First Trust Portfolios Canada
Monday Morning OUTLOOK

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November 9, 2026

Aftermath of the Blue Tsunami

Last week's election was one of the harshest repudiations of any president's party since at least World War II. As of today, it looks like the Democrats will end up with 56 seats in the U.S. Senate and about 260 in the House, a gain of nine and about forty-five, respectively.

We believe there are several key reasons for the blue tsunami. First, the normal tilt of mid-term voters against the party that occupies the White House. Second, because in the Trump era Republican voters, for a variety of reasons, turn out to vote less in mid-term cycles than in presidential cycles.

But even these dynamics don't fully explain the size of the swing toward the Democrats. Fuel prices are unusually high and have been ever since the onset of the U.S.-Iran War, a war both President Trump and V.P. JD Vance said angered voters.

Consumers see fuel prices every day. Diesel prices, in particular, are important to the trucking industry and farmers, which might explain why Republicans underperformed in some more rural and usually Republican states and districts. The price of diesel, for example, is more than double what it was early this year, hitting a record high going back to at least the 1990s.

We also believe that younger voters feel an unusually acute angst about the economy driven by a sense that capitalism is a game rigged against them by their elders. Many of them have seemingly decided that maybe socialism is worth a try.

And although we think capitalism is far superior, we can understand their angst. During COVID the Federal Reserve, under Chairman Jerome Powell, vastly expanded the money supply, which generated the highest inflation since the early 1980s but also massively pumped-up asset values. In part, the goal was to create a "wealth effect" to maintain spending levels until the economy got back to normal.

But pumping up asset values, by its nature, benefits those with assets much more than those without. Baby Boomers, many of whom have been saving and investing for decades benefited much more than younger Americans, who have not had the time to accumulate assets, or were too young to have been in the workforce at the time of the surge in the money supply.

In the meantime, the school system has failed many of these young Americans by leaving them in debt to pay for educations that do not provide them the resources to pay the debt off and afford a home at the same time. In many ways this is a triple or quadruple whammy. Many schools teach that America is deeply flawed, then encourage debt in order to pay for this education. All the while, our economic policy is driven by a desire to avoid pain at all costs by printing and borrowing money that just causes inflation which makes life harder. Inflation is kryptonite to voters, but those with assets end up with some benefits.

Behind all of this is a deeply divided political environment and a President with a 37% approval rating. Apparently, President Trump has decided to dig in his heels and there is a high likelihood of vetoes, and a prolonged government shutdown in the next twelve months.

We will also likely see a Constitutional battle about "impoundment." This power was used by Presidents from the early years of the Republic through President Nixon in the early 1970s. As Executives they refused to spend funds appropriated by Congress. The Supreme Court will be forced to step in.

Because of the size of the deficit and a divided government, tax cuts stand no chance. By contrast, the odds of a significant tax hike in 2029 went up substantially. The Democrats have at least a 50% chance of winning the White House, Senate, and House in 2028, and if they do, they are almost certainly going to increase the top tax rate on regular income, lift the tax on corporate profits, and consider higher tax rates on capital gains and dividends, among other changes, including a special tax on billionaires.

Thankfully, for now, the economy is OK and labor market is strong. Payrolls increased 165,000 in October and were revised up in prior months. The jobless rate is 4.1%. Initial claims for jobless insurance have averaged 195,000 the past four weeks, the lowest since 1969, when the labor force was less than half the current size and so fewer people were available to lose their jobs.

However, policymakers may have an opportunity to lift taxes and expand the government starting two years from now. If they do, voters may look back on 2026 and wonder why they were so angry. For now the stock market does not seem too worried, but a push to raise taxes, block investment in data centers and AI, and increase spending and regulation are never good for stocks in the long run.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
11-10 / 7:30 am	CPI – Oct	+0.3%	**+0.3%**		+0.6%
7:30 am	"Core" CPI – Oct	+0.2%	**+0.2%**		+0.3%
11-12 / 7:30 am	Initial Claims – Nov 7	195K	**189K**		189K
9:00 am	Existing Home Sales – Oct	3.850 Mil	**3.810 Mil**		3.990 Mil
11-13 / 7:30 am	PPI – Oct	+0.4%	**+0.5%**		+1.3%
7:30 am	"Core" PPI – Oct	+0.3%	**+0.5%**		+0.7%

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