Partisanship in Fund Portfolios: Biased Expectations or In-Group Favoritism?

Osama Mahmood Khawar
University of Florida

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Introduction

- Unprecedented rise in political polarization and partisan conflict in the U.S. recently (Azzimonti 2018)
- Political identity in the U.S. has grown in alignment with racial, religious and ideological identities (Mason & Wronski 2018)
- Strong and growing evidence of partisan identity impacting **economic expectations** (Curtin 2016; Gerber & Huber 2009; Mian et al. 2018).
- Partisan group identity is increasingly susceptible to **in-group favoritism** (Tajfel 1982; Aboud 2003; Aboud 2008)

Motivation

Recently, there has been growing evidence of partisan identity shaping economic expectations of professionals in the finance industry

- **Credit rating analysts** not affiliated with the ruling party downward-adjust corporate credit ratings more frequently due to their pessimistic economic outlook (Kempf and Tsoutsoura 2018)
- **Bankers** not aligned with the incumbent party charge higher loan spreads (Dagostino et al. 2020)
- Political alignment between **firms' management** and the president is associated with higher investment (Rice 2020)
- Is the same true for Mutual Fund Managers?

Motivation

Moreover, there is also evidence of partisan in-group favoritism in the finance industry

- Financial **news networks** have higher likelihood of using a positive (negative) tone when covering a politically aligned (misaligned) firm (Goldman et al. 2020)
- Political alignment between **CEOs** and independent **directors** significantly reduces the latter's monitoring effectiveness (Lee et al. 2014)
- **Fund managers** allocate higher portfolio weights to politically aligned firms (Wintoki & Xi 2020)

Main Results

- Misaligned managers have a pessimistic economic outlook i.e. they underweight small-cap, volatile and high B/M stocks and overweight momentum stocks (Bonaparte el at. 2017)
- Republican managers increased portfolio beta by about 0.4 (35% of sample average) after the 2016 election (Meeuwis et al. 2018)
- No evidence for in-group favoritism in mutual funds once managers without political affiliation information are excluded from sample
- There is a partisan bias in holdings of stocks exposed to COVID-19 (and Brexit) but limited evidence for past pandemics (H1N1, Ebola and Zika) - partisan bias manifests in politicized topics (Cookson et al. 2020)

Data & Sample

Following Hong and Kostovetsky (2012), I construct a sample of U.S.-based active, equity mutual funds with a single manager

- 1,627 managers and 2,139 funds for 01/2005 to 06/2020, while HK find 2,362 single managers for 1992 to 2006
- FEC political donations data is used to identify managers' political affiliation
- A Morningstar-CRSP linktable is used to obtain holdings data from CRSP
- The final holdings data has donation data for 332/1,341 managers (25%)[1]

[1] HK identified 600/2100 managers (29%)

Economic Expectations

To test the "biased economic expectations" hypothesis, I use the following regression model on the sample of only the "donating" managers:

$$weight_{ijt} = \alpha_0 + \beta_1 misalign_{it} \times variable_{jt} + \Gamma' Controls + \delta_{it} + \lambda_{dt} + \psi_{st} + \epsilon_{ijt}$$

- $weight_{ijt}$ is the portfolio weight of stock j in fund i in month t
- $misalign_{it}$ indicates the manager is not aligned with the incumbent party
- $variable_{jt} \in$ [bm, log(mkt_cap), idio. vol., 12-mth ret, beta] $= \Gamma' Controls$
- δ_{it}, λ_{dt} and ψ_{st} are fund-month, industry-month and state-month FE
- Standard errors are triple-clustered by fund, by stock and by month

Economic Expectations

VARIABLES	(1) bm	(2) log(mkt_cap)	(3) idvol	(4) r12	(5) beta
misalignXvariable	-0.0456**	0.0482***	-0.00471*	1.082***	-0.00503
	(-2.152)	(2.654)	(-1.859)	(3.276)	(-0.640)
bm	0.0545***	0.0320**	0.0332**	0.0319**	0.0324**
	(3.176)	(2.190)	(2.251)	(2.171)	(2.208)
log_mkt_cap	0.184***	0.163***	0.184***	0.184***	0.184***
	(9.169)	(7.047)	(9.111)	(9.156)	(9.107)
idvol	0.00242	0.00223	0.00421*	0.00235	0.00235
	(1.208)	(1.123)	(1.889)	(1.176)	(1.175)
r12	1.326***	1.355***	1.331***	0.884***	1.323***
	(5.241)	(5.543)	(5.308)	(2.931)	(5.223)
beta	-0.0179***	-0.0167***	-0.0186***	-0.0183***	-0.0165***
	(-2.992)	(-2.827)	(-3.128)	(-3.050)	(-2.627)
Constant	-1.984***	-1.997***	-1.974***	-1.982***	-1.976***
	(-6.438)	(-6.765)	(-6.364)	(-6.426)	(-6.373)
Observations	2,798,130	2,798,130	2,798,130	2,798,130	2,798,130
R-squared	0.570	0.571	0.570	0.570	0.570
Industry X Month FE	Yes	Yes	Yes	Yes	Yes
State X Month FE	Yes	Yes	Yes	Yes	Yes
Fund X Month FE	Yes	Yes	Yes	Yes	Yes
Triple Clusters	Yes	Yes	Yes	Yes	Yes

$\longrightarrow$ Results are largely consistent with Bonaparte et al. (2017)
$\longrightarrow$ But for sophisticated/professional individuals (i.e. fund managers)

Trump 2016 Election

Next I implement the following model in a 6-month window around the 2016 election:

$$weight_{ijt} = \alpha_0 + \beta_1 rep_{it} \times after_t \times variable_{jt} + \beta_2 rep_{it} \times variable_{jt} + \beta_3 after_t \times variable_{jt} + \beta_4 rep_{it} + \Gamma' Controls + \delta_{it} + \lambda_{dt} + \psi_{st} + \epsilon_{ijt}$$

Here $after_t = 1$ for 11/2016 and ahead

$\longrightarrow$ Standard errors are double-clustered by fund and by stock (too few months)

$\longrightarrow$ All results are as expected except for momentum stocks (weakly significant in the opposite direction)

Trump 2016 Election

VARIABLES	(1) bm	(2) log_mkt_cap	(3) idvol	(4) r12	(5) beta
repXafterXvariable	0.116**	-0.0103	-0.00221	1.782*	0.0756**
	(2.256)	(-0.863)	(-0.578)	(1.699)	(2.293)
repXvariable	0.0894	-0.0322	0.00903	-1.366	0.0170
	(1.415)	(-0.783)	(1.163)	(-1.152)	(0.471)
afterXvariable	-0.0792*	0.00259	0.00494	-2.072**	-0.0350
	(-1.683)	(0.228)	(1.385)	(-2.267)	(-1.188)
Constant	-3.250***	-3.266***	-3.263***	-3.261***	-3.244***
	(-6.433)	(-6.561)	(-6.448)	(-6.454)	(-6.428)
Observations	64,342	64,342	64,342	64,342	64,342
R-squared	0.533	0.533	0.533	0.533	0.533
Controls	Yes	Yes	Yes	Yes	Yes
Industry X Month FE	Yes	Yes	Yes	Yes	Yes
State X Month FE	Yes	Yes	Yes	Yes	Yes
Fund X Month FE	Yes	Yes	Yes	Yes	Yes
Fund Clusters	Yes	Yes	Yes	Yes	Yes
Stock Clusters	Yes	Yes	Yes	Yes	Yes

$\longrightarrow$ Republicans significantly increased weights on high beta stocks

$\longrightarrow$ The beta result *should* replicate at the portfolio level as portfolio beta is a linear combination of individual stock betas

Trump 2016 Election

Using a portfolio-level data, Implement the following model:

$$mret_{it} = \alpha_0 + \beta_1 rep_{it} \times after_t \times snp_t + \beta_2 rep_{it} \times snp_t$$
$$+\beta_3 rep_{it} \times after_t + \beta_4 rep_{it} + \Gamma' Controls + \delta_i + \tau_t + \epsilon_{it}$$

- Dependent variable, $mret_{it}$, is the month's fund return
- snp_t is the market excess return (from Kenneth French)
- $\Gamma' Controls$ are fund age, number of stocks, turnover ratio, expense ratio, fund flow, and log of assets
- δ_i and τ_t are fund and month fixed effects

Trump 2016 Election

VARIABLES	(1) 12-month	(2) 18-month	(3) 24-month	(4) 30-month	(5) 36-month
repXafterXsnp	0.387**	0.301**	0.253*	0.0937	0.0531
	(2.387)	(2.164)	(1.904)	(1.337)	(1.067)
repXsnp	-0.135**	-0.0523	-0.0296	-0.00297	0.00220
	(-2.066)	(-1.240)	(-0.632)	(-0.111)	(0.0863)
repXafter	-0.792**	-0.785**	-0.567*	-0.365*	-0.169
	(-2.220)	(-2.196)	(-1.762)	(-1.745)	(-1.302)
Constant	-0.903	6.196***	0.476	0.463	0.463
	(-0.641)	(9.140)	(1.042)	(1.081)	(1.467)
Observations	1,638	2,429	3,221	3,984	4,724
R-squared	0.574	0.578	0.669	0.739	0.724
Controls	Yes	Yes	Yes	Yes	Yes
Month FE	Yes	Yes	Yes	Yes	Yes
Fund FE	Yes	Yes	Yes	Yes	Yes

Robust t-statistics in parentheses
*** p<0.01, ** p<0.05, * p<0.1

$\longrightarrow$ 0.387 represents about 35% higher beta than sample average
$\longrightarrow$ This result is consistent with Meeuwis et al. (2018)
$\longrightarrow$ Negative *repXafter* represents lower alpha

In-Group Favoritism

Following Wintoki & Xi (2020), I estimate a firm's political affiliation as follows:

$$firm\_rep = \frac{TotalRepublicanDonations(\$) - TotalDemocratDonations(\$)}{TotalRepublicanDonations(\$) + TotalDemocratDonations(\$)}$$

Managers' affiliation (mgr_rep) is calculated similarly and, like them, I define:

$$pol\_sim = 1 - \frac{|mgr\_rep - firm\_rep|}{2}$$

In-Group Favoritism

Following Wintoki & Xi (2020), I estimate the following model:

$$weight_{ijt} = \alpha_0 + \beta_1 pol\_sim_{ijt} + \Gamma' Controls + \delta_i + \lambda_d + \psi_s + \tau_t + \epsilon_{ijt}$$

- δ_i, λ_d, ψ_s, τ_t are fund, industry (SIC2), firm state and month fixed effects
- Standard errors are clustered by fund
- $\Gamma' Controls$ are market capitalization, Book-to-Market ratio, and past (12-month) returns

In-Group Favoritism

VARIABLES	(1) Full	(2) Non-Donors	(3) Donors	(4) Donor Firm	(5) Both Donor	(6) Full	(7) Full
pol_sim	0.0354***	0.0759***	0.00556	0.0108	-0.00875	0.0221	0.00519
	(3.443)	(8.941)	(0.362)	(0.885)	(-0.595)	(1.559)	(0.430)
non_donor_firm						0.0128**	
						(2.110)	
log(mkt_cap)	0.360***	0.352***	0.384***	0.482***	0.513***	0.362***	0.411***
	(17.64)	(16.32)	(14.78)	(29.75)	(23.96)	(17.35)	(16.99)
bm	0.0248***	0.0269***	0.0176***	0.0168***	0.0139**	0.0252***	0.0212***
	(11.27)	(11.60)	(4.088)	(5.396)	(2.180)	(11.76)	(12.47)
r12	0.0430***	0.0398***	0.0514***	0.0893***	0.113***	0.0426***	0.0407***
	(9.265)	(8.916)	(7.083)	(16.74)	(11.95)	(9.342)	(10.70)
Constant	0.753***	0.695***	0.829***	0.737***	0.800***	0.757***	0.774***
	(96.96)	(98.62)	(93.21)	(62.38)	(49.84)	(88.85)	(84.81)
Observations	9,754,250	6,883,233	2,871,017	4,538,813	1,268,101	9,754,250	10,021,832
R-squared	0.539	0.547	0.533	0.529	0.509	0.539	0.574
Stock FE	No	No	No	No	No	No	Yes
Fund FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Month FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes	No
Firm State FE	Yes	Yes	Yes	Yes	Yes	Yes	No

$\longrightarrow$ Their results were driven by inclusion of politically unidentified managers

$\longrightarrow$ They got a 1.67 t-stat once they dropped unidentified managers (Table IA8)

Donor Firms' Underperformance

VARIABLES	(1) alpha	(2) alpha	(3) alpha	(4) alpha	(5) alpha
rep	0.0504	-0.636***	-0.733***	-1.012***	-1.090***
	(0.968)	(-11.43)	(-4.510)	(-16.18)	(-5.002)
dem	0.164**	-0.549***	-0.670***	-0.944***	-1.104***
	(2.478)	(-7.922)	(-4.265)	(-12.31)	(-4.373)
log(mkt_cap)		0.359***	2.653***	0.531***	6.272***
		(34.81)	(15.04)	(37.70)	(14.68)
bm				1.200***	5.856***
				(28.08)	(14.26)
r12				-0.129***	-0.549***
				(-23.97)	(-6.246)
npm				0.0746	-0.0102
				(1.222)	(-0.0727)
roe				0.777***	-0.960***
				(11.39)	(-3.171)
cfm				-0.0623	0.0993
				(-0.995)	(0.702)
debt/at				-1.422***	2.343***
				(-11.90)	(3.607)
Constant	-0.0131	-4.754***	-36.08***	-7.264***	-88.26***
	(-0.621)	(-34.48)	(-15.02)	(-37.61)	(-14.96)
Observations	679,300	679,145	679,064	447,854	447,829
R-squared	0.000	0.002	0.037	0.006	0.060
Stock, Month FE	No	No	Yes	No	Yes
Stock, Month Clusters	No	No	Yes	No	Yes

Partisan Bias, Pandemics & Politicization

I measure the exposure of a stock to a given pandemic (and Brexit) in a given quarter by the 10-K textual analysis measures provided by Hassan et al. (2020) and Campello et al. (2020).

I use the following model to examine partisan bias in pandemic-exposed stocks:

$$\text{weight}_{ijt} = \alpha_0 + \beta_1 \textit{rep}_{it} \times \textit{measure}_{jt} + \beta_2 \textit{dem}_{it} \times \textit{measure}_{jt} + \beta_3 \textit{measure}_{jt} + \Gamma' \textit{Controls} + \delta_{it} + \lambda_{dt} + \psi_{st} + \epsilon_{ijt}$$

Since COVID-19 (and Brexit) was a highly politicised topic, I expect to find strong results for it but not for past pandemics.

Partisan Bias, Pandemics & Politicization

VARIABLES	(1) h1n1	(2) ebola	(3) zika	(4) covid	(5) brexit	(6) brexit_ccak
repXmeasure	0.00263	0.00249	0.00251	0.00586**	0.00898**	0.0371
	(1.255)	(1.584)	(1.617)	(2.026)	(2.047)	(1.113)
demXmeasure	-0.00343	-0.000216	0.00292*	-0.00217	-0.00467	-0.170***
	(-1.505)	(-0.157)	(1.678)	(-0.732)	(-1.352)	(-2.760)
measure	-0.00133***	0.00124*	0.000576	0.00171*	-0.00429***	-0.131***
	(-2.920)	(1.710)	(1.196)	(1.737)	(-2.844)	(-6.937)
Constant	-1.519***	-2.755***	-2.982***	-3.319***	-2.983***	-2.580***
	(-8.028)	(-20.96)	(-20.64)	(-12.67)	(-20.63)	(-14.41)
Observations	1,695,745	1,034,341	808,087	181,369	808,087	320,401
R-squared	0.584	0.580	0.563	0.545	0.563	0.570
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Fund X Month FE	Yes	Yes	Yes	Yes	Yes	Yes
Industry X Month FE	Yes	Yes	Yes	Yes	Yes	Yes
State X Month FE	Yes	Yes	Yes	Yes	Yes	Yes
Sample	2009-10	2014-15	2016-17	2020	2016-17	2016-17

$\longrightarrow$ Results are significant only for politicized topics like COVID-19 and Brexit
$\longrightarrow$ Partisan Bias manifests stronger in topics with higher media salience

Conclusion

- Consistent with recent literature, I find that partisan identity strongly shapes economic expectations by using US Mutual Fund managers as the setting
- Misaligned managers underinvest in risky, small and value stocks and overinvest in momentum
- Consistently, after the unexpected result of the 2016 election, managers that suddenly got "aligned", significantly increased their portfolio beta
- This paper replicated the baseline result of Wintoki & Xi (2020) showed that it was driven by including unidentified managers in the sample
- Partisanship manifests strongly in politicised topics: strong difference for COVID-19 and Brexit-exposed stocks but no major differences for past pandemics

Donor Under-performance

VARIABLES	(1) ret	(2) ret	(3) ret	(4) ret	(5) ret
rep	0.124**	-0.823***	-0.793***	-1.195***	-1.171***
	(2.349)	(-14.60)	(-5.116)	(-19.07)	(-5.725)
dem	0.261***	-0.722***	-0.683***	-1.157***	-1.134***
	(3.872)	(-10.26)	(-4.201)	(-15.05)	(-4.710)
log_mkt_cap		0.496***	3.052***	0.778***	6.757***
		(47.91)	(11.86)	(55.65)	(15.85)
bm				2.270***	6.755***
				(53.68)	(13.29)
r12				-0.0400***	-0.458***
				(-7.774)	(-7.634)
npm				0.0342	-0.0469
				(0.571)	(-0.317)
roe				0.109*	-1.335***
				(1.646)	(-3.574)
cfm				-0.0517	0.135
				(-0.840)	(0.901)
debt_at				-1.785***	3.092***
				(-15.20)	(4.051)
Constant	0.801***	-5.741***	-40.61***	-10.40***	-94.59***
	(38.61)	(-41.56)	(-11.60)	(-54.31)	(-15.81)
Observations	729,534	729,373	729,310	469,823	469,808
R-squared	0.000	0.003	0.173	0.010	0.204
Stock, Month FE	No	No	Yes	No	Yes
Stock, Month Clusters	No	No	Yes	No	Yes

Economic Expectations

VARIABLES	(1) bm	(2) log_mkt_cap	(3) idvol	(4) r12	(5) beta
misalignXvariable	-0.0296*	0.0306**	-0.00255	0.814***	0.000675
	(-1.869)	(2.061)	(-1.190)	(2.811)	(0.0963)
bm	0.0410***	0.0257***	0.0264***	0.0254***	0.0259***
	(3.626)	(2.768)	(2.835)	(2.760)	(2.801)
log_mkt_cap	0.196***	0.182***	0.196***	0.196***	0.196***
	(15.70)	(11.14)	(15.60)	(15.66)	(15.58)
idvol	0.00201*	0.00192*	0.00307**	0.00199*	0.00198*
	(1.773)	(1.688)	(2.230)	(1.751)	(1.748)
r12	1.626***	1.638***	1.626***	1.264***	1.622***
	(6.601)	(6.742)	(6.612)	(4.265)	(6.570)
beta	-0.0165***	-0.0159***	-0.0169***	-0.0167***	-0.0169***
	(-4.532)	(-4.366)	(-4.658)	(-4.555)	(-3.803)
Constant	-2.135***	-2.138***	-2.130***	-2.134***	-2.132***
	(-11.08)	(-11.43)	(-10.96)	(-11.04)	(-10.96)
Observations	840,662	840,662	840,662	840,662	840,662
R-squared	0.562	0.562	0.562	0.562	0.562
Industry X Quarter FE	Yes	Yes	Yes	Yes	Yes
State X Quarter FE	Yes	Yes	Yes	Yes	Yes
Fund X Quarter FE	Yes	Yes	Yes	Yes	Yes
Fund Clusters	Yes	Yes	Yes	Yes	Yes

Wintoki & Xi (2020)

VARIABLES	(1) Full	(2) Non-Donor Mgrs	(3) Donor Mgr	(4) Donor Firm	(5) Both Donor	(6) Full	(7) Full
pol_sim	0.0403***	0.0791***	0.00689	0.0121	-0.00593	0.0241*	0.00830
	(3.855)	(9.022)	(0.437)	(0.975)	(-0.392)	(1.668)	(0.678)
non_donor_firm						0.0158**	
						(2.554)	
log_mkt_cap	0.183***	0.176***	0.200***	0.240***	0.257***	0.184***	0.206***
	(19.15)	(16.89)	(16.27)	(30.91)	(24.06)	(18.83)	(17.75)
bm	0.0469***	0.0513***	0.0294***	0.0300***	0.0219*	0.0479***	0.0378***
	(10.60)	(11.34)	(3.192)	(4.821)	(1.690)	(11.13)	(10.89)
r12	1.369***	1.227***	1.747***	2.651***	3.357***	1.357***	1.341***
	(9.686)	(8.704)	(8.010)	(16.68)	(11.81)	(9.752)	(11.51)
Constant	-2.034***	-2.000***	-2.206***	-2.929***	-3.133***	-2.053***	-2.357***
	(-13.99)	(-12.51)	(-11.67)	(-22.98)	(-17.57)	(-13.83)	(-13.28)
Observations	2,976,907	2,116,465	860,442	1,412,848	396,893	2,976,907	3,058,502
R-squared	0.531	0.540	0.524	0.523	0.504	0.531	0.566
Stock FE	No	No	No	No	No	No	Yes
Fund FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Quarter FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes	No
Firm State FE	Yes	Yes	Yes	Yes	Yes	Yes	No
Fund Clusters	Yes	Yes	Yes	Yes	Yes	Yes	Yes