RBC BlueBay Asset Management

Marketing communication

Mid-term blues for a humbled President

After the wave….

Key points:

- **U.S. midterms:** the Democrats swept both chambers of Congress, with the result representing a significant and humbling defeat for the Trump administration.
- **Iran conflict:** in the aftermath of mid-term elections, it now seems that a material escalation in the conflict with Iran is more of a tail risk, rather than a more dominant theme.
- **U.S. inflation & rates:** even if the scenario of a status quo continuation in the Middle East, U.S. inflation is expected to peak in the coming months, and we still see the Fed hiking in December and Q1, before rates are held steady.
- **Eurozone sovereigns:** on the belief that the Eurozone is unlikely to break-up any time soon, we think that sovereign credit spreads are wider than is justified by an analysis of likely default rates over the coming investible time horizon.
- **UK gilts:** we have turned somewhat more constructive on the outlook for gilts. Although headline inflation may be above 5% next spring, in the absence of a broadening of price pressures, we think that the BoE may only hike rates once or twice more.

London, 6 November 2026: The results from this week's US midterm elections came as a surprise, even to those such as ourselves, who had been consistently calling for the Democrats to win control over both chambers of Congress over the past several months.

With a blue wave sweeping the board, so the outcome of the vote represented an unabridged humbling for the Trump administration.

In this respect, it is interesting to note that President Trump has acknowledged that his misadventures in the Middle East have played an important part in his Party's defeat.

Close confidants, including JD Vance and Don Trump Jr. appear to be seeking to distance themselves even further and pushing for an end to the conflict, with an eye on how this impacts their own standing in 2028 and beyond.

Chatter has hinted at the removal of hawks such as Pete Hegseth from the administration and in this respect, it now seems that a material escalation in the conflict with Iran is more of a tail risk, rather than a more dominant theme, that needs to be considered, in terms of the macro landscape.

Reaching a peace deal with Iran may remain difficult. However, even in a situation characterised as a continuation of the status quo in the Middle East, US inflation is likely to peak over the next few months and may be expected to be back below 3% by the middle of next year.

On this basis, we still see Warsh hiking rates in December, with a further move to follow in Q1, but thereafter, rates are likely to be on hold. As this trajectory is not far from what is discounted in markets, it is hard to project a substantial rally in yields, unless growth slows materially.

Democrat gains have precipitated a material reversal in AI-related stocks over the past several sessions. However, from a macro perspective, although greater restrictions with respect to the build-out of AI infrastructure are now to be expected, we still see business investment spending throwing a large amount of money at the economy in the months ahead. Consequently, the backdrop for GDP remains robust.

In this respect we think that we would need to see a very material drop in stock valuations before this represents a tightening of financial conditions to the point where the Fed can be expected to amend its intended policy path.

We would also observe that price action in the past few days has been linked to hedge fund de-grossing with further pod closures in the equity community.

Indeed, a regulatory-induced slowing of AI-related projects may actually help ensure that the pace of growth is more sustainable going forwards.

Over recent months, constant upward revisions in spending plans have led to a deluge of debt and equity issuance, which has been weighing heavily on markets, with demand failing to keep pace with supply. Should this now slow somewhat, we think that spreads for hyperscalers may stabilise.

Consequently, we find ourselves minded to add exposure in that space, having previously been very sceptical of the prospects for AI-related debt over the course of the past year.

Robust GDP growth in the US is likely to slow CPI from returning to the Fed’s target in the year ahead. However, our sense is that as long as it is on a declining trajectory below 3%, this will be enough to satisfy Warsh and other members of the FOMC, and so further rate hikes beyond Q1 should not be required.

Meanwhile, in Europe, although the near-term inflation peak may be higher than the US, the move down in inflation in the year ahead could well be more pronounced. Elevated gas prices could see Eurozone CPI peak at 4.5% in Q1.

However, inflation may well be back below 2% by this time next year, as base effects that have been pushing inflation higher reverse. Consequently, we continue to think markets are under-estimating the possibility that, after hiking rates again this December, the ECB could be on hold and could then end up easing before the end of 2027.

This outlook leaves us relatively constructive in our views with respect to European yields. We would also note that in a world where energy prices have marched relentlessly higher, so this has created upward pressure on euro sovereign bond spreads. Therefore, should this reverse, then those countries such as France and Italy, which carry the highest debt burdens, can be the largest beneficiaries.

Although we remain structurally more bearish on France, it is clear that investors are broadly short OAT exposure at this time and so the pain trade may be for spreads to narrow over the next couple of months, and this represents a tactical opportunity on the long side.

On the belief that the Eurozone is unlikely to break up any time soon, we think that sovereign credit spreads are wider than is justified by an analysis of likely default rates over the coming investible time horizon.

Reflecting on this, during recent weakness, we have added to exposure in Italy as well as France. We have also re-entered exposure in Romania, where bonds continue to offer attractive value at a spread above 300bp, in the wake of a recent political compromise, which may help to avert a ratings downgrade.

We have also turned somewhat more constructive on the outlook for gilts. Although headline inflation may be above 5% next spring, in the absence of a broadening of price pressures, we think that the Bank of England may only hike rates once or twice more.

This follows its decision to raise interest rates to 4% at yesterday's MPC meeting. The Bank of England has remained more dovish than other central banks, on the belief that its starting point at the beginning of this year saw its policy stance already in restrictive territory.

With respect to UK politics, we continue to highlight the risk of an early election. Yet were this to be announced, any probability that is attached to a Conservative victory, could help gilts to rally, as long as Prime Minister Burnham does not suddenly turn too fiscally profligate.

Japanese markets have been relatively quiet due to national holidays in the past week. In EM, Venezuela and Argentina have underperformed, partly relating to Trump stumbles and the read-across from Brazilian elections, in the wake of Lula's victory. The Monroe doctrine had seen Latam outperform on the notion that this was the US sphere of influence in the Western hemisphere, but this is now being questioned as the political tides appear to turn.

That said, we actually think there is very little read across from Brazil to Argentina, or any other countries in the region where elections are upcoming in the year ahead. Moreover, we continue to look for a recovery in Brazilian assets, on the notion that Lula actually represents continuity in the country, rather than marking a more abrupt change.

FX markets have continued to trade with low volatility, and it is striking to reflect how little FX seems to be a point of conversation at macro round tables with other investors, or at other industry events.

Generally speaking, should energy prices soften, this should help the euro recover recent losses and in the wake of the mid-term results, we have closed a long US dollar position. We have added exposure in Mexican peso and more broadly, continue to see value in a number of EM currencies, where carry versus volatility makes for a prospectively attractive risk relative to reward.

In corporate credit, October had already witnessed a widespread de-risking in credit hedge funds and a cleansing of positions. This means that now the technical backdrop appears more constructive. However, spreads will be closely tied to developments in equity markets over the coming days and could be vulnerable from an extended flight to quality.

That said, we are now more inclined to add risk rather than reducing it, with spreads having already moved materially wider over the past few weeks. On a relative basis, euro credit spreads have lagged those in the US last month as a result of wider regional sovereign spreads.

However, with sovereigns now retracing their moves, there is scope for euro credit to catch up in a rally. We have extended directional risk in credit during the past few weeks and continue to do so. With seasonals turning positive, so we favour running moderately long risk exposure, as we head towards the end of the year.

Looking ahead

In some respects, it has been interesting listening to President Trump waffling on about the height of the ceiling of his ballroom under construction and get the image of a broken man, who is ageing and who appears increasingly out of touch.

It is possible that the Democrats could end up with a previously unthinkable 56 seats in the Senate, depending on the results that come through from Mississippi and Alaska, and although this would leave them 11 votes short of a potential majority to impeach the President, it is still the case that the probability of Trump failing to see out his term has inevitably increased. There are widespread recriminations in the Republican Party, with Florida Governor DeSantis describing results as a near "extinction level event".

Earlier in the year, we had wondered whether a mid-term loss would actually matter that much to Trump, but the initial analysis suggests that he has been left materially deflated by the scale of the drubbing at the polls, by voters who had felt betrayed by the US President.

In this respect, it seems that Trump is now on the defensive rather than on the attack and although he may want to come back swinging, there is a sense that we may have witnessed a defining moment in the context of his presidency.

This could point to a calmer investment landscape once the current tech and AI gyrations have played out. In this case yields and spreads are more likely to fall than rise, as investors engage with value that is on offer based on current valuations.

This is not to say that challenges in the landscape don't persist, but after a rough year for fixed income investors, there is now at least a sense that a lot of the bad news is built into the price.

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