

Portfolio Manager Insights

What the Midterm Election, Budget Deficit, and National Debt Mean for Investors

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Investment Committee

As the midterm election season unfolds, investors are keeping a close eye on the outcome due to the implications for Congressional control. Current forecasts suggest that a divided government is the most likely scenario, since Republicans hold slim majorities in both the House and Senate.¹ Although a shift in party control would represent a change from the past two years, these situations are common and tend to occur during midterm election cycles.

While election outcomes are never certain, one thing that is clear is that the federal budget deficit grew to just under \$2 trillion over the past year, its highest level in absolute terms since 2021.² This means that the government spent significantly more than it received in revenues. This is likely to remain the case regardless of which party controls Congress next year since challenges such as rising interest costs and entitlement spending have built up over decades. This adds to the national debt, which has risen past \$40 trillion, or over 120% of the size of the economy.³

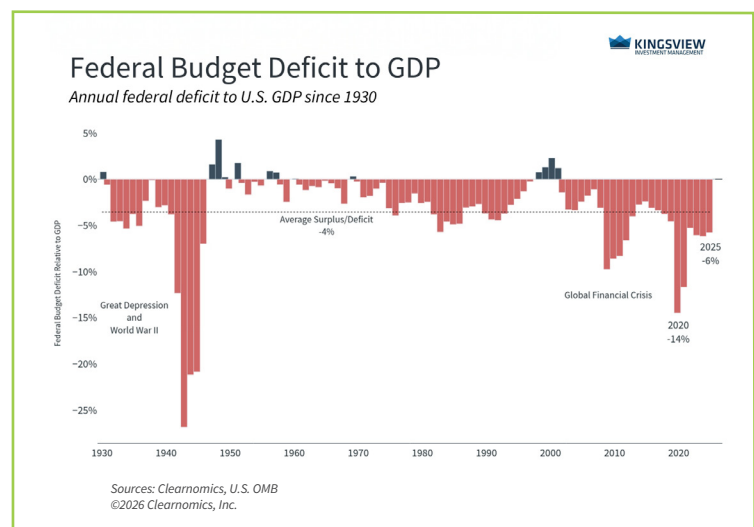
For investors who follow these headlines, it can be natural to feel concerned, regardless of political views. This is why it's important to maintain a long-term perspective that separates political issues from investment and financial planning ones. **What do investors need to know about the deficit and election this political season?**

Before discussing the impact of government spending on financial markets, let's first review the numbers. The federal government recorded a \$1.99 trillion deficit for the fiscal year that ended September 30, 2026, which represents an increase of 12% from \$1.78 trillion the prior year.⁴ This is because the government spent \$7.4 trillion but only collected \$5.4 trillion in revenue via taxes, tariffs, and other means.⁵

This difference is made up for with borrowing through the issuance of Treasury securities, which are bought by investors and institutions around the world. Based on current Gross Domestic Product (GDP) figures, the latest deficit is likely to be around 6% of GDP, similar to the ratio in 2025.⁶

The chart above shows that deficits in recent years have been high relative to history. The budget deficit has averaged 4% of GDP for nearly a century, and periods of financial and global disruption have led to wider gaps, such as during World War II and the 2008 global financial crisis.

THE FEDERAL BUDGET DEFICIT HAS GROWN



Second, rising interest rates are compounding the government's fiscal challenges. The 30-year Treasury yield has remained above 5% since June, while the 10-year yield is still hovering near this level. This matters because as existing government debt matures, it must be refinanced at higher rates, which increases interest payments and worsens the budget imbalance. This is one reason the Treasury Department has intervened by buying more Treasury securities to help stabilize U.S. interest rates.⁹ It has even engaged in other operations, such as supporting the Japanese yen, to indirectly stabilize rates.

The national debt is a long-term challenge to which there are no simple solutions since it involves decisions around taxes, entitlement programs, and spending priorities. At the same time, predictions when it comes to policies have not always been accurate, especially during periods of strong economic growth. For example, the market decline that followed last year's tariff announcements was shorter than many expected, and gave way to a rebound that brought major indices to new all-time highs.

This is why it's important as an investor to stay level-headed when it comes to political topics. The chart above shows that economic policy uncertainty has been a contributor to short-term market swings in recent years, but these periods have tended to be short-lived. Prior episodes, including this year's geopolitical conflict in the Middle East, created volatility as investors tried to measure the impact on the economy and corporate profits. While oil prices are still elevated, markets have performed well due to healthy economic trends.

None of this is to say that every year is positive, the national debt is not a challenge, or that policy is irrelevant. Instead, the point is that underlying factors such as corporate earnings, interest rates, and longer-term economic trends tend to be the primary drivers of market performance over time. For investors, it's more important to make sound investment decisions based on these longer-term trends, rather than on political headlines or which party controls Congress.

The bottom line? The midterm election and the growing federal deficit are important topics, but history shows that long-term portfolio outcomes are driven by fundamentals rather than by political outcomes.

References

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