Post-Election Rally Quickly Reverses to Dramatic Decline

U.S. equity markets initially surged following a "Blue Tidal Wave" of U.S. midterm election results, but the rally lasted just one day as weakness in the Technology sector sparked a broad sizable decline on day 2 following the results. Democrats outperformed even the high-end of positive expectations, recapturing control (with strong majorities) of both chambers of Congress (the House of Representatives and the Senate) and also seizing governor seats in multiple states. The results ensure that as of January 2027, U.S. governing structure (between the executive and legislative branches) will be divided between the two political parties. Split control will define the final two years of the Trump Administration, following Republican control of the House, Senate, and presidency in 2025 and 2026. Although election odds from polling surveys and prediction markets clearly favored Democrats (allowing financial markets to prepare for a split government result), election outcomes contain high uncertainty. Ultimately, the margin of victory was resounding, and more than many investors expected.

The initial positive market reaction (equities higher, interest rates and oil prices lower), in our view, was partially a clearing event with the election concluded after equity index gains had largely stalled since mid-year and both interest rates and oil prices had surged higher. As well, markets contemplated the benefits of split government, which often prevents Congress from passing major legislation (reducing uncertainty). In addition, large Democrat majorities could change the trajectory of President Trump's second term, perhaps convincing him to soften positions on tariffs and trade policy. But optimism faded on Thursday, 11/5/26, as investors assessed potential roadblocks to artificial intelligence (AI) data center and infrastructure projects. Multiple new state governors campaigned on limiting data center expansion, and dozens of municipalities voted to restrict data center projects in Tuesday's elections. For now, we view data center resistance as more of a "build it the right way" (avoiding hardship on the local community) rather than a "not build it at all" issue, but the pushback raises questions about the pace of non-residential fixed investment (a Commerce Department category that measures business investment including data centers) commitments, which has been a meaningful contributor to U.S. economic growth in 2026. A slowdown in AI-related spending would also create headwinds for overall corporate earnings growth as the Technology sector has been the largest contributor to S&P 500 earnings growth in recent periods.

We believe that demand for AI compute remains on a strong growth path and leading companies have communicated plans to increase capital spending in 2027 and beyond. While the pace of investment could change if financial conditions tighten (limiting access to capital) or the economy slows, the political resistance in 2026 threatens to slow the supply of compute capacity but is not a demand issue. Strong demand is a core component of a healthy product or service and, ultimately, we expect companies to find ways to meet that demand. But data center opposition should be taken seriously and could remain a headwind for the industry well into 2027. The midterm election results suggest that roadblocks and regulation will be considered as voters have voiced a populist concern. Perhaps providing some downside market support as sentiment deteriorates is a combination of positive economic and earnings fundamentals that have exceeded expectations. In addition, we expect that many states and communities will pursue AI data centers and infrastructure projects that deliver high-paying jobs, tax revenues, and community investment. In addition, the U.S. must maintain its global leadership in AI capability and support, and restricting innovation becomes a national security issue.

Market Reaction. On Wednesday, 11/4/26, the day after the midterm election, the S&P 500 equity index closed at 7,689, up +1.6%, the largest one-day increase in three months (since 8/4). Both long-term and short-term interest rates (Treasury yields) dropped with the 10-year Treasury yield (TY) moving to 4.88%, down 6 basis points (bp) on the day, and the 2-year TY down 4 bp to 4.58%. In addition, U.S. oil prices, as measured by West Texas Intermediate crude (WTI), decreased -8% in one day to $88 per barrel, its lowest closing price since early September. Despite the overall market gains, stocks with large AI infrastructure exposure (semiconductors, electronic equipment, energy and power suppliers, construction and engineering) lagged as the data center angst was revealed. This angst continued on Thursday, 11/5/26, and intense technology weakness resumed, leading to a collapse in investor sentiment and broad losses on the day.

On 11/5/26, one day following its best day in three months, the S&P 500 suffered its worst day of 2026, with a decline of -4.4% to close at 7,354 (the lowest closing price since 7/29/26). In fact, it was the index's worst one-day decline since April 2025 at the height of the 'Trump Tariff Tantrum.' All eleven S&P 500 macro sectors (as measured by MSCI's global Industry Classification Standards, or GICS) were lower, led by a stunning -7.3% one-day drop in Technology (Tech). Tech weakness was led by an -11.4% decrease in the semiconductor and semiconductor equipment sub-industry group. Other GICS sector declines were not as severe, but Industrials dropped -4.1% and Consumer Discretionary decreased –3.7%. Just one month ago, Tech sector strength propelled overall market gains and on 10/6/26, both the S&P 500 and its Technology sector closed at an all-time high. Since 10/6 (through 11/5/26), the Tech sector pullback reached -17.0%, and the S&P 500 peak-to-trough pullback was -5.9%. It is common for the S&P 500 to experience regular pullbacks of -5% to -10%, and we are currently in that range. Since 1980, the average intra-year peak-to-trough move for the S&P 500 was -14.3%. In 2026, through 11/5/26, the largest index decline was -9.1% from 1/27/26 to 3/30/26, a period of two months that included the buildup and then the launch of the military conflict with Iran. A -9% decline in the current environment would take the index down to 7,100 (from its 11/5 closing price of 7,354).

The S&P 500 index is weighted by market capitalization, and Technology remains the largest of the 11 sectors, comprising 36% of the total index value as of 11/5/26. The next largest sectors were Financials (13%), Health Care (11%), and Consumer Discretionary (10%). We advocate remaining diversified across the sectors, also paying attention to the sector weights in the index. Weakness in Tech stocks becomes a drag on the S&P 500, making it difficult for the overall index to rise, even if other sectors are moving higher. While Thursday's market ultimately included all sectors trading lower, for the week-to-date (as of 11/5), just four sectors were negative (Technology, Energy, Industrials, and Utilities), and the other seven sectors were either flat or higher. Of course, November is not yet a week old, and if we include October through 11/5 (a period of five weeks), the S&P 500 has decreased -3.9%, but 8 sectors have increased. While Technology and Communication Services decreased -14% and -13.7% over that period, other sectors have posted solid gains. While volatility is likely to continue over the near term, both economic data and earnings growth could provide market support.

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Fundamentals appear constructive. In the third quarter (3Q26), the U.S. economy, as measured by gross domestic product (GDP), grew +3.4% on an annualized basis, adjusted for inflation. The report exceeded the FactSet consensus estimate from Wall Street economists and the pace of growth exceeded both 2Q26 (+2.2%) and 1Q26 (+2.5%). The major contributors to growth were healthy as well, as the key contributors to the private economy (not government), businesses and consumers, showed solid growth. Both business investment (+12.7% annualized) and consumer spending (+3.8% annualized) delivered the best growth quarters of the year. Business investment was led by AI infrastructure spending, including information processing equipment, software, research & development, and industrial equipment. Consumer spending reflected growth in both services and goods, with services spending growth picking up from the prior quarter (2Q26) and spending on goods growth slowing from 2Q26. Consumer growth of +3.8% was the best in nine quarters and was a strong result despite weak consumer sentiment due to inflation and affordability concerns. In our view, spending is driven by high-income consumers, a solid labor market, and a willingness to dip into savings. On 11/6/26, the Bureau of Labor Statistics (BLS) reported October labor data that included an increase in nonfarm payrolls (jobs) of +165 thousand (K), and the previously reported September and August jobs data were revised higher. Business investment comprised 16.7% of inflation-adjusted GDP in 3Q26, up from 15.3% in 3Q24 (two years ago). This has been the largest contributor to better-than-expected GDP growth in 2026, in our view, but creates a high bar for sustained growth contribution in 2027. New data center resistance confirmed by election results creates challenges for business investment in future periods, but we would expect most ongoing projects to continue.

Recent market volatility is happening as many publicly traded companies are reporting 3Q26 financial results. As of the morning of 11/6/26, 444 (88%) of S&P 500 constituents had reported sales and earnings data. Reported sales growth for the index (weighted by market capitalization) was up +13.5% and above the +12.0% consensus estimate (as of 9/30/26). Earnings growth-to-date was even better, tracking +28.5%, and in-line with the 9/30 consensus estimate. This follows earnings growth of +29% in 1Q26 and +30% (excluding one-time investment gains) in 2Q26, reflecting an exceedingly strong earnings growth environment. Over the 10-year period, 2016 to 2025, S&P 500 earnings growth averaged +10% annually. While 3Q26 growth trends are strong, the actual results have not exceeded estimates as much as in recent quarters, and we have likely seen the peak in the earnings growth rate. While 2026 reported earnings will approach or exceed +30%, the estimate for 2027 is +16%. This remains above the long-term trend but reflects deceleration that will be intensely scrutinized in the face of data center uncertainty. We estimate that the Technology sector has contributed about 50% of S&P 500 2026 earnings through 3Q26, well above its 36% weighting in the index. For now, earnings remain a bright spot for markets, and we expect growth trends to continue, but recent market weakness is likely pricing in some possibility that earnings growth estimates could trend lower next year.

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Other Disclosures:

Gross domestic product (GDP) refers to the monetary measure of the market value of all final goods and services produced within a country's borders within a specific time period. Real GDP is adjusted for the impact of inflation. GDP numbers are compiled by the Bureau of Economic Analysis (BEA), a division within the U.S. Department of Commerce. Quarterly GDP is reported as a percentage change from the prior quarter, annualized. The BEA also reports data on a year-over-year percentage change from the same period one year prior. Major components of GDP include personal consumption expenditures, non-residential fixed investment, residential investment, government expenditures, and adjustments for inventories and net exports (imports). Both information technology equipment and software are sub-categories within non-residential fixed investment. In 3Q26, inflation-adjusted (real GDP) increased +3.4% on an annualized basis (subject to revision). The 1Q26 increase was +2.5%, and the 2Q26 increase was +2.2%. Consumer spending is measured by personal consumption expenditures (PCE). We track business investment through non-residential fixed investment. The most recently released GDP report (10/29/26) BEA GDP report is here. Subcategories within non-residential fixed investment include information processing equipment, software, and research and development. This includes some, but not all, of the data center and information technology investment across the economy. Full-year 2025 GDP, adjusted for inflation, increased +2.1%.

FactSet is a data aggregation software utilized by D.A. Davidson's Investment Management & Research. The FactSet consensus refers to the aggregate of all analyst estimates from firms that submit estimates to FactSet for a given financial metric.

Volatility looks at to what degree and how quickly prices move over a given span of time. In the stock market, increased volatility, in the form of rapidly falling prices, is often a sign of rising uncertainty.

S&P 500 earnings growth reflects the year-over-year change in operating earnings on a per share basis. Earnings data are aggregated for all S&P 500 constituents and are measured according to the relative market capitalization weights for each company. Estimated earnings are the combined FactSet estimates of analysts covering each company included in the index. Our earnings and sales growth data is sourced from FactSet.

The Global Industry Classification Standard (GICS) is a four-tiered, hierarchical industry classification system. Companies are classified quantitatively and qualitatively. Each company is assigned a single GICS classification at the sub-industry level according to its principal business activity. MSCI and S&P Dow Jones Indices use revenues as a key factor in determining a firm's principal business activity. The 11 sectors are: Communication Services, Consumer Discretionary, Consumer Staples, Energy, Financials, Health Care, Industrials, Information Technology, Materials, Real Estate, and Utilities.

The consumer price index (CPI) is a measure of average change over time in the prices paid by urban consumers for a market basket of goods and services. It is reported monthly by the U.S. Bureau of Labor Statistics. An alternative measure of consumer inflation is the personal consumption expenditure (PCE) price index. PCE inflation is the percentage rate of change in the price index for personal consumption expenditures (PCE). The index is published monthly by the U.S. Bureau of Economic Analysis.

Generative artificial intelligence (GenAI): We think of artificial intelligence as using advanced computers to process large amounts of data to ultimately approach human problem-solving and decision-making. Early versions were often called "machine learning" and could sift through large data sets and accurately predict single outcomes. Now, generative AI goes further to utilize all forms of inputs. While still predictive models, generative AI can give detailed responses, much better than a search engine, which does a good job of telling the user where to go to find additional information. As generative AI systems access more data, they become larger and learn to make better decisions. At each iteration, the system gains knowledge, enhancing its predictive (reliable) capabilities and ability to produce original content. Generative AI systems become more robust as they are used as all new data can be trained into the system, creating new challenges and opportunities.

U.S. oil prices are often described using the price per barrel of West Texas Intermediate (WTI. This is a high quality low density crude oil grade sourced primarily from the Permian basin. Futures contracts and spot prices are traded on the New York Mercantile Exchange (NYMEX). Data

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on the economics of oil price changes on the retail price of gasoline can be found from the Federal Reserve Bank of St. Louis and the U.S. Energy Information Administration (EIA).

The Strait of Hormuz is located in the gulf between Oman and Iran. According to the U.S. Energy Information Administration, an estimated 20 million barrels per day are transported on ships through the Strait on a daily basis. This includes liquified natural gas (LNG) as well and is an essential waterway for Gulf energy exports.

The Automobile Club (AAA) monitors daily fuel prices in the U.S., which can be tracked at: gasprices.aaa.com.

The 2026 U.S. national mid-term election was held on 11/3/26. While this is the middle of the Presidential four-year term, all of the U.S. House of Representatives were on the ballot (two-year terms) and about 1/3 of the U.S. Senate (six-year terms). In recent mid-term elections (since 2000), political party control of one or both houses of Congress have flipped to the opposing party. The unofficial results as of 11/6/26 saw the Democratic party take back control of the House and Senate and also win several Governor seats that were previously held by Republicans. Real Clear Politics (RCP) is a U.S. political news, analysis and polling website. One of its best-known products is the RCP Poll Average, which aggregates polling results from multiple polling organizations for elections. Instead of deciding which individual poll is "right," RCP combines a group of recent polls to produce an average.

Annual S&P 500 peak-to-trough declines are computed using the closing daily prices in a given calendar year for the index. D.A. Davidson publishes the annual peak-to-trough decline since 1980 in its quarterly publication, “Market Chart Book-WM Research” most recently updated in September 2026.

Generative artificial intelligence (GenAI): a subset of artificial intelligence and machine learning that can produce new text, images, video, or audio clips from users’ prompts. GenAI is trained on large datasets of training data, called a large language model (LLM), to find statistical patterns in the LLM. The GenAI uses those statistical relationships to generate unique responses to prompts. AI infrastructure refers to spending on data centers, graphic processors (GPUs), networking, power, and cloud computing capacity.

The Bureau of Labor Statistics (BLS) compiles U.S. labor statistics from two monthly surveys. The household survey measures labor force status by demographics, while the establishment survey measures nonfarm employment and data by industry. The nonfarm payrolls component of the establishment survey is drawn from private businesses and government entities. The nonfarm payrolls number is among the most widely used data points to assess U.S. employment trends. The unemployment rate is the percentage of the labor force that is jobless and actively willing and available to work.

We track a measure of wages, average hourly earnings, or AHE, of all private employees, which is calculated and reported on a monthly basis by the U.S. Bureau of Labor Statistics. The data measures average hourly earnings of all private employees on a “gross” basis (includes overtime and late shift work but excludes benefits).

The Treasury yield curve displays the market interest rate across different contract lengths for U.S. Treasury securities, indicating the relationship between the interest rate and the time (“term”) to maturity. The yields of the 2-year and 10-year U.S. Treasury notes are widely followed barometers of the current U.S. interest rate environment. Treasury security data used in calculating interest rate spreads is obtained directly from the U.S. Treasury Department, through FactSet.