

## SIGNALS FROM GUBERNATORIAL ELECTIONS

Despite what the media claims, voters generally do not change much from election cycle to election cycle. When politicians drift too far toward either end of the political spectrum, they are punished at the polls. This should be the main takeaway from the recent Virginia and New Jersey gubernatorial and down-ballot state legislative elections.

### Here are the most important political lessons from these elections:

1. Without former President Trump running (or in office), the Democratic message to voters must shift its focus and direction.
2. White working class and rural voters, two significant voting bases for Donald Trump, will still turn out in high numbers in favor of more conventional GOP candidates.
3. The GOP continues to grow its Hispanic voting base. One county in New Jersey (Passaic County) experienced this firsthand, with several towns heavily concentrated with Hispanic voters leading the way. Based on last Tuesday's results, one political betting market now has Republicans favored to win the Senate seats in Arizona and Nevada, even though both will have incumbent Democrats running for re-election.
4. Republicans may have won in Virginia this year, but it is still a blue state. Four years ago, when Trump was in office, the Democrats won Virginia by nine points; this year the GOP won by two points. In other words, results in Virginia are likely the result of current discontent with the direction of Congress rather than long-term political changes in the state.
5. The GOP is in excellent position to win the House next year and probably the Senate. The Virginia governor's race is often a leading indicator of which way the following mid-term elections will go. If the GOP sees nationwide gains anything like they made in Virginia last week, they will easily win the House in 2022.

### Further Observations and Economic Implications

While it's fun to analyze past election performance, they are no guarantee of future results. With the mid-term elections still a year away, Congress and the President still have ample time to enact legislation they agree upon before submitting themselves again to voters. This occurred last week when the House rubberstamped a hotly contested \$1 trillion infrastructure spending bill passed this summer by the Senate, sending it to President Biden's desk. The bill will generate extra spending for highways, mass transit, airports, water systems, broadband internet, electric vehicles, and renewable energy.

Without question, this bill and the spending it will generate, shifts resources from the private sector (individuals and businesses) to the public sector (government), and to an extent the Federal Reserve. The outcome will involve more money printing that will push inflation higher. However, this bill did not create new entitlement spending, and is a small part of total nominal GDP over the next 10 years. Despite these concerns, the budget deficit should be substantially smaller in 2022.

Of note, the larger, fully partisan plan to raise taxes and create new entitlements has lost momentum. The odds of Congress passing this much more economically harmful legislation is now much less, in part because of last week's election results.

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# INSIGHTS

Economically speaking, 2021 was and still is simple. Solid growth, higher inflation, and a bull market in stocks have been the mantra all year along. Looking ahead to 2022, the Fed is still pumping money, interest rates remain low, and the economy continues to add back the jobs it lost during lockdowns. Two or three rate hikes are expected, but personnel changes and political pressure at the Federal Reserve should make it less aggressive. As a result, one rate hike very late next year is the most likely outcome. At the same time, election results show a backlash against bigger government. There are still more positives than negatives overall, and thus investors should approach 2022 with cautious optimism.



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