CIO Perspectives

US Midterm Election Results and Their Market Implications

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US midterm election results

According to AP's election update as of 9 a.m. November 6 JST, in the US midterm elections, Democrats appear to have won 54 seats in the Senate and Republicans 44 seats, with 2 seats undecided, while Democrats appear to have won 253 seats in the House and Republicans 155 seats, with 27 seats undecided. Democrats have secured majorities in both chambers of Congress, making it virtually certain that the "Red sweep"—a situation in which Republicans control the presidency as well as both the Senate and the House—will come to an end. There is a historical pattern in midterm elections in which the President's party tends to lose, so the Republican defeat itself is not surprising. However, Republicans are likely to have lost more seats this time than that historical pattern would suggest. President Donald Trump promptly conceded defeat and conveyed his congratulations to Democrats.

The outcome is expected to diminish the Trump administration's ability to implement its policies, but it will not necessarily make it easier for Democrats to achieve their policy objectives. This is because even if Democrats pass legislation in both chambers, it can be blocked by the President's veto. Indeed, President Trump has said that he will become "Mr. Veto," and Democrats have not won enough seats to override a veto.

After the new Congress convenes on January 3, 2027, the hurdles to implementing policies that require legislation will rise, and the Trump administration is likely to rely more heavily on presidential authority. In trade, the risk of additional tariffs remains. The administration's investigations into excess production capacity and related issues under Section 301 of the Trade Act have not yet been made public, and they could lead to new tariffs.

On the military front, the course of potential attacks on Iran will draw attention. President Trump said last month that he would not attack Iran until the midterm elections. This may have been intended to stabilize oil prices before the election, but the possibility of renewed attacks after the election warrants attention. Given the administration's emphasis on the "Western Hemisphere," sanctions against Latin American countries, military coercion, and military operations aimed at maintaining public order and achieving other objectives also pose risks.

Meanwhile, congressional approval is indispensable for the budget and for raising the debt ceiling. Although bipartisan passage is ultimately expected, conflict between the two parties may deepen before an agreement is reached, making the risks of a government shutdown and debt default more likely to weigh on financial markets.

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Japanese Equity Market Outlook

The U.S. midterm elections produced the outcome anticipated beforehand, with the Democratic Party gaining the upper hand. Japanese equities opened lower on November 4. As reports emerged that Democrats were on course to secure majorities in both the House and the Senate, share prices fell sharply, led by AI semiconductor-related stocks. The Nikkei 225 briefly dropped by around 3,000 points, reaching an intraday low of 60,030. With political leadership shifting toward the Democrats, concerns grew that the AI semiconductor business—which had expanded rapidly under the Republican administration —could lose momentum, including as a result of restrictions on data center construction. This prompted a further sell-off in AI semiconductor-related stocks. Japanese equities continued to decline on November 5 and 6, with the Nikkei 225 falling into the 50,000 range on November 6 for the first time in about six months.

We believe that the recent correction in Japanese equities has already priced in, to some extent, negative factors such as the scale and viability of hyperscalers' massive capital spending, the risk of failing to recoup those investments, and the credit risk of AI cloud companies. At the same time, there is no denying the productivity gains that AI can deliver. We therefore remain convinced that the AI semiconductor business is on a medium- to long-term growth trajectory. The prospect of tighter Democratic regulation of data centers is a concern. However, given the importance of maintaining the United States' technological edge in AI, regulations that could impede the industry's growth will require careful consideration. We do not believe that tighter regulation is inevitable. However, remarks from Democratic figures following the election about AI companies and data center construction were more critical than expected, renewing concerns about the impact on related businesses. Following the sharp sell-off in AI semiconductor stocks in the U.S. market, Japanese equities also fell sharply on November 6.

The interim earnings reports for fiscal 2026 currently being released have, like the first-quarter results, confirmed strong corporate performance. Upward revisions to full-year company forecasts have far outnumbered downward revisions, and we see no major concerns about fundamentals. We also expect Japan-specific factors—including stronger shareholder returns and improved corporate governance, both of which we believe still have room for improvement—to remain in play. Accordingly, our overall positive view of Japanese equities over the medium to long term is unchanged. Moreover, compared with the South Korean and Taiwanese markets, where AI semiconductor-related stocks have a greater influence, companies across a broader range of sectors in Japan are also reporting solid results. We see these broad-based earnings as a positive. For now, we will need to monitor the performance of AI semiconductor-related stocks and how the Trump administration operates following the midterm elections. However, as these uncertainties are priced in, we believe the appeal of Japanese equities will once again be recognized.

Global Equity Market Outlook

On November 4 and 5, global equities, as measured by the MSCI All Country World Index (including dividends and expressed in local-currency terms), rose 1.30% on November 4 and fell 3.0% on November 5, respectively. In the United States, the S&P 500 rose 1.58% on November 4, as equity markets appeared to welcome a temporary easing of uncertainty surrounding the midterm election results.

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However, on November 5, the S&P 500 plunged 4.4%. The Information Technology sector fell sharply, led by AI-related stocks, including memory chip stocks that had attracted attention for their role in building AI infrastructure. This decline appeared to reflect growing concerns that Democrats' stronger-than-expected gains in both chambers of Congress, along with their victory in the closely watched Texas gubernatorial race, could lead to tighter regulation of existing and new data centers and curb demand for data center infrastructure.

The S&P 500 had been on a downward trend since reaching a record high on October 6, as investors were already focused on concerns about the returns on massive AI investments, such as data centers, amid a series of fundraising activities by major U.S. AI-related companies. Uncertainty over the future of regulations on data center construction—highlighted by this year's gubernatorial elections—also appears to have heightened concerns about AI investment. However, a close review of the latest financial results from semiconductor companies and major U.S. technology firms shows that demand for AI remains strong, with no signs of a slowdown in investment. We therefore continue to view AI as a structural growth theme for equities over several years. Regulatory uncertainty could continue to fuel market volatility, particularly in AI-related stocks. Nevertheless, the MSCI All Country World Index's projected earnings-per-share growth for 2027 stood at approximately 17% at the end of October, while its forward price-to-earnings ratio was around 15 times. These figures suggest that valuations remain attractive.

The election results also appear to have reduced the likelihood that legislation leading to a wider fiscal deficit will be enacted under the Trump administration. If this eases upward pressure on U.S. interest rates, it could provide a tailwind for the U.S. equity market. Although U.S. political developments will continue to warrant close attention, we expect stocks—particularly in the United States—to remain firm if investors turn their focus to fundamentals, including robust economic growth and corporate earnings.

Bonds and Foreign Exchange Outlook

The yield on the 10-year U.S. Treasury fell from 4.96% at the close on November 3 to 4.83% on November 5, while bond prices rose. Following the midterm election results, President Trump said that the Republican Party's defeat was due to the attack on Iran. Bond yields also fell as WTI crude oil futures prices plunged on the 4th amid growing hopes that the military conflict between the U.S. and Iran was nearing its end, followed by a sharp drop in U.S. stock markets on the 5th. The Democrats' capture of both chambers of Congress is also thought to have weighed on yields, as investors anticipated that the kind of expansive fiscal spending advocated by President Trump would be less likely.

Looking ahead, we expect U.S. bond yields to face upward pressure as the Federal Reserve (Fed) continues to raise interest rates against a backdrop of resilient economic growth supported by AI investment. Persistent inflation concerns are also likely to put upward pressure on yields. However, if fighting in the Middle East comes to an end and oil prices continue to fall, easing inflation concerns could eventually prompt the Fed to change its policy stance. This possibility warrants attention. In addition, since early October, declines in technology stocks have coincided with falling U.S. Treasury yields. If concerns intensify that Democratic control of Congress will

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slow the pace of AI-related investment, bond yields could fall further alongside a decline in equities.

The yen edged higher against the U.S. dollar following the midterm elections. The decline in U.S. bond yields, among other factors, put upward pressure on the yen. Although the dollar has recently weakened, we expect it to remain prone to appreciation, supported by the strength of the U.S. economy and relatively high interest rates resulting from Fed's rate hikes. However, the risk that political gridlock following the midterm elections could reverse the prevailing trend in foreign exchange markets warrants attention. If the path toward reducing the U.S. current account deficit through the large-scale tariffs advocated by President Trump becomes less clear, this could contribute to a sustained decline in the dollar against major currencies, including the yen, against the backdrop of the twin deficits.

In assessing currency market trends, it will also be important to determine whether the election results lead to any changes in U.S. foreign exchange policy. According to U.S. media reports, President Trump said that he had no plans to make changes to his administration following the midterm elections. Treasury Secretary Bessent is expected to remain in his post. Nevertheless, it will be important to watch whether President Trump shifts toward policies intended to weaken the dollar in order to protect U.S. manufacturing.

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  [Calculation formula] Assets amount under contract x fee rate (%) x length of the contract (days) / 365

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