

# A Blue Wave, A Blue Tide... No...A Blue Ripple



**Jean-Philippe Bry,  
Vice-President and Strategist,  
Signature Global Asset Management.  
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In the end, the U.S. midterm elections turned out to be a blue *ripple* rather than a blue wave. In fact, pollsters got it mostly right this time in predicting a Democratic congress and continued Republican senate where Republicans picked up two, possibly three seats. Several state governorships have flipped to Democrats but not as many as hoped for by the Democratic leadership, especially in important states like Florida and Ohio.

For markets, a split government historically means government gridlock where very little legislation happens, and there is no reason to believe it will be different this time.

Importantly for markets, it means that the Trump administration's tax cuts are intact but any further tax cuts are dead.

For Canada and concerns about passage of the U.S.-Mexico-Canada Agreement (USMCA or NAFTA 2), the vote will be based less on partisan politics than the importance of Canadian trade to a state or congressional district. In other words, the USMCA will have overwhelming support from border states as well as those with meaningful trade with Canada which will be enough to secure its passage.

As for possible legislative initiatives, infrastructure is often mentioned but it will be challenging to pass anything through a Republican senate because of the parties' different approaches. Democrats typically want direct government intervention and spending, whereas Republicans, historically, have distrusted government and prefer public-private partnerships.

Health care is an area that will be difficult to find agreement, although one would expect Democrats to make some proposals that will almost certainly be voted down by the senate. Drug pricing could be the exception given the attention that Trump has given it. But one should not expect major health care reform; just some measures around the edges.

Trade will remain the domain of the executive with little impact on current U.S.-China negotiations. However, Democrats are not averse to the concerns that the administration is voicing about China. There is a rising consensus in Washington that the relationship must change because China has "taken advantage" of the U.S. As a result, Democrats are more likely to stand behind Trump on many of these negotiations with China.

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It is likely that Democrats will use their new position as the head of various committees to launch their own investigations into Russian meddling in U.S. elections, Trump's businesses and the extent to which these companies may be benefitting from his presidency. They have the power to subpoena members of the Trump family and past associates which they are likely to use. Trump isn't likely to take it well. If Democrats overplay their hand it could negatively affect business sentiment, especially if they push to impeach the president. Impeachment would not pass the two-thirds majority needed in the senate.

The U.S. was divided before the election and it is likely to be more polarized going forward. Many of the newly elected Democrats are from the left wing of the party and many of the Republicans that lost their seats were more centrist. With both parties being represented by the more ideological wings of their respective parties, the notion that they will be able to find some common ground appears optimistic. The likelihood is that U.S. politics will be more of the same.

In Signature's view, expect gridlock, which historically is not a bad condition for markets.

We recently increased our equity allocation from underweight to neutral in our balanced funds following the October correction and do not see the midterm election results as a reason to change our neutral positioning at this time.

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