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US Policy Pulse

Reading the Midterm Election Tea Leaves

In this report, we examine the political and household economic signals shaping the 2026 midterm elections and the potential implications of a change in congressional control for policy and markets.

Key Insights:

- Republicans currently hold 220 seats in the House of Representatives to Democrats' 215—the thinnest margin of House control since 1930—meaning Democrats need a net gain of just three seats to take control, while Republicans can afford to lose no more than two.
- The Democrats' lead in generic-ballot polls, which ask voters what political party they would choose if the election were held today, has widened to 8.1 percentage points, while presidential approval stands near 40%; consumer sentiment sits at 47.8, well below the historical election-year average of 85, and the price of regular gasoline is up 29.5% since August 2025. This backdrop, along with the concentration of toss-ups for GOP-held seats and the historical average 30-seat loss in the House for the sitting president's party, suggests a difficult environment for Republicans.
- Republicans face meaningful risk of losing the House but should retain the Senate, in our base case: Democrats need a net gain of four seats to secure an outright majority in the Senate.
- The Sept. 16 prediction-market readings for Democratic control were 86%–88% for the House and 54%–59% for the Senate.
- Forty-seven percent of registered voters say the cost of living will be the single most important factor in their voting decision, up from 39% in January.
- Historically, the strongest S&P 500 average annual return in the year following a midterm under a Republican president occurred with a split Congress, at 23%, which compares with -10% when Republicans controlled both the White House and Congress.

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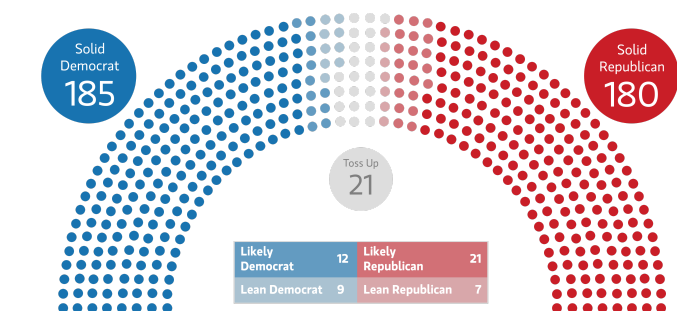
The 2026 midterm campaign has entered its final stretch, with less than two months until Election Day. The contest has escalated, shaped by a convergence of affordability pressures, geopolitical and trade uncertainty, and narrow congressional margins that could materially alter the policy path in 2027. National political indicators and household-affordability measures favor Democrats, while fundraising, congressional redistricting and chamber-specific dynamics provide meaningful counterweights. Voter perceptions of cost levels and the geopolitical environment are likely to be as important as more traditional election-year indicators like presidential approval ratings and economic growth.

The currents benefiting each party have become fodder for broad media speculation over the election outcome. Rather than add to that noise, we use a range of midterm indicators to help investors identify the signals that have historically mattered most and provide a framework for understanding the factors that could drive results. Our objective is not to call election results but rather to assess the electoral and economic forces shaping both chambers of Congress and provide investors with a framework for understanding the market implications of the results.

Election State of Play

The House remains more exposed to change in the upcoming elections, reflecting both the narrow Republican majority and the fact that all 435 seats are contested every two years. Republicans currently hold 220 seats to Democrats' 215, which is the thinnest margin since 1930, meaning Democrats need a net gain of just three seats to take control, while Republicans can afford to lose no more than two. The race-level map also looks unusually competitive: In a Sept. 11th snapshot, Cook Political Report identified 21 "toss-up" districts, 16 of which were Republican-held; that means the GOP will need to defend more than three times as many of the most competitive seats as Democrats (see Exhibit 1).

Exhibit 1: House of Representatives Race: Seat Ratings

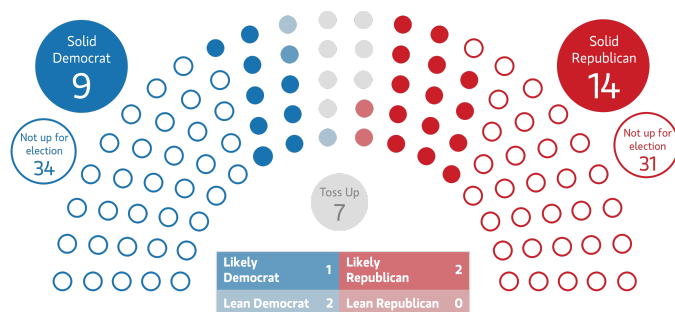


Source: Cook Political Report, Morgan Stanley Wealth Management Global Investment Office as of Sept. 11, 2026

While midcycle redistricting provided Republicans with a net four-seat structural advantage, the concentration of GOP-held toss-ups, combined with national polling that favors Democrats and historical data that supports an average 30-seat loss for the sitting president's party, illustrates how quickly the chamber's narrow majority could change hands.

The Senate presents a meaningfully higher structural hurdle for turnover. Unlike the House, senators serve six-year terms and only about one-third of seats are normally contested every two years, limiting the number of opportunities for either party to change control in a single cycle. Under the current composition, Democrats would need a net gain of four seats to secure an outright majority; Republicans could lose as many as three seats and retain control through the Republican vice president's tiebreaking vote, although a net loss of more than two would eliminate an outright 51-seat GOP majority. Historically, the sitting president's party has lost an average of four Senate seats in midterm elections, but the combination of staggered terms and the smaller number of genuinely competitive races makes Senate control less sensitive to the broad national environment than the House (see Exhibit 2).

Exhibit 2: The Senate Race: Seat Ratings



Source: Cook Political Report, Morgan Stanley Wealth Management Global Investment Office as of Sept. 15, 2026

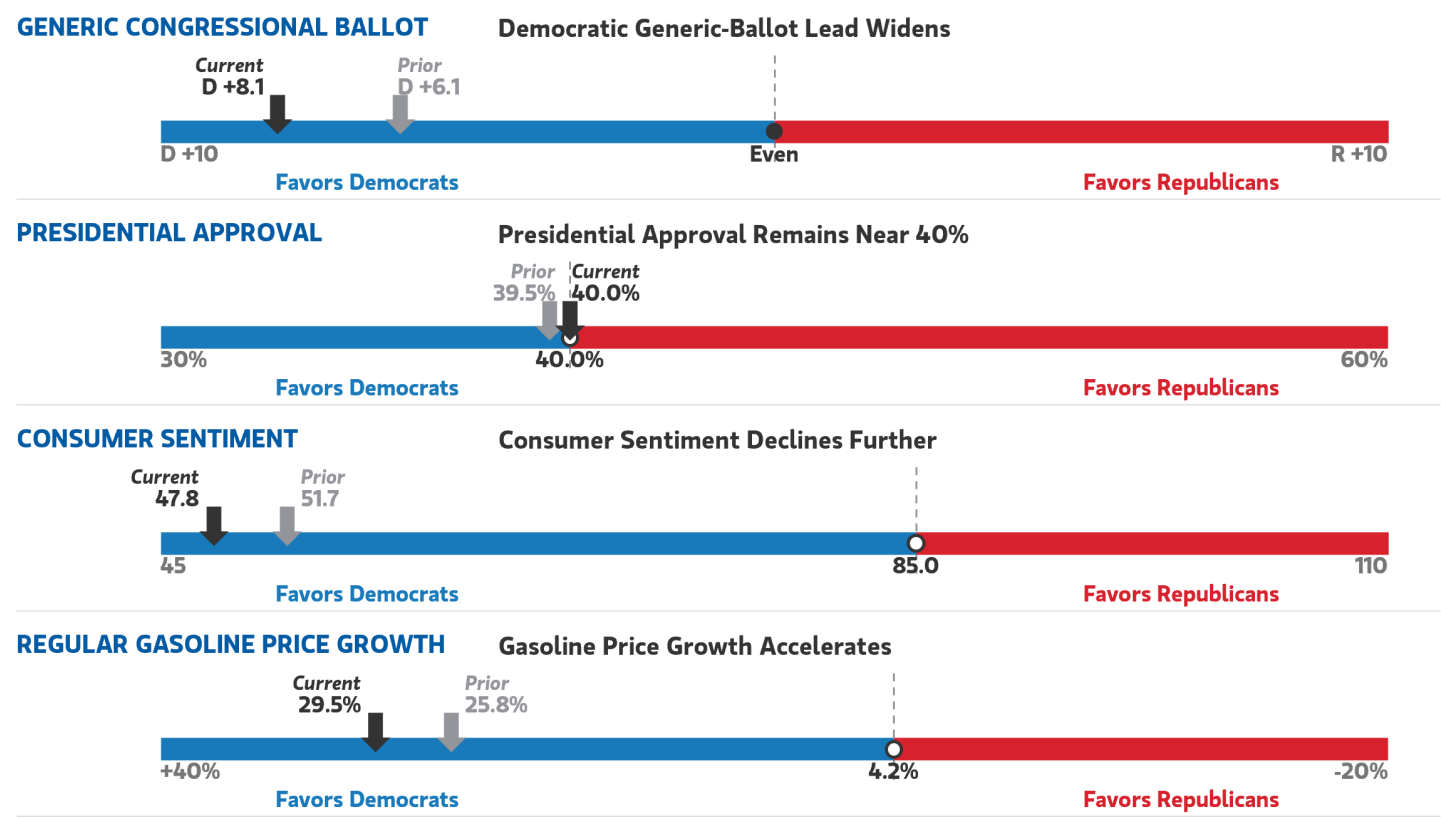
It is our base case that Republicans will retain the Senate but face a meaningful risk of losing the House. That said, in the Senate, the outcome could be tipped in the Democrats' favor due to geopolitical and inflationary risks that could have outsized impacts in states like Ohio, Maine and Texas. Here, protracted renegotiation of the US-Mexico-Canada Agreement (USMCA) impacting the auto industry and pressures on oil and gas prices from the Iran war may play a significant role in determining Senate results. In the House, the balance of power is likely to hinge on a small number of competitive districts, with redistricting dynamics, political fundraising, concerns regarding inflationary pressures on the cost of living and voter turnout ultimately driving results.

Shifting Election Signals

Turning from the congressional map to the broader electoral environment, it is important to recognize that current seat counts alone do not determine the result. Rather, the forces that capture and shape voter behavior like national political sentiment and household affordability are likely to be more meaningful, particularly since control of Congress rests on a small number of competitive seats. To help separate signal from noise, we track a focused set of indicators that together provide a directional read on the midterm environment: generic congressional polling, presidential approval, consumer sentiment and gasoline prices. Importantly, these measures are not intended to predict Election Night outcomes, but rather to frame the broader backdrop against which House and Senate contests are unfolding.

Our midterm signal monitor (MSM) shows some of the key political and household economic measures on a month-over-month basis that are currently driving the election trajectory. The MSM was built by selecting regularly updated indicators with a documented historical relationship to incumbent-party performance, and then comparing current with prior readings. Generic ballot and presidential approval capture the national political environment directly, while consumer sentiment and gasoline prices provide high-frequency household economic signals: Based on our prior [analysis](#), consumer sentiment has correlated with incumbent outcomes, and rising gas prices were associated with the sitting president’s party losing an average of 32 seats.

Exhibit 3: Midterm Signal Monitor Supports Democratic Performance



Source: RealClearPolling, University of Michigan Surveys of Consumers, Bureau of Transportation Statistics, U.S. Energy Information Administration, Morgan Stanley Wealth Management Global Investment Office as of Sept. 16, 2026

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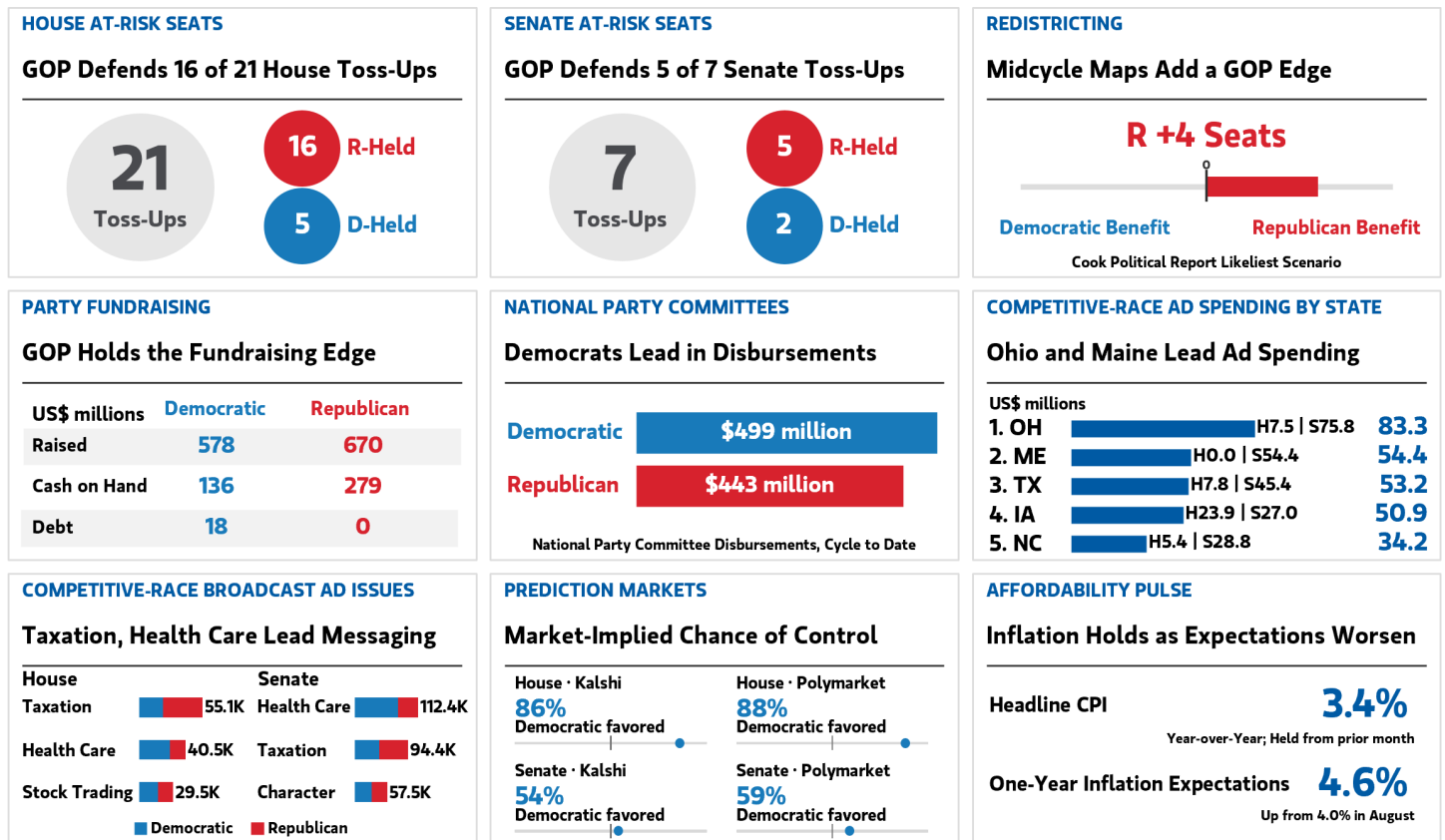
Our latest MSM showed the Democratic generic-ballot lead widening to 8.1 percentage points from 6.1, while presidential approval edged up to 40% from 39.5%, remaining near the 40% historical reference point—a benchmark for when the opposition party gains momentum (see Exhibit 3). Consumer sentiment declined to 47.8 from 51.7, well below the 85.0 historical election-year average, and regular gasoline price growth accelerated to 29.5% from 25.8%. These readings suggest a difficult national environment for the president's party, as the signals are reinforcing rather than offsetting one another, but our MSM is best viewed as a directional monitor rather than a seat forecast because the four indicators have different methodological relationships to election outcomes.

While the MSM provides a read on direction, the trends do not translate uniformly across individual races. Congressional control ultimately depends on the interaction of many other factors, including district-level competitiveness, fundraising, redistricting, campaign spending and issue salience. For this reason, we broaden the lens through our Midterm Election

Dashboard, which highlights the structural and race-specific forces that could either reinforce or offset national signals heading into Election Day.

The dashboard underscores why a challenging national backdrop does not predict control of Congress. Republicans currently hold 16 of the 21 House toss-ups and five of the seven Senate toss-ups, while midcycle redistricting has added a four-seat GOP edge. Republicans also lead in total fundraising and cash on hand, although Democratic national party committees have disbursed \$499 million, compared with \$443 million for Republicans. Prediction markets showed an 86%–88% probability of Democratic House control and a 54%–59% probability of Democratic Senate control as of Sept. 16. The two markets therefore pointed in the same direction for both chambers, although the Senate readings remained considerably closer to even odds (see Exhibit 4).

Exhibit 4: Midterm Election Dashboard Highlights Important Race-Level Counterweights



Source: Cook Political Report, Federal Election Commission, AdImpact, Kalshi, Polymarket U.S. Bureau of Labor Statistics, University of Michigan Surveys of Consumers, Morgan Stanley Wealth Management Global Investment Office as of Sept. 16, 2026

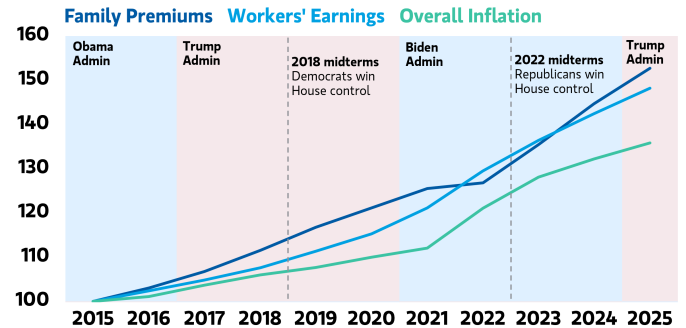
Campaign spending and messaging are reinforcing the central role of affordability in the elections. Ohio and Maine lead competitive-race ad spending at \$83.3 million and \$54.4 million, respectively. Taxation is the leading House broadcast-ad issue at 55,100, while health care leads the Senate at 112,400, followed by taxation at 94,400 ad airings. The ad spend does not indicate positive or negative messaging on these topics, but we can infer that ads discussing One Big Beautiful Bill Act tax savings or cuts to health care benefits—which are two sides of the same law—are likely addressing the same core election issue: affordability. Our dashboard shows the headline Consumer Price Index (CPI) at 3.4% year-over-year, holding steady from the prior month, with one-year inflation expectations at 4.6%, up from 4.0% in August. Together, this data suggests that voters may be responding more strongly to the impact on their household finances from the recent period of sustained inflation rather than the current pace of inflation on its own.

The Affordability Problem

The distinction between the rate of inflation and underlying price levels is important heading into the midterms, as voters are likely to assess economic conditions through the cost of recurring necessities rather than headline CPI alone. We therefore look beyond the aggregate inflation data to the household expenses that show the most affordability pressure. According to an Aug. 30 Reuters/IPSOS poll, 47% of registered voters say the cost of living will be the single most important factor in their decision, up from 39% in January. Pew Research found that economic issues—and affordability in particular—are what voters most want candidates to address.

Pew Research has also found that large majorities of people polled remain highly concerned about the cost of health care, food, housing and energy. For example, the cost of health care premiums grew 53% from 2015–2025, outpacing worker earnings, which increased 48%, and overall CPI inflation at 36%. Higher hospital and prescription drug prices, provider consolidation, chronic disease, rebounding utilization after the disruption of the pandemic and costly new therapies—including GLP-1 drugs—pressed plan spending higher, despite policy efforts to reduce costs across the Obama, Trump and Biden administrations, from the Affordable Care Act to Medicare drug-price reforms (see Exhibit 5). Furthermore, the CPI for food has accelerated rapidly in recent years, rising approximately 30% since 2021 due to pandemic disruptions; higher commodity, energy, labor and transportation costs; and shocks including the Ukraine war, avian flu and drought (see Exhibit 6).

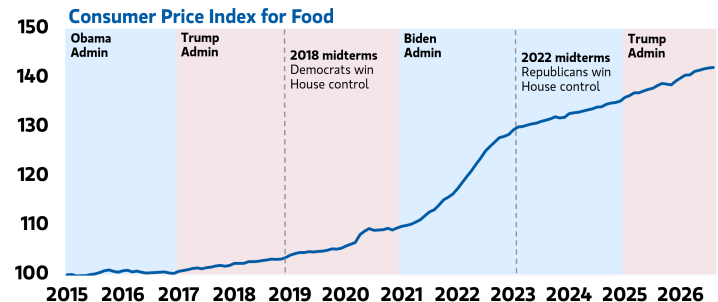
Exhibit 5: Family Health Premiums Have Outpaced Earnings and Inflation



Note: Cumulative index levels, 2015=100. Family premiums use exact annual levels; workers' earnings and overall inflation use annual changes calibrated to KFF's 2020 and 2025 checkpoints. Workers' earnings briefly exceeded family premiums in 2022–2023.

Source: KFF, Morgan Stanley Wealth Management Global Investment Office as of Sept. 17, 2026

Exhibit 6: Food Prices Have Risen 40% Since 2015

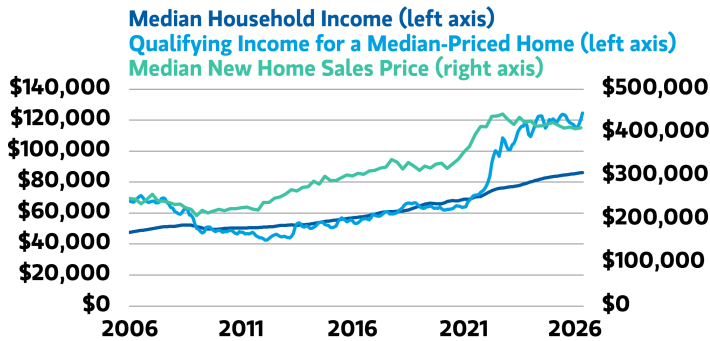


Note: January 2015=100. October 2025 data is unavailable due to the 2025 lapse in appropriations. Data is not seasonally adjusted.

Source: US Bureau of Labor Statistics, Morgan Stanley Wealth Management Global Investment Office as of Sept. 17, 2026

Inflation measures don't include all the costs that households face. Mortgage rates and interest rates overall are substantially higher than before the pandemic. The average rate on a 30-year fixed mortgage reached 7% on Sept. 15, the highest level in over a year and up from 3.51% in late January 2020. Home prices have also escalated: The median new home sales price has risen 66.7% over the past 20 years to \$410,700, putting home ownership further out of reach for many Americans today; in May, the Atlanta Fed calculated that a household needed \$124,674 in annual income to meet the 30%-of-income affordability threshold for housing, 45% more than the median household earns (see Exhibit 7). In comparison, at the end of 2019, payments on a median-priced home were about 3% below the 30%-of-income threshold. In our July 2025 *AlphaCurrents Macro*, "[Housing in the Next Decade](#)," we discuss housing affordability and the future of housing more broadly.

Exhibit 7: Higher Home Prices and Mortgage Rates Have Strained Affordability

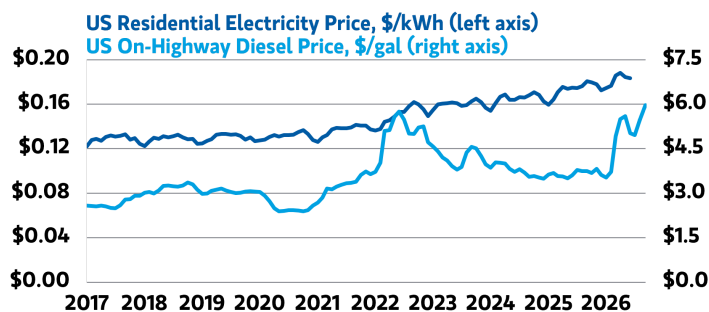


Note: Median sales price of new houses sold for the US (MSPUS) is quarterly; intervening blank months are connected between observations. Qualifying income assumes mortgage and other housing payments equal to 30% of annual income.

Source: Federal Reserve Bank of Atlanta, Home Ownership Affordability Monitor, Federal Reserve Bank of St. Louis (FRED), MSPUS, Morgan Stanley Wealth Management Global Investment Office as of Sept. 17, 2026.

Finally, energy costs, while they are included in headline CPI, provide a useful lens on the affordability challenge because they are both a persistent household burden and a more volatile inflation transmission channel. Residential electricity prices have risen relatively gradually but remain near record levels, up roughly 50% since 2017, leaving consumers exposed to a structurally higher recurring utility bill (see Exhibit 8). Rising power demand from AI and data-center development has pushed electricity affordability further into the political debate, and concerns over grid capacity, local power prices and who ultimately bears the cost of new infrastructure have made data-center development a very visible midterm campaign issue.

Exhibit 8: Essential Energy Costs Remain Elevated Across Households and Supply Chains



Source: US Energy Information Administration, Morgan Stanley Wealth Management Global Investment Office as of Sept. 17, 2026

Gasoline and diesel prices, meanwhile, have been more volatile and more directly exposed to geopolitical and supply disruptions, creating a channel through which overseas conflict can quickly feed back into domestic affordability. US

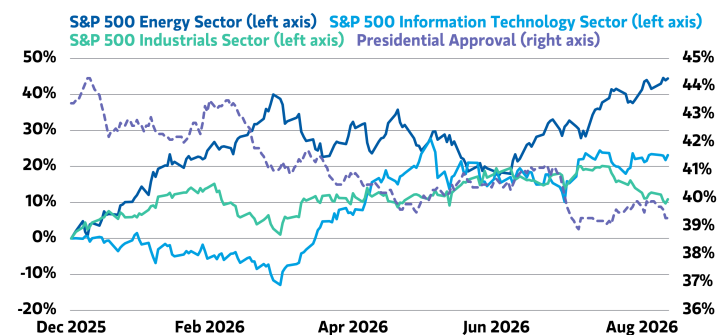
diesel prices have risen 51% since December 2025 and now stand above \$6 per gallon for the first time. While households have limited direct exposure to diesel, its role across freight, agriculture, construction and supply chains can transmit higher costs into food, shipping and operating expenses. Taken together, sticky electricity costs and volatile fuel prices highlight a broader theme of the affordability discussion: Slower inflation does not necessarily mean household costs have normalized, particularly when essential energy expenses remain elevated and vulnerable to both structural demand growth and geopolitical shocks. We explored rising affordability challenges at length in our July 2026 *AlphaCurrents: The Economy Explained*, "[Making It to the Middle Class in America](#)."

Pricing the Midterms

Affordability may help shape voter behavior, but for investors the more consequential question is how the resulting balance of power could alter the policy backdrop and affect market performance. Traditional asset markets often reflect the expected consequences of different governing configurations, and so we turn to how the midterms may already be reflected in market pricing and where the greatest sensitivity could emerge if expectations change.

In an analysis of the 11 S&P 500 sectors, we found that three sectors—energy, information technology and industrials—moved alongside the deterioration in presidential approval and the improvement for Democrats in congressional polling. For example, as presidential approval has fallen to 40% from 43.4% since January, energy has gained 44.5%, information technology 23.2% and industrials 10.9% (see Exhibit 9). However, the relationship breaks down when comparing the correlation on a change-to-change basis, suggesting that the broader trends likely rely more on the macroeconomic backdrop and business cycle than polling changes.

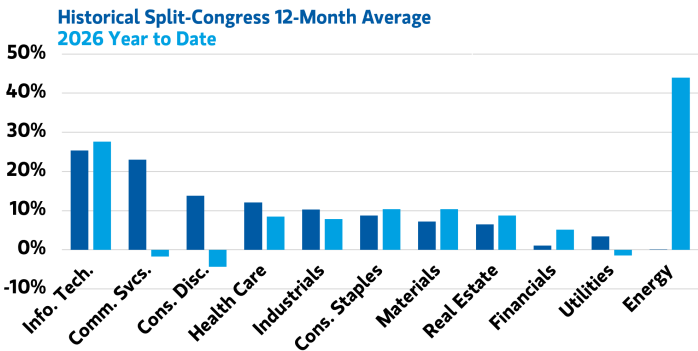
Exhibit 9: Sector Gains Have Coincided With Shifts in Political Indicators



Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of Sept. 11, 2026

While macroeconomic and sector-specific fundamentals appear to have been the primary drivers of year-to-date performance, the strong gains may leave several sectors more sensitive to a change in the policy backdrop. A shift toward Democratic congressional control, for example, could increase policy and headline risk for select technology companies through antitrust, privacy and AI-related oversight; and for energy producers through greater scrutiny of pricing, tax treatment and fossil fuel policy. Looking at historical performance, we found that when Congress was split under a GOP president, info tech and energy underperformed 2026 year-to-date returns by 2.2 and 43.9 percentage points, respectively, with recent energy momentum driven by the Iran war (see Exhibit 10). The risks are not uniform across sectors, though, and the magnitude of any policy change would be affected by the composition of the Senate, presidential veto authority and the ability of Congress to translate oversight priorities into legislation.

Exhibit 10: 2026 Sector Returns Have Outpaced Historical Split-Congress Averages

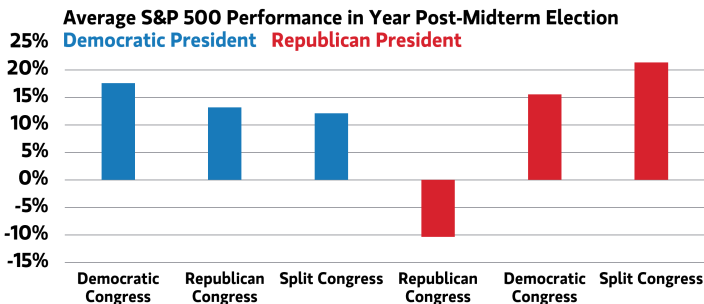


Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of Sept. 17, 2026

That said, based on our analysis, the strongest S&P 500 average annual return in the year following midterm elections at 23% occurred under a Republican president with a split Congress. Similarly, when a Republican presidency has coincided with a unified Democratic congress, the equity market outperformed other scenarios by over 15 percentage points. Whether Congress is unable to pass legislation through chamber gridlock or unified opposition to a sitting president, the result is often a stable legislative backdrop with few disruptions for the equity market. The tailwinds are further fanned by a deregulatory agenda often associated

with the Republican party, creating a constructive backdrop for returns (see Exhibit 11). However, we encourage investors to stay disciplined in their investment strategies, keeping macroeconomic factors and the business cycle at the forefront of their considerations, as inflationary pressures and the AI cycle are likely to be more influential at this time.

Exhibit 11: Markets Have Outperformed Post-Midterm When a GOP White House Has Been Paired With a Split Congress



Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of Sept. 17, 2026.

Investment Conclusion

Even after accounting for the Republicans’ redistricting advantage going into US midterm elections, the Democrats have a credible path to control of the House. The GOP’s narrow majority, the concentration of Republican-held toss-ups and the historical midterm “penalty” (the president’s party loses House seats) combined with voters’ affordability concerns support this outcome, but the Senate presents a higher hurdle for the Democrats. Our base case therefore is a Democratic House paired with a Republican Senate.

While favorable macroeconomic and sector-specific fundamentals appear to have been the primary drivers of year-to-date performance, the strong gains may leave several sectors more sensitive to a change in the policy backdrop, as divided government could limit legislative tailwinds. We encourage investors to maintain a disciplined, long-term perspective, as macroeconomic conditions, the business cycle, inflationary pressures and the AI investment cycle are likely to remain the primary drivers of market performance.

Disclosure Section

For index, indicator and survey definitions referenced in this report please visit the following:
<https://www.morganstanley.com/wealth-investmentsolutions/wmir-definitions>

Glossary

Term premium is the excess yield that investors require to commit to holding a long-term bond instead of a series of shorter-term bonds.

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