Conversations with Commerce Trust

The Economy, Markets, and the 2026 U.S. Midterm Elections

Recorded August 11, 2026

David Hagee, Chief Investment Officer: Hello and welcome to Conversations with Commerce Trust, our show about the markets, investment themes, and economic insights that matter to you. I'm your host, David Hagee, Chief Investment Officer with Commerce Trust. Today we're discussing the upcoming midterm elections and their economic and market influences with Kelly Jernigan (Director of Family Wealth Strategy). Welcome back to the podcast, Kelly.

Kelly Jernigan, Director of Family Wealth Strategy: Great to be here, David. Thank you for having me.

David Hagee: Excited to have you. We're on the cusp of election season, so no better time to talk about what this is going to look like or what we think it's going to look like for the midterm elections. And then really, more importantly for us is the influence it's going to have on both the economy and the markets.

Historically, as we look back, the midterm elections for a president tend to be a period where you see a reversal of the party in control of Congress.

Today, I'm looking at a Senate that is 53 Republicans, 47 Democrats, and a House where the Republicans have control over it. It looks like a very narrow majority at 217 to 215, with a couple of independents in there.

So, Kelly, as we're looking at the midterms, we're not getting into the political game here, but what are the thoughts so far from our analytical firms in terms of a potential for a reversal here?

Kelly Jernigan: You know, usually the party that's in control of the White House loses seats in the midterm election. Other than that, the party in power in the executive (branch) has lost seats. And I think most political pundits still think that the House will go Democratic.

I've seen some reports where, again, Democrats are expected to pick up the House, but maybe not gain as many seats as they usually would in a midterm. As you said, things are both very tight in the House and in the Senate. Democrats need four seats; senate is more in play.

Chances are Democrats take the House is what it looks like according to the research, and the Senate is more of a toss-up.

David Hagee: Yeah, that's the same reporting we're seeing from other partners as well, like Evercore ISI and Bloomberg, that it looks like the most competitive Senate seats out there are going to be in mostly Democratically held areas. So, it makes it that much higher of a hurdle for the Democrats to retake the Senate as it sits today.

Given that's the case, a couple of the issues surrounding the election. We're looking at the Middle East conflict right now, and then we're also looking at sort of this broader issue around inflation with energy price shocks factored in there.

And then finally, a bit of an uneven economy right now. You have people that have accumulated assets doing extraordinarily well, the so-called "wealth effect," really driving their consumption, where others are being more broadly impacted by inflation.

Kelly, what do you see as the major issues that are crystallizing around this election?

Kelly Jernigan: So, I think inflation, as you mentioned looms large. It tends to be stickier than people expect. And it is tied to the Middle East conflict. And certainly, there have been on-again, off-again peace negotiations. And so, the more that that stays an unknown, the bigger impact that that is going to be both in terms of inflation and in terms of the election.

You also mentioned that there really is this affordability issue that the Democrats are trying to run on between the haves and the have-nots. The markets have been very strong. That's created a wealth effect where if you're invested in the markets, then you're doing very well. If you're not invested in the markets, then you're probably feeling more of the pressures of inflation. And so that's another electoral factor. And sometimes that's called the "K-shape economy."

So again, affordability ties in with inflation. So, politics, geopolitics, inflation are becoming more of the electoral issues than the market, which, the market, supported by earnings, we've seen continues to be rather buoyant.

David Hagee: That being the case, as we look at history, really one year after the midterms, markets have been up 100% of the time, which is almost ripe for a reversal there in itself, right? Nothing's an absolute, of course, but it's been wildly positive up on average around 18% over that time period.

So, it's a lot of consternation that goes into the markets ahead of elections, but when we make it through, it tends to smooth itself out, and the market enjoys the certainty of having the government that's been elected in place to be able to provide a steady hand at fiscal policy there. We've been using a framework of five different components to be able to evaluate the economy. I think using a political lens on them could be very helpful.

As we're looking at oil and energy, impacts of, say, a Democratic-led House and Republican-led Senate for oil and energy, probably more broadly, the Middle East conflict, Kelly, what are our thoughts around that?

Kelly Jernigan: I think, if you look at, what we would have is a divided, you know, government. And so, you know, it would be very tough to get things passed.

Some of the things that we're certainly seeing is that you would see more pressure to resolve the Middle East conflict from Congress.

I think for oil, a big thing that there isn't political control over is the status of reserves. And so that would be something that we would continue to look at. But this government continues to look for sources for energy production, and that would continue.

I think those are all things to look at. And then, of course, turning to inflation, would be the Fed (Federal Reserve) policy. And that's something that we're keeping our eye on as well, David.

David Hagee: Yeah, I think that that's both an issue rolling into the elections, as we discussed before, that as energy prices are whipping around a little bit here as we're going towards a peace deal and away from a peace deal, you've seen that inflation really bite on lower-income consumers, especially when it comes to the energy shock. That's just a larger piece of the basket of their consumables out there.

But with that, you could see that oil piece start to become a little bit more controlled out there, especially with the amount of drilling that's going on inside the U.S..

Moving forward into the other couple of components here, we're almost at net zero migration into the U.S. right now. That we're not growing our workforce at this point, so it's become a little bit tighter job market all of a sudden.

We're looking at rather than adding jobs, we just had the July print of negative 23,000. So, it's really sort of been bouncing around without that denominator growing.

In terms of politics, what are we thinking in terms of what that's going to shake out to be?

Kelly Jernigan: So, I think with jobs, you bring up a couple of very good things. One is we haven't been really creating jobs, right? Now, the jobs market's been whipping around, but there's really been two constants.

One is that immigration is net zero. The other is that people are not participating as much in the workforce. And part of that could be related to this wealth effect, right? As people see their 401k balances grow and they're closer to retirement, they may decide to pull that trigger and go ahead and retire. So, with the latest jobs report, our unemployment actually went down, and a lot of that was due to participation rate, both to people leaving the workforce and to immigration.

Again, with a divided government, probabilities of having some kind of immigration reform, I think, would be fairly small. You would still see immigration slow. So, it would take, I think, a bigger change in government to see net change to immigration policy. But jobs, even though jobs are slowing, odds of recession are still very low because of productivity and because of reinvestment in the economy.

David Hagee: Yeah, I think that's a good point, that as we look at sort of the strength of the U.S. economy, one, we've become more productive as workers, and two, we've seen a broader expansion to the next area that I'd like to talk about, the AI (artificial intelligence) capital spend.

As we're looking at this, this has been a huge driver for the U.S. economy and it's also allowed us to become more productive, right? That we all sort of sneak a little bit of a large language model into our day-to-day life to have a little bit of AI exposure in there.

In terms of the artificial intelligence capital buildout. Are we thinking that you're going to see more regulation to slow this down? I saw the rules more recently have changed to allow less scrutiny on data center bonds out there, so they'll be able to issue those more freely and easily to fund this capital exposure. What are we thinking politically-wise on AI?

Kelly Jernigan: So, I think this is where you could look at "all politics is local," where you'll have some races with that "not in my backyard" approach to AI data centers specifically.

But in terms of AI buildout, I think you'll see broad support for that. And that will continue because in order for us to keep the productivity growing, we'll need to keep reinvesting and building out AI. You know, to some extent you have, local politics in conflict with broader national politics. And usually, when that happens, the broader national politics tend to rule the day.

David Hagee: Completely agree. And I think AI is at a weird place from a regulation point of view that it seems like the industry is calling for some regulation. I don't think governments really got their arms around it so far in terms of broader policies at the federal level.

A couple other topics, and I'll be quick on fiscal policy. We continue to deficit spend at a very high rate. Any thoughts around fiscal policy changes that you see happening with the midterms?

Kelly Jernigan: So, I don't know that we'll really see much in terms of fiscal policy because it'll take, you know, if you have divided government, right, it takes two to tango and, you know, Democrats and Republicans really don't like dancing with one another when it comes to passing legislation.

I would say, to turn to the bond market, that tends to be where we see the first signs of, “Is there trouble for the dollar? Is there trouble with deficit spending?”

And as you know, at the beginning of the year, we were talking cuts. Now we're talking about a potential raise. Of course, there's a new Fed chairman, and he's taking a little bit of a different approach in terms of communication. I think the market's still adjusting to that.

But David, as you and I know, the Fed is data-centric and we'll see when September comes if they're going to, you know, raise or stand pat with rate hikes.

David Hagee: I think the big driver here is that you've seen that increasing term premium inside of meaning that the federal government has to pay more to issue debt for longer term debt out there because of this profligate spending or this overspending that we've seen from the federal government.

But it would appear that at this point, the Federal Reserve is probably in that pause mode. I don't think we have a rate cut on the table so far because inflation's run high, and jobs are weakening, but they're not overall weak at this point. So, an interesting time.

And then finally, just want to touch on tariffs. We've transitioned from the court shooting down the IEEPA (International Emergency Economic Powers Act) tariffs to now having a new tariff regime and trying a different angle to get those in place. In terms of tariffs, do we see any major influence on the U.S. economy or change with the elections here in the midterm?

Kelly Jernigan: So, David, I have the "fun data fact," and $100 billion is the amount of money that the government has refunded in tariffs due to the Supreme Court's ruling on IEEPA. I think with the tariff policy, you'll see very little agreement between, if we have a Democratic House and the executive, you'll see again more tariffs by executive decree and trying to establish how that policy could be done without legislation.

David Hagee: I would agree with you that it doesn't seem to be overly influenced by Congress. I do love the "stat of the show" for you. That's an area that I'm having some fun with.

But as we look forward, that tariffs at this point, one, seem to have been digested by the economy, and two, don't seem overly effective at putting in place safeguards for U.S. businesses moving through that.

If I look at Liberty Street, which is the economics branch of the New York Fed, they're claiming that about 85 cents on the dollar was digested by U.S. consumers, not by importers, not by exporters, but it's the U.S. consumer that's really eating through that.

So, that leads me to one other area as we transition this over the markets. It would seem that your stat of the show, that $100 billion, is going to go straight into the pockets of U.S. corporations as they're receiving the refund here.

Earnings have been very, very robust this year. Politics aside, as I translate through the market, it would appear that a significant driver of the market is this earnings expansion that we've seen. We're up well into the double digits on earnings, which is an extraordinarily fast growth rate, and that the S&P 500 (Index) has been touching all-time highs over the course of the summer here.

Kelly, any thoughts broadly on the market, where we're at, or what you see the drivers are in the second-half of the year for market returns?

Kelly Jernigan: David, your point about earnings is a great one. And we think in the long run, earnings drive the market. And so, with that, we would continue to see market expansion. When you do have more political and macro uncertainty, then that's where you can have pullbacks.

We saw that in emerging markets specifically where returns are being driven by South Korea, SK Hynix (SK Hynix Inc.), Samsung (Samsung Electronics Co., Ltd.), Taiwan, TSMC (Taiwan Semiconductor Manufacturing Company Limited), of course, which is a chip producer, where those two in Taiwan and South Korea have become a larger part of emerging markets than China by some measure.

In the U.S., we've experienced the same thing, we had a little bit of a swoon from some of the chip makers. But again, earnings have reasserted themselves for the long run. So, we think with that focus on fundamentals and with earnings being the long-term driver that will still benefit from companies investing in AI, and that will continue to diffuse into other areas that we've seen such as utilities and industrials. So, you know, those returns are not becoming as concentrated in just a couple of chip makers.

David Hagee: Well, Kelly, I'll share with you my ”stat of the show,” I’m very excited to share a large number of $540 billion.

That's the amount of debt issuance anticipated by J.P. Morgan (JPMorgan Chase & Co.) this year with regard to the AI buildout. So, I think it's a significant transition for us that we've seen this transition from using retained earnings, and then really at the end of last year, you saw Meta (Meta Platforms, Inc.) have a massive debt issuance of around $30 billion. And then they also went to the private credit markets for another $29 billion to fund a large data farm in Louisiana.

But as we roll through, as this AI capex (capital expenditure) is really at the margins pushing the U.S. economy higher, and we're looking at roughly a trillion dollars worth of AI spend this year, the funding mechanism for that has switched from retained earnings over to debt issuance.

And at this point, I think investors are starting to show a little bit of fatigue as you see less subscribers to these bond deals coming through. So, something to keep an eye on, but an eye-watering $540 billion worth of debt issuance just for the AI buildout.

Well, Kelly, thanks for the interesting discussion today. For more on this topic, please visit www.commercetrustcompany.com for additional commentary and our mid-year outlook.

If you've enjoyed what you've heard, you can subscribe to our show on Apple Podcasts, Spotify, Amazon Music, or wherever you get your podcasts from.

Thank you for joining us on Conversations with Commerce Trust, I'm David Hagee, we'll talk again soon.

August 11, 2026
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