



## Politics and Fund Managers

By Robert Huebscher

September 1, 2009

This is not an article about politics. Nor is its point to reveal the results of an investing competition between the political parties. But those readers who would like to know whether to invest with Democrat or Republican fund managers finally have some guidance, thanks to a new study, [Red and Blue Investing: Values and Finance](#), by Harrison Hong, a professor of Economics at Princeton, and Leonard Kostovetsky, a Business professor at the University of Rochester.

Hong and Kostovetsky are the first to study political leanings and their effect on fund management. Using publicly available data from the Federal Elections Committee's Web site, they determined which fund managers were contributing more to Democratic candidates and which were contributing more to Republicans.

If a manager contributed more, on balance, to a particular party, he or she was assigned to that party. Moreover, if the manager contributed at least \$2,000 (the original cap for individual contributions in an election cycle under the McCain-Feingold Act), the manager was labeled a *strong* Democrat or Republican.

Using data from 1992 to 2006, they found contribution data for approximately 600 of the 2,100 managers in Morningstar's universe. Of these, 60% were Republicans and 40% were Democrats.

The authors' goal was not to determine which party attracts better investors, but since that is what I – and, I suspect, most readers – want to know, I'll discuss those results first.

Republican managers did better than Democratic managers, on an absolute basis and on a risk-adjusted basis. The difference, however, was very small – approximately 36 basis points per year. The authors caution that these results cannot be the foundation of a trading strategy, since the political affiliations were determined *ex-post* (after the fact). They also note, however, that political affiliations are relatively stable over time so, all else being equal, you might eke out a few basis points with a Republican manager.

Both Republican and Democratic managers performed better than non-donors. That discrepancy may reflect mere self-selection, however, since successful managers accumulate wealth that allows them to make political contributions.



The authors' primary focus was to examine more broadly how political affiliations affect investment decisions. Their key finding was that Democratic fund managers held less (than Republican and non-donor managers) in industries that are considered socially irresponsible (e.g., tobacco, guns, defense, and natural resource exploration). Strong Democrats under-weighted these stocks by about 1%, after adjusting for style and size characteristics. Republican managers over-weighted politically sensitive industries by 37%, but that finding was not statistically significant.

A higher proportion of socially responsible investing (SRI) funds are run by Democrats. But the authors dropped SRI funds from their study to avoid any bias; they wanted to study manager decisions in funds that did not have an SRI mandate.

SRI funds under-weight politically sensitive stocks by 1.6%, slightly more than the under-weighting by strongly Democratic managers. The authors controlled for a number of other personal characteristics of managers (such as gender, age, and graduate degree), so they are confident the under-weighting is related to the managers' political affiliation.

The authors studied a database of hedge funds and found similar under-weighting of politically sensitive industries.

The study suggests Democratic managers engage in "closet" SRI management through their under-weighting of politically sensitive industries, and their actions are not counteracted by Republican managers. As a result, the authors estimate, those managers keep approximately 1.3% of politically sensitive stocks off the market (they are no longer investment candidates for their funds), which depresses the prices of those stocks.

The impact of this closet SRI management can be compared to the S&P index inclusion effect, a well-documented phenomenon where prices of securities in the index are elevated because of their inclusion. Nearly 5% of mutual fund assets are held in S&P 500 index funds. The downward price pressure on the stocks outside the S&P 500 not held by those index funds is of the same magnitude as that exerted by Democratic managers on politically sensitive stocks.

Don't attach too much significance to these results. As the authors note, political contributions may reflect managers' relationships with individual candidates rather than party affiliations. Many of the non-donors may be politically affiliated despite their lack of contributions. And the sample size was fairly small – only 35 managers were identified as strong Democrats and 26 as strong Republicans.

Additionally, the period the authors described was, on balance, one of Republican ascendancy, at least in D.C. Perhaps they're just picking up the fact that the managers who are shrewd and influential enough to perform well are also shrewd enough and



influential enough to make a rational (and ultimately apolitical) decision to shift their donations to the party in power.

Kostovetsky told me he has not made any changes to his asset allocation as a result of his findings – because his holdings are indexed. He cautioned that advisors should “look carefully at what the manager is doing and whether he or she is working on your behalf.”

Politically motivated investments are more likely to occur among those managers who have donated the most money. For this reason, below are the largest contributors to Democratic and Republican candidates and their net contributions over the time period examined by the authors:

#### **Top 10 Republican Contributors**

Oberweis, James D.	\$455,031	Oberweis Securities
Weiss, Richard T.	\$419,095	Strong Capital Management
Skirkanich, J. Peter	\$373,500	Fox Asset Management
Marsico, Thomas F.	\$304,300	Marsico Capital Management
Albers, Charles E.	\$284,105	Oppenheimer Funds
Fisher, Kenneth L.	\$260,850	Fisher Investments
Fedak, Marilyn G.	\$203,500	AllianceBernstein
King, Roger E.	\$125,550	Dreyfus
Brinson, Gary P.	\$123,201	UBS
Sarofim, Fayez	\$123,000	Fayez Sarofim & Co

#### **Top 10 Democratic Contributors**

Rogers Jr., John	\$390,231	Ariel Investments
Black, Scott M.	\$352,800	Delphi Management
Marks, Howard S.	\$276,463	Oaktree Capital Management
Falcone, Nola M.	\$269,650	NMF Asset Management
Collier, Sophia	\$210,300	Citizens Funds
Turner, Robert E.	\$138,100	Turner Investment Partners
Aronson, Theodore R.	\$128,900	Aronson Johnson Ortiz
Sosnoff, Martin T.	\$115,700	Atalanta/Sosnoff
Osterweis, John S.	\$114,500	Osterweis Capital Management
Holland, Louis A.	\$109,800	Holland Capital Managemtn

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