

Blue Tsunami Hits After Weak October and Muted Third Quarter

If you didn't think enough had happened since the beginning of the Trump presidency, the world just witnessed a historic U.S. midterm election result, with traditionally conservative states turning blue. Next up: Iran.

Market volatility increased in the second half of the year, with pronounced spikes in July and October. Despite the acute sector rotation in July, primarily driven by AI-related weakness, markets ended the third quarter up modestly, in the 1–2% range across major indices.

The biggest story over summer was the lack of any meaningful sign of de-escalation in the Middle East, with further supply chain disruptions adding up significantly since the war began at the end of February. Crude oil was up over 30% in the second quarter, directly contributing to inflationary pressure and losses of approximately 3% across global bond markets. If one wanted to pinpoint the single biggest issue heading into the November election, it was undoubtedly cost pressures.

As polls increasingly began to price in Democratic strength, October demonstrated pronounced weakness in the tech-heavy NASDAQ (-5.3%) and emerging markets (-8.0%). While crude was up 15% for the month, funds still flowed into traditional safe-haven assets in October, propelling bonds higher by 1.5% in Canada and 1.9% globally.

Competing Forces Heading into the Election

The capital spending boom that has driven this four-year bull market was exemplified in June by the world's largest-ever initial public offering (IPO) of SpaceX. Anthropic will very likely make that record capital raise short-lived, as its IPO prospectus is now out in the market. In addition to the capital being raised for mega-IPOs, companies have recently been accessing debt and equity capital across the large-cap artificial intelligence (AI) space, including Alphabet (Google) and Amazon.

The global build-out in AI, alongside investment in military infrastructure (think increased NATO commitments), is leading to historically strong growth across regions and industries. In 2026, U.S. unemployment has fallen from 4.5% entering the year to 4.1% as of the last reading, anecdotal of the employment strength the global economy has been experiencing from a major boom in cold war meets space race meets technological revolution.

The AI-led commodity super cycle that is now well underway increasingly resembles the Chinese-demand-led boom of the 2000s. Combine that with the Iran supply-side shock, and the 10-year U.S. Treasury yield ended the quarter near 5.3%, a level last seen before the end of the housing market boom in 2007. Looking out even further, the long-dated U.S. 30-year Treasury yield briefly exceeded 5.6% in early October. The rising cost of government debt is not unique to the U.S., as most Western countries are seeing their bond yields reach 20-plus-year highs. This may seem draconian to younger clients, but we see the current rate environment as a reversion to normal, rather than the rate environment since the Great Financial Crisis being normal.

While headwinds from the cost of debt and inflationary pressures look set to undermine current economic strength, earnings and sales growth continue unabated for now. Offsetting the historic good times, increasing growth in fundamentals in corporate profits has paired with continuous pressure on share valuations. Today, the equal-weighted S&P 500 (i.e., an average of the 500 U.S. companies in the index) price-to-earnings ratio sits at its average dating back to 2010. In other words, investor concerns are already being reflected in prices to such an extent that a slowdown may be more than reflected in prices already, marking a significant distinction from the end of the dot-com era.

What Is on Our Radar Post-Democratic Sweep?

There are many historical precedents for changes in the U.S. government during midterm elections. It is considered somewhat of a tradition for voters to punish the party of the sitting President, and Trump made this all but assured through tariffs and war. Republicans lost their majorities in both the House of Representatives and the Senate, most importantly by a profound margin. A blue wave was anticipated, but a blue tsunami arrived on the evening of November 3.

While the magnitude of the swing was larger than anticipated, investors traditionally need not fear. Looking back to 1950 and breaking each President's term into four years, the third year after midterm elections has historically produced the strongest equity market results. Midterm years have also most often resulted in year-end rallies and an opposition led Congress has historically delivered the best 12-month stock returns. In practical terms, over the next two years, the implications for public policy, the economy and financial markets should not be exaggerated as the White House retains firm control over tariffs and foreign policy.

While Trump may not materially change over his remaining term, markets initially responded positively to the election news. Oil prices were already declining amid news that the Iranian President had granted his government authority to pursue peace talks. Combined with the election result, this has brought WTI crude oil below $90/bbl, a tailwind for lower inflation and bond yields.

While there is much to be optimistic about with a more in-check President, in the back of our minds is the fact that the USS Theodore Roosevelt aircraft carrier and more than 10,000 military personnel are heading to the Middle East. As we have been stating for the better part of two years, the road ahead is fraught with challenges we do not underestimate, many of which are geopolitical and uncertain in timing and magnitude. If global commodity markets deteriorate further and inflation heads higher, financial market history suggests equity valuations could move lower. And while growth is strong in the near term, the AI build-out is crucial for this strength to continue.

Closing Thoughts

We see paths to continued historically strong economic and equity market performance, while also recognizing that the hurdle for companies and investors has increased in light of attractive returns available in bonds. While we don't see an imminent economic downturn, we recognize that strong economic growth, higher-than-anticipated inflation, and elevated borrowing costs and interest rates could create headwinds for equity valuations.

The markets give us both risks and opportunities through time. Both sets of choices have increased in recent months which we welcome, and our investor tool kit has expanded in light of recent changes in market structure.

As always, reach out to our team if you have any questions.

Bessette Wealth Management

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