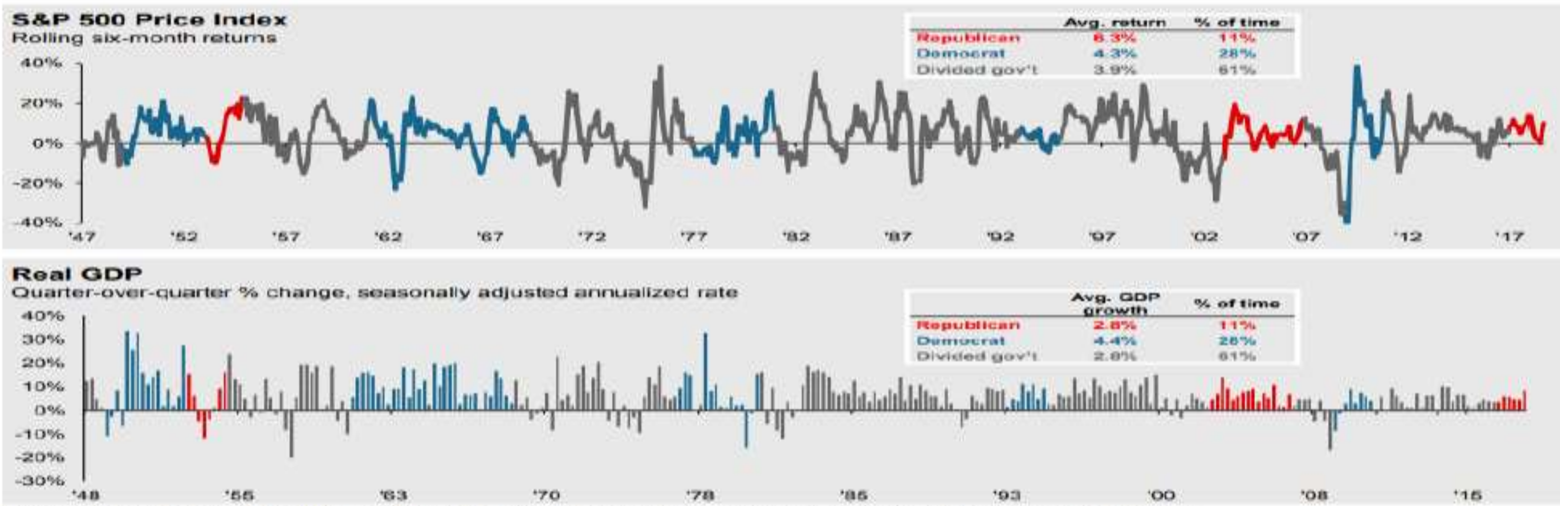
Economy

- The 2016 election resulted in the first Republican unified government since 2006. But historically, divided government, under which the U.S. will operate come 2019, has been more common and generally less conducive to sweeping legislative changes. Therefore, **we do not believe the 2018 midterms will spark policy outcomes that provide a significant boost to economic growth in the U.S.**
- It seems unlikely that Republicans in the Senate and White House will agree to any major changes to the 2017 tax reform bill proposed by Democrats in the House. Conversely, Democrats in the House are unlikely to agree to tax cuts anywhere near the magnitude that occurred in 2017. Hence, **the tax cuts enacted at the end of last year are unlikely to be repealed or significantly expanded.** Areas that may prove fruitful for compromise might include infrastructure spending and health care. Areas that are still very uncertain include immigration reform and international trade.
- President Trump has appeared sympathetic to policy stimulus of all kinds, and **a slowdown in economic growth heading into the 2020 election might lead policymakers to boost spending.**
- **Alternatively, a divided Congress and the President may engage in a prolonged budget standoff next year that results in a debt ceiling debacle and a sharper deceleration in federal government spending.**
- For Treasury supply, the budget deficit will continue widening over the next few quarters, but for the pace of widening will slow by the second half of 2019. As a result, though the level of net Treasury issuance will remain high, the pace of growth is also likely to slow.
- It would also not lead to a subsequently more hawkish Fed. **What does the election mean for interest rate? We expect the Fed to continue with its gradual interest rate increase policy.**
- Using history as a guide, the trend in federal consumption and investment shows no obvious trend when the federal government is under divided or unified party control, regardless of which party holds the reins.
- **The United States-Mexico-Canada Agreement (USMCA) to replace the North American Free Trade Agreement (NAFTA) will likely see a vote in 2019, although a divided government could make this a bit more of a rocky process.**



Source: FactSet, Office of the President, J.P. Morgan Asset Management; (Top) Standard & Poor's; (Bottom) Bureau of Economic Analysis.
Guide to the Markets – U.S. Data are as of September 30, 2018.

Source: J.P. Morgan Asset Management

<u>Markets</u>

- Now that the elections are over and results were in line with expectations, **some uncertainty has been removed. Markets do not like uncertainty.**
- With the economy in solid shape almost across the board, the environment remains constructive for corporate profits though the rate of growth will slow as we go through 2019 due to a the waning effects of the tax reform and the impact of higher interest rates.
- As the market digests higher rates, major changes like **a positive agreement on trade with China, may be needed to spark interest on non-US equities that have more attractive valuation characteristics.**
- With no recession is sight, but a slower rate of growth on the horizon, **a somewhat more conservative domestic equity posture may be warranted.**

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