Does US Politics Influence Investment Decisions? Evidence from Global Mutual Funds

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Abstract

We examine the investment behaviour of US-based global mutual fund managers to ascertain whether the apparent relations between stock market returns and the US presidential elections are indeed taken into consideration by money managers when making investment decisions and, if so, whether those decisions have any impact on investment returns. We use a Sharpe style methodology to examine the distribution of assets between the domestic and international markets of US-based global mutual funds during the nine US elections cycles from 1973 through 2008 and to assess whether the political climate in the US has any influence on the domestic and international portfolio exposure of these funds. Our results suggest that global fund managers invest more domestically during the years when a Republican president is in office and favour international markets when Democratic presidents are in power. This behaviour, however, does not appear to be beneficial for the shareholders of these global funds, since their riskadjusted performance is higher, albeit weakly, during Democratic administrations. Regarding the fouryear presidential election cycle, it appears that global fund managers do not take it into consideration, or this cycle may have disappeared.

Keywords: global mutual funds; regional exposure; performance; stock returns; stock prices; market efficiency; presidential-election cycle; US politics

Introduction

Researchers have studied for quite some time the relationship between politics and the behaviour of investors. For instance, there is an extensive body of evidence in the literature demonstrating that, at least in the United States, the returns of common stocks tend to follow a fouryear cycle that seems to correlate with the presidential elections. Allvine and O'Neill (1980), Huang and Schlarbaum (1982), Herbst and Slinkman (1984), Colón De Armas (1984), Huang (1985), Hensel and Ziemba (1995), Gärtner and Wellershoff (1995), Johnson et al. (1999), Booth and Booth (2003), and Beyer et al. (2008) all find evidence suggesting that, at least since 1961, common stocks provide, on average, higher returns during the last two years of a US president's term in office than in the first two years. Foerster and Schmitz (1997), although analysing its international aspects, also provide evidence supporting the existence of this fouryear US cycle.

This evidence notwithstanding, the literature has not established categorically whether this fouryear cycle regularity in common stock returns, that closely follows the terms in office of US presidents, is actually caused by factors that can be attributed to presidential elections. To further complicate matters, Colón De Armas (2013) find evidence indicating that this cycle disappeared after 1980.

A related body of research examines the performance of the US stock market under the administration of presidents of the two major political parties. For instance, Niederhoffer et al. (1970), and Riley and Luksetich (1980) find that prices in the US stock market increase more often the day after a Republican presidential candidate wins an election than when a Democrat prevails. Niederhoffer et al. (1970), however, find no significant differences between stock market returns during Republican and Democratic administrations, although they note that during the third year of a president's term, stock prices tend to increase more when a Democratic president is in office than when a Republican occupies the presidency. Hensel and Ziemba (1995) and Johnson et al. (1999) find that small firms have

significantly higher returns under Democratic presidencies, but that the returns for large firms are not statistically different across the administrations of both major parties. Santa-Clara and Valkanov (2003) find higher returns under Democratic than Republican presidencies, but the effect is more strongly observed for small firms.

The literature not only finds these relationships between politics and stock returns, but several authors attempt to explain why these relationships may exist. For instance, one plausible reason why these patterns may evolve is that the actions taken by politicians (e.g. government spending, social policies, taxation, regulations, and trade policies) affect the risk of investments in the market. Campbell and Li (2004) discard this possibility since, after accounting for volatility, they do not find significant differences in risk and returns across the presidential cycle. Powell et al. (2007), after considering some methodological issues and extending the period under study, essentially arrive at the same conclusion. Sy and Zaman (2011), on the other hand, find higher returns under Democrats than Republicans and attribute these differentials to risk.

Other researchers examine the possible linkage between politics and economics by considering whether some industries may benefit more from government actions than others. In that regard, Belo et al. (2013) find that stock returns of firms with more exposure to government spending fare better under Democratic than Republican administrations. Similarly, Boutchkova et al. (2012) find that industries that are more sensitive to political events exhibit greater return volatility. Stangl and Jacobsen (2007), however, attribute the Democrat premium and the fouryear presidential cycle effect to market wide factors, since they could not find either of them in particular industries, but only for the market as a whole.

Ferguson and Witte (2006) find a linkage between government actions and stock returns but conclude that Congress is the culprit since stock returns are lower, and volatility is higher, when Congress is in session.

Yet another reason why politics may influence stock returns may be due to the volatility introduced into the system by the mere fact of the uncertainty inherent in elections outcomes, as suggested by Bialkowski et al. (2008).

Finally, one way to corroborate if government actions influence stock returns is to extend the analysis to consider other countries besides the US. After all, if politicians may influence the stock market it is hard to imagine why that behaviour should be limited only to US government officials. Bohl and Gottschalk (2006), however, find that the Democrat premium and the fouryear presidential cycle effect are not global phenomena, but rather are mostly a peculiarity of the US stock market.

Despite the efforts of these researchers, and many others, the relation between the US stock market and presidential politics, if any, is an issue not yet settled in the literature. Not only has causality not been established, but the true existence of these return regularities is still an open research issue. Therefore, much is left for investigators to address.

An avenue of research which may provide new insight within this literature is to examine the behaviour of investment managers. With this objective in mind, in this study we try to ascertain whether the apparent relations between stock market returns and the party affiliation of the US president are indeed taken into consideration by money managers when

making investment decisions. Take, for instance, the fact that the results in the literature tend to suggest that US stock returns are higher when a Democratic president is in office. If these higher returns were the result of good public policy decisions and a better management of the economy, portfolio managers would be well advised to invest domestically when a Democrat is elected, and to search for higher returns outside the US when a Republican is in office. If these higher returns reflect a riskier environment, then the opposite may be true. In that regard, the actual composition of the domestic or overseas portfolio is less important, since what matters is the decision to invest domestically or abroad. On the other hand, if the results in the literature were spurious in nature and, although correlated with the political affiliation of the president in office, are not really caused by it, there may not be an apparent reason for the behaviour of global portfolio managers to be affected one way or the other by these results.

In other words, the decisions made by US-based global mutual fund managers when selecting the location of the investments in their portfolios have the potential to shed some light on these issues. US-based global open-end mutual funds fall within the international mutual funds umbrella that also includes foreign, country, and regional mutual funds. For US investors, global funds present an exceptional opportunity to access both the US and the foreign markets at a sensible price. The Investment Company Institute reports that, as of 2011, assets in international mutual funds represented 13% of the $11.8 trillion US mutual fund industry[1].

As defined by Morningstar[2], global fund managers have considerable investment flexibility and differ from the other types of international mutual funds because they hold a significant portion (between 25%-50% or even higher) of their portfolios invested in domestic securities. They can hold an evenly distributed portfolio between domestic and foreign securities or they may decide to overweight any of these two markets. This investment freedom allows them to search for good investment opportunities at home or abroad. Thus, we hypothesised that in the investment process of these fund managers the political stability in both the US and abroad is an important issue. If the party in power in the US has an impact on that decision, it may be indicative that the relation between stock market returns and presidential elections is on a solid footing. If not, we may conclude that the regularities found by previous research may be more spurious than real.

Although the examination of mutual funds' portfolios and their risk-adjusted performance is not an unexplored topic, very few studies are solely devoted to international mutual funds. Cumby and Glen (1990) conducted one of the few studies that have examined the performance of international mutual funds. Goetzmann et al. (2001), and Chua et al. (2008) also studied international mutual funds, but they focused on the fair pricing of international mutual funds due to the time differences between the US and foreign markets. To the best of our knowledge, our study is the first to explore the relation between global fund portfolios, their performance, and US presidential administrations.

In this study we focused our attention on the distribution of assets of US-based global fund portfolios during the nine most recent presidential administrations for which data are available for the entire fouryear term. In particular, we examined whether the managers of these global funds used the political affiliation of incumbent presidents in making their investment decisions regarding how their assets would be allocated between the domestic and foreign markets and, if so, whether those decisions had any impact on the investment

returns of these global funds. In addition, we examined whether the fouryear presidential election cycle documented by some researchers in the literature played any part in their investment decisions as well, and whether fund returns were influenced in any way by taking that cycle into consideration.

Our results suggest that global fund managers invest more domestically during the years when a Republican president is in office and favour international markets when Democratic presidents are in power. This behaviour, however, does not appear to be beneficial for the shareholders of these global funds, since their riskadjusted performance is higher, albeit weakly so, during Democratic administrations.

Finally, it appears that global fund managers, when making investment decisions, do not take into consideration the fouryear presidential election cycle. Alternatively, given that seven out of the nine administrations examined occurred after 1980, these results may serve to corroborate the findings of Colón De Armas (2013) who found that this cycle disappeared after that year.

The rest of the paper consists of four additional sections. Section 2 describes the sample of funds used to conduct this study. Section 3 presents our methodology. Section 4 discusses the empirical results. Finally, Section 5 offers some concluding remarks.

Fund samples

We examine global fund managers during the nine most recent presidential administrations for which data are available for the entire fouryear term. Accordingly, we start our analyses with the 1972 election of Richard M. Nixon (Republican) and end in the year 2008, after the reelection, in 2004, of George W. Bush (Republican). In all, we examine six Republican administrations and three Democratic administrations. The elections included, and their corresponding results in terms of the president elected, are presented in Table 1.

Table 1 – US Presidential elections

Election year	President	Party Affiliation
	Gerald R. Ford	Republican
	James E. Carter	Democrat
	Ronald W. Reagan	Republican
	Ronald W. Reagan	Republican
	George H. W. Bush	Republican
	William J. Clinton	Democrat
	William J. Clinton	Democrat
	George W. Bush	Republican
	George W. Bush	Republican

Note: This table presents the results of the nine US Presidential elections we examine.

In December of each election year, we identify all global mutual funds as classified in the Center for Research and Security Prices (CRSP) Survivorship-Bias-Free Database. For funds with multiple classes we choose the class with the longest return history, since the portfolio underlying each class of the same mutual fund is identical[3]. Since we are interested in portfolio management, no global index funds are included in the sample. Table 2 provides a description of the sample including the number of funds and the median value of three of their most common characteristics: total net assets, expense ratio, and turnover ratio. We examine a total of 357 US-based global mutual funds. In Panel A of Table 2, we break down the number of funds by election year. For the first two presidential administrations, we identify only two distinct mutual funds. In later years, however, we are able to include more funds with the 1996 election having the largest number with 97. The median of total net assets range from a low of $400,000 for the election of 1972 to a high in 1980 of $221 million. The median expense ratio remains below 2 percent, with a high of 1.8 percent for the election of 1976. The median portfolio turnover increases steadily from 5.3 percent in 1980 to 71.5 percent for the election of 2000[4].

Table 2 - Samples description

Panel A: Election year

Election year	Number of funds	Total net assets	Exp. Ratio	Turn. ratio
1972	2	0.4	0.01	---------
1976	2	0.75	0.018	---------
1980	3	221	0.0123	0.053
1984	10	99	0.0106	0.219
1988	31	41	0.0163	0.465
1992	48	52	0.0165	0.575
1996	97	96	0.0175	0.6025
2000	74	125	0.0133	0.715
2004	90	99	0.0149	0.49

Panel B: By party

Party	Number of funds	Total net assets	Exp. Ratio	Turn. ratio
Democrats	147	80	0.0174	0.5978
Republicans	210	93	0.0142	0.57

Notes: This table presents some descriptive statistics of the samples of US-based global funds we examine during nine US Presidential elections considered.

Panel A presents the description of the samples of funds per election cycle. Panel B shows fund descriptions per ruling party. Total net assets is reported in millions of dollars. The ex-

pense ratio relates to the most recently completed fiscal year and is represented in decimal format. The turnover ratio is represented in decimal format and corresponds to the most recently completed fiscal year.

In Panel B of Table 2, the funds in the sample are categorised by the party affiliation of the incumbent president. During the three Democratic administrations, we examine a total of 147 global funds with median total net assets of $80 million, median expense ratio of 1.74 percent and median turnover ratio of 59.78 percent. During Republican administrations, we consider a total of 210 funds with median total net assets, median expense ratio, and median turnover ratio of $93 million, 1.42 percent, and 57 percent, respectively. Although not reported in Table 2, we find statistically significant differences between the average total net assets and average expense ratio between parties. The average total net assets are $630 million under Democratic administrations and $1,275 million under Republican administrations, and the difference between the averages is statistically significant at the 10% level. The average expense ratio under Democratic administrations is 1.73 percent, while under Republican administrations it is 1.38 percent. The difference between the average expense ratios is statistically significant at the 1% level. Although not presented in the table, this sample of global funds are almost all-equity funds – a feature which helps to motivate the model used in the style analysis presented later on. Based on CRSP portfolio composition data, these funds hold a median value of 87.17 percent of their portfolio in stocks and a 4.11 percent in cash. The median value of fixed-income, derivatives or preferred stock holdings is zero.

Methodology

3.1 Portfolio exposures

The analysis starts by examining the distribution of assets between the domestic and international markets of US-based global mutual funds during the nine US elections cycles from 1973 through 2008. The purpose of this analysis is to determine whether global fund managers consider the party affiliation of the incumbent president in their investment decisions.

Since we do not have direct access to the portfolio holdings of mutual funds, we employ Sharpe's (1992) quadratic programming technique, also known as style analysis, to estimate the domestic/international portfolio mix of each global fund in the sample. Style analysis allows for the estimation of each fund's portfolio exposure to each market index from the publicly available fund returns. Comer et al. (2009) and Comer and Rodríguez (2011), among others, use style analysis in their respective examinations of hybrid funds and fixed income mutual funds[5].

To implement this methodology, it is assumed that fund returns can be expressed as:

$$r_i = \sum_{j=1}^{n} w_{i,j} r_j + e_i$$

(1)

where, r_i is the total return of fund i, $w_{i,j}$ is the exposure of fund i to index j, r_j is the total return of index j, and e_i is the unexplained component of fund return.

Three indexes or factors are included in equation (1). As in the case of Hensel and Ziemba (1995) and Siegel (1998), the S&P 500 index is chosen to represent the domestic market. The MSCI World ex US is used to represent the foreign market, and the Lehman Brothers Short Treasury index is used as a proxy for the cash portion of the fund's portfolio. Table 3 shows the distribution of returns for a portfolio of funds during each election year. The table also shows the distribution of returns for the two stock indexes, the S&P 500 (US) and the MSCI World ex US (Foreign).

Table 3 – Distribution of returns

	Funds			US			Foreign	
Election year	Mean	Std. Dev.		Mean	Std. Dev.		Mean	Std. Dev.
1972	-0.0028	0.058		-0.0005	0.0546		0.0016	0.0571
1976	0.011	0.0393		0.0058	0.0427		0.0171	0.0392
1980	0.0107	0.0405		0.0052	0.041		0.0058	0.0457
1984	0.0147	0.0475		0.0121	0.0543		0.0306	0.0513
1988	0.0065	0.0354		0.0102	0.0408		-0.0017	0.0581
1992	0.0123	0.0278		0.0114	0.0258		0.0119	0.0372
1996	0.0121	0.0527		0.0133	0.0496		0.0075	0.0461
2000	0.0022	0.0454		-0.0007	0.0469		0.0036	0.0474
2004	-0.0017	0.0459		-0.0053	0.04		-0.0001	0.0518

Notes: This table presents the mean and standard deviation of the monthly returns, in decimal format, of a portfolio of funds during each election cycle. The same statistics are presented for the S&P 500 (representing the US market or domestic market) and the MSCI World ex US index (representing the foreign market).

Portfolio weights represent factor loadings on an index strategy that does the best job of explaining the fund's return and are generated as the solutions of a quadratic programming problem that is expressed as follows:

$$\text{Min}\left[\text{var}\left(r_i - \sum_{j=1}^{n} w_{i,j} r_j\right)\right] \qquad (2)$$

subject to

$$1 \leq w_{i,j} \leq 0 \quad \forall j$$

$$\sum_{j=1}^{n} w_{i,j} = 1$$

We estimate equation (2) using monthly returns during each of the four year periods corresponding to each presidential administration under consideration. By analysing these results, we are able to obtain a better understanding of the investment preferences of global fund managers during the different presidential cycles. Accordingly, we are able to assess whether the political climate in the US has any influence on the domestic and international portfolio exposure of these funds. Special consideration is given to the differences between the exposures to the domestic or international markets according to the party affiliation of the incumbent president. Also, we are able to break down each cycle to focus on whether these global funds are overweighting the US market during the last two years of a president's term in office as would be suggested by some of the evidence provided in the literature supporting the existence of a fouryear presidential election cycle whereby higher common stock returns are obtained precisely during those years.

To complete the analysis, however, and to properly evaluate their performance during each presidential administration, we need to calculate riskadjusted returns.

3.2 Risk-adjusted performance

To measure the risk adjusted performance of the funds, we turn to the traditional Jensen's alpha and examine the sign and significance of the intercept estimated from the following single index model:

$$r_i - r_f = \alpha_i + \beta_i \left(r_j - r_f \right) + e_i$$

(3)

In equation (3), the MSCI World Index is used as the market. This choice of market benchmark is due to the fact that, from the 233 unique funds in the sample, 173 of them (or 74 percent of the sample) list the MSCI World Index as their "best fit index". The Lehman Brothers Short Treasury Index is used as the risk free rate.

We examine the risk adjusted performance of global fund managers during each of the nine four-year periods. Together with the results from the portfolio exposures above, these performances allow us to get a clear picture, not only of the portfolio composition of these global funds, but also to assess the performance of each individual global fund during each

Republican and Democratic administration. These results allow us to answer some interesting questions: Do US-based global funds prefer the domestic market during a particular party administration? If so, does that preference have an impact on fund returns? Do global funds perform better during Republican or Democratic administrations? More, importantly, do these fund managers recognise the existence of a presidential election cycle? Are they able to profit from it? With these questions in mind, let us now turn to the empirical results.

Empirical results

4.1 Portfolio exposures

Table 4 presents the results of our three-factor model estimated by using equation (2) and the monthly returns of an equallyweighted portfolio composed of all the funds in existence during each administration. These results appear to validate the threefactor model and its ability to explain global fund returns, since the adjusted R-squared of the model ranges from a low of 74 percent for the 1993-1996 Democratic administration of President William J. Clinton, to a high of 99 percent for the 2005-2008 second term of Republican President George W. Bush. It is also important to notice that most of the factor loadings for the domestic and foreign indexes are significant at the 1% level. The notable exceptions are the 1972 and 1976 elections, which is not surprising given the fact that only two global funds exist during these two election cycles.

Table 4 - Portfolio exposures

Election year	Number of funds	US	Portfolio exposures Foreign	Cash	Adj. R squared
1972	2	1	0	0	0.9148
1976	2	0.8883	0.0722	0.0395	0.9189
1980	3	0.8311***	0.1156***	0.0532	0.9008
1984	10	0.6435***	0.2425***	0.1138*	0.8688
1988	31	0.4610***	0.3641***	0.1747***	0.9155
1992	48	0.4835***	0.4201***	0.0962	0.7496
1996	97	0.3317***	0.6682***	0	0.8146
2000	74	0.4288***	0.5551***	0.0159	0.9846
2004	90	0.4540***	0.5459***	0	0.9916

Notes: This table presents the results of the estimation of the exposures to US, and foreign markets as well as to the risk-free rate (representing funds' cash holdings) for a portfolio of all the funds in existence during each US-presidential cycle. Exposures are represented in decimal format. ***, **, * denotes statistical significance at the 1, 5, and 10 percent level respectively.

The results in Table 4 also demonstrate that the estimated values for the exposure to the domestic market vary considerably. For the 1973-1975 Republican administration of Presidents Richard M. Nixon and Gerald R. Ford, this factor loading is 1, meaning that, on average, these funds are fully invested in domestic securities in spite of the fact that these are global funds. The domestic factor loading reaches its minimum during the 1997-2000 second term in office of Democratic President William J. Clinton, with an estimated value of 33 percent. The factor loadings for the foreign portion of the portfolios also vary from one election to the next. Corresponding to the 1973-1976 administration, this factor loading reaches the lowest possible value of zero. However, foreign exposure rises monotonically after 1972 reaching its highest value, 66 percent, during the 1997-2000 administration, declining thereafter[6]. Next, we consider whether these variations in exposures to the domestic and foreign markets are in any way related to the party affiliation of the incumbent president.

Table 5 shows the exposures of our sample of global mutual funds according to the president's political party. We estimate the portfolio exposure of each global fund during each of the four-year presidential administrations. The values in Table 5 are the cross-sectional means of all the funds during each administration. During Democratic administrations, global funds had an average exposure to the US market of 35.24 percent, which is lower than the 42.58 percent exposure during Republican administrations. Accordingly, the average exposure to foreign markets during Democratic administrations is higher, 55.79 percent, than during Republican administrations, 48.92 percent. For both exposures, domestic and foreign, the differences between portfolio exposures during Democratic versus Republican administrations are statistically significant at the 1% level.

Table 5 – Portfolio exposure per party ruling

			Portfolio exposures	
Party		US	Foreign	Cash
Democratic		0.3524	0.5579	0.0693
Republican		0.4258	0.4892	0.0835
Difference		-0.0734***	0.0687***	-0.0143

Notes: This table presents the average exposures to US and foreign markets as well as to the risk-free rate (representing funds' cash holdings) of all the funds in existence during each US-presidential cycle. Averages are computed for each party ruling cycles. Exposures are represented in decimal format. ***, **, * denotes statistical significance at the 1, 5, and 10 percent level respectively.

The results in Table 5 suggest that global fund managers invest more domestically during the years when a Republican president is in office and favour international markets when Democratic presidents are in power. These results raise the issue of whether this behaviour by fund managers pays off for fund shareholders.

4.2 Risk-adjusted performance

Table 6 presents data on riskadjusted performance for the global funds in our sample using the classical Jensen's alpha calculated according to equation (3). Panel A of Table 6 shows the average alpha for all the funds in the sample according to the party affiliation of the incumbent president. The reported value is the equally weighted annualised alpha. We also test for the statistical difference between average alphas. As a group, global fund managers successfully beat the benchmark during Democratic administrations with an average monthly alpha of 0.0011, which is equivalent to approximately 1.33 percent per year, and is statistically significant at the 5% level. When a Republican president is in office, the average monthly alpha is positive, and greater than the alpha obtained during Democratic administrations, but it is not statistically significant. Also, there is no significant difference between the performances of global funds during the administrations of both parties.

Panel B of Table 6 demonstrates that, when considered individually, global fund managers obtain more positive, and significantly positive, alphas during Republican administrations, but they also obtain more negative, and significantly negative, alphas as well.

These results tend to imply that the decisions by global fund managers to favour the domestic market during Republican administrations and the foreign markets during Democratic presidencies are not beneficial for fund shareholders since their riskadjusted performance is higher, albeit weakly, during Democratic administrations.

Table 6 - Risk adjusted performance per party ruling

Panel A: Aggregate results

Party	N	Alpha Mean
Democratic	147	0.0011**
Republican	210	0.0048
Difference		–0.0037

Panel B: Individual Funds

	Positive alphas (sig.)	Negative alphas (sig.)
Party		
Democratic	87 (6)	60 (10)
Republican	113 (36)	97 (27)

Notes: This table presents the results of the estimation of alpha as a measure of risk-adjusted performance. In parentheses are the number of statistically significant alphas. Panel A of the table presents the aggregate results for each ruling party. Panel B shows the number of positive and negative alphas for the individual funds. ***, **, * denotes statistical significance at the 1, 5, and 10 percent level respectively.

4.3 Presidential-election cycle

Finally, the data in our sample allows us to consider whether US global fund managers, when making investment decisions, use and profitably exploit the fouryear presidential election cycle. According to some authors, that cycle results from the tendency of common stocks to provide, on average, higher returns during the last two years of a US president's term in office than in the first two years. Thus, if that cycle were to be taken into consideration by fund managers when making investment decisions, one would expect global funds to have higher exposures to the US market during the last two years of a president's term in office. To determine if that is indeed the case, we examine the estimated portfolio exposures discussed in Section 4.1 and verify how many funds do have a higher exposure to the US market during the last two years of each administration. The results appear in Table 7.

Table 7 – Global funds and the presidential election cycle

Panel A: Aggregate results

Exposure to the US in years 3 and 4 of presidents term	N	Alpha
Mean		
Lower	227	0.0051
Higher	130	0.00018
Difference		0.0049

Panel B: Democratic administrations

Exposure to the US in years 3 and 4 of presidents term	N	Alpha
Mean		
Lower	120	0.0016
Higher	27	−0.0013
Difference		0.0029**

Panel C: Republican administrations

Exposure to the US in years 3 and 4 of presidents term	N	Alpha
Mean		
Lower	107	0.0089
Higher	103	0.0006
Difference		0.0084

Notes: This table presents the relation between portfolio exposure, funds risk-adjusted performance and the US presidential election cycle. Panel A of the table shows the aggregate results, i.e. independent of the ruling party. Panel B presents the results during a Democratic administration. Panel C shows the results for the Republican administrations. ***, **, * denotes statistical significance at the 1, 5, and 10 percent level respectively.

These results show that 130 funds, or 56 percent of the sample, across the nine administrations examined, have higher exposures to the domestic market during the last two years of the fouryear presidential election cycle. Consistent with the results in Table 5, the majority (103/130) of the global funds that invest more heavily at home than abroad during the last two years of a president's term in office do so during Republican administrations.

In terms of performance, however, having a higher exposure to the US market during the last two years of any presidential administration does not appear to be beneficial. For instance, the results presented in Table 7 demonstrate that, in aggregate, that is, regardless of the party of the incumbent president, average performance is lower (0.00018 versus 0.0051) for global funds with higher exposure to the domestic market during the last part of each administration. The difference between the average alphas, however, is not significant. During Democratic administrations the results are more robust because the average alpha for funds with higher exposure to the domestic market during the last two years of a president's term in office is not only lower (0.0013 versus 0.0016), but the difference is statistically significant. For Republican administrations, the results are qualitatively similar, with lower performance (0.0006 versus 0.0089), although not statistically significant, for funds with higher exposure to the domestic market.

Since only 36 percent of the global funds in the sample have higher exposures to the domestic market during the last two years of a US president's term in office, these results may suggest that global fund managers, when making investment decisions, do not take into consideration the fouryear presidential election cycle. Alternatively, given that seven out of the nine administrations examined occurred after 1980, these results may serve to corroborate the findings of Colón De Armas (2013) who finds that this cycle disappears after that year. The likelihood of this alternative conclusion is strengthened by the fact that return performance is lower for funds with higher exposure to the US market during the last two years of a president's term in office.

4.4 Matched-funds sample analysis

To better understand the behaviour of US global fund managers, and to address any statistical issue for the lack of balance in the number of Democrat and Republican administrations, in this section we follow a sample of funds in existence during each pair of consecutive presidential administrations. For example, a total of 37 funds are in existence during both, the 1996-2000 Democratic administration of William J. Clinton, and the 2000-2004 Republican administration of George W. Bush. By analysing funds that exist in each pair of consecutive presidential administrations, we are left with a reduced subset of our sample, but we can perform pair matched t-tests on these funds to examine their behaviour. Accordingly, we compute the change in exposure to domestic and foreign markets, as well as the change in risk-adjusted performance. Table 8 reports the results.

Table 8 - Matched-funds sample analysis

Adminis-trations	Change	No. of funds	US	Foreign	Cash	Alpha
72–76 to 76–80	Rep to Dem	2	0.133	-0.072	-0.061	-0.0031
76–80 to 80–84	Dem to Rep	2	-0.14	0.0707	0.0693	-0.0026
80–84 to 84–88	No change	3	0.0394	0.0807	-0.1201	0.0061
84–88 to 88–92	No change	8	0.0366	0.0115	-0.0359	-0.0091***
88–92 to 92–96	Rep to Dem	13	0.0215	-0.0714*	0.0425	0.0021***
92–96 to 96–00	No change	37	0.2307***	-0.2653***	0.0346***	0.0023***
96–00 to 00–04	Dem to Rep	35	-0.0707*	0.0608	0.0099	-0.025
00–04 to 04–08	No change	48	0.017	-0.0401	0.0231**	0.0006

Notes: This table present the results of a matched pair t-test analysis for groups of funds in existence during two consecutive administrations. The table presents the change in exposure and risk-adjusted performance. Exposures are represented in decimal format. ***, **, * denotes statistical significance at the 1, 5, and 10 percent level respectively.

The number of funds that meet the conditions to be included in this matched-funds sample analysis ranges from a low of two in the first two pairs of administrations to a high of 48 in the last pair. In terms of exposures, we find that funds significantly increase their domestic exposure from the 1992-1996 administration to the 1996-2000 administration, both Democratic administrations. We also report a significant decrease in domestic exposure from the Democratic administration of 1996-2000 to the Republican administration of 2000-2004. Considering foreign exposure, we find a significant decrease from 1988-1992 to 1992-1996, which corresponds to a change from a Republican to a Democratic administration. We also report a significant decrease in the exposure to foreign markets from 1992-1996 to 1996-2000, during a two term Democratic administration.

Finally, Table 8 reports the results of the risk-adjusted performance during each two-term period. We find a significant decrease in fund performance from 1984-1988 to 1988-1992, which corresponds to a two-term Republican administration, but this performance appears to be unrelated to the exposures since none of them are significant. Funds' performance significantly increases from 1988-1992 to 1992-1996, when a change from a Republican to a Democratic administration takes place, and the exposure to the foreign market is reduced. Performance continues to improve during the second term of the Democratic administration 1996-2000, only this time the exposure to the US market increases, and the exposure

to the foreign market is reduced.

For the most part, these results are consistent, and confirm, our earlier results to the effect that global fund managers do not appear to take politics into consideration in their investment decisions and, when doing so, they do not necessarily benefit fund shareholders.

Conclusion

The relation between the US stock market and presidential politics, if any, is an issue not yet settled in the literature. Although many researchers find evidence suggesting the existence of some stock return regularities that may be related to presidential elections, causality has not been established. More importantly, the true existence of these return regularities is still an open research issue. Therefore, much is left for investigators to address.

An avenue of research which may provide new insight within this literature is to examine the behaviour of investment managers. In particular, it is important to ascertain whether the apparent relations between stock market returns and the US presidential elections are indeed taken into consideration by money managers when making investment decisions. In that regard, the decisions made by US-based global mutual fund managers when selecting the location of the investments in their portfolios have the potential to shed some light on these issues.

Global fund managers have great investment flexibility since they can hold an evenly distributed portfolio between domestic and foreign securities or they may decide to overweight any of these two markets. This investment freedom allows them to search for good investment opportunities at home or abroad. Thus, we hypothesise that in the investment process of these fund managers the political stability in both the US and abroad is an important issue. If the party in power in the US has an impact on that decision, it may be indicative that the relation between stock market returns and presidential elections may be on solid footing. If not, we may conclude that the regularities found by previous research may be more spurious than real.

In this study we focus our attention on the distribution of assets of US-based global fund portfolios during the nine most recent presidential administrations for which data are available for the entire fouryear term. In particular, we examine whether the managers of these global funds use the political affiliation of incumbent presidents in making their investment decisions regarding how their assets are allocated between the domestic and foreign markets and, if so, whether those decisions have any impact on the investment returns of these global funds. In addition, we examine whether the fouryear presidential election cycle documented by some researchers in the literature plays any part in their investment decisions, and whether fund returns are influenced in any way by taking into consideration that cycle.

Our results suggest that global fund managers invest more domestically during the years when a Republican president is in office and favour international markets when Democratic presidents are in power. This behaviour, however, does not appear to be beneficial for the shareholders of these global funds, since their returns are higher, albeit weakly, during Democratic administrations.

Finally, it appears that global fund managers, when making investment decisions, do not take into consideration the fouryear presidential election cycle. Alternatively, given that seven out of the nine administrations examined occurred after 1980, these results may serve to corroborate the evidence reported in the literature which shows that this cycle disappears after that year.

Notes

1. Investment Company Institute: www.ici.org.

2. Morningstar: www.morningstar.com.

3. For further details see O'Neal (1999).

4. Portfolio turnover data were not available in CRSP for the 1972 and 1976 samples of funds.

5. Admittedly, examining actual mutual fund holdings would have been a more efficient way to study portfolio exposures to domestic and foreign markets. Detailed mutual funds holdings, however, are only available from CRSP beginning in 2003. Thus, using these data would have limited our examination to just one election cycle, which would have resulted in too small a sample to draw meaningful conclusions. Style analysis, on the other hand, allowed us to examine all the election cycles starting with the 1972 election.

6. At first glance, in Table 4, the fact that the exposure in the foreign financial market goes from 0% in 1972 to more than 60% in 1996, while the pattern of US exposure has decreased, may give the impression that the exposure variable is nonstationary. Had this been the case, an analysis of changes in exposure, instead of average exposures, may have been warranted. A more robust statistical analysis demonstrates that is not the case. Specifically, we performed DickeyFuller Unit Root tests on US, foreign, and cash exposures and find that these exposures are stationary.

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