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# Political Cognitive Biases Effects on Fund Managers' Performance\*

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May 28, 2020

## Abstract

Does political affiliation matter for stock-market investing? Rare events can produce polarized narratives that potentiate cognitive dissonance on a spectrum of agents. Using a comprehensive dataset of equity hedge funds' performance and managers' political affiliation matched by their partisan contributions, I document higher returns of funds managed by Democrats for ten subsequent months—from December 2008 to September 2009—when the interpretation of the US central bank policy was politically polarized and conducive to cognitive dissonance. This result is robust to a set of falsification tests and randomized *quasi*-experiments.

*JEL Classification:* D72, G11, G14

*Keywords:* Political Biases; Money Managers' Performance

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*“The great enemy of truth is very often not the lie—deliberate, contrived and dishonest—but the myth—persistent, persuasive and unrealistic. Too often we hold fast to the clichés of our forebears. We subject all facts to a prefabricated set of interpretations. We enjoy the comfort of opinion without the discomfort of thought.”*

— John F. Kennedy, Commencement Address at Yale University, June 11, 1962

## 1 Introduction

Ideology is an important bias in the financial industry which is not usually factored in. The partisan-based difference in the performance by investors is an indication of the extent to which ideology can affect the processing of information. Hong and Kostovetsky (2012) document significant differences in the holdings of socially responsible companies by Democratic-run and Republican-run mutual funds. Addoum and Kumar (2016) argue that political transition affects industry-level composition of investor portfolios, which weaken arbitrage forces and create predictable patterns in industry returns. Bonaparte, Kumar, and Page (2017) show that investors become more optimistic and increase allocations to risky assets (i.e., exhibit a stronger preference for high market *beta*, small-cap, and value stocks) when their preferred party is in power, regardless of the differential response to economic conditions by Democrat and Republican investors. Using granular panel data from American equity hedge fund managers’ political contributions and performance, I find that the Democratic managers outperformed the Republican managers for ten consecutive months—from December 2008 to September 2009—by a total of 7.2 percentage points return at the high of the financial crisis when there was disagreement along partisan lines about what the right monetary policy should be. This study adds to the body of research on a variety of “irrational” factors in financial decision-making (Barber and Odean 2001).

American equity hedge funds allocate clients’ capital in US equities subject to constraints agreed to by the investors. These constraints may include the extent of exposure to the overall market moves (*beta*) and sector concentrations. Managers commonly have substantial discretion within these constraints on how to allocate the capital, and both *beta* and concentrations are subject to that discretion. The managers are compensated by receiving a percentage of the total returns of the fund over a benchmark plus a percentage of the capital under management.

Funds underperforming a benchmark are frequently closed early because the managers lose the expectations of the performance-based fee and want to remove the poor performance from evaluation by prospective clients.<sup>1</sup> It is assumed that, although there is a difference between the principal’s (investor’s) and the agent’s (manager’s) utility functions, managers have sufficient incentives to deploy their full capabilities to maximize the fund’s returns. The efficient markets theory implies that managers will utilize their training and all available information to maximize the fund’s returns and that they will ignore irrelevant data.

The details of the US monetary policy, although scrupulously dissected by the professional classes, is rarely a subject of political rancor, much else for dramatically different interpretations of its expected effects by the political parties. The one exception was the period after Obama’s election.<sup>2</sup> While several expected policy actions—including quantitative easing operations undertaken by the US central bank—were viewed by the economic profession as most consistent with the understanding at the time, there was a vast partisan divide in their interpretation. Conservative commentators were prognosticating “hyperinflation” and “bankruptcies” as a result of these policies and the subsequent debasement of the dollar, while the liberal ones were either muted in their response or offered a defense for these policies (see Figure 1).

Rational managers seeking to maximize their funds’ returns would ignore these prognostications in their allocation decisions (Fama 1970). One should not expect to observe a difference of decisions by rational agents based on their political preference. Yet, we have observed differences in funds’ performance depending on the narratives (Shiller 2017) preferred by the managers. These differences became salient during the period of intense partisan discussions about the central bank’s policy, but not in any other periods.

I identified political preferences by the managers by their political contributions. During the 2016 electoral campaign, there were invectives that donations buy political influence. The relatively small amounts and the wide contributors’ base observed in the sample, however, make expressing partisan preference the more likely explanation for contributing and are unlikely to be associated with buying policy.

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<sup>1</sup> See Bykhovsky (2011) for a discussion of the informational asymmetry that allows hedge fund managers to shut down funds without loss in reputation.

<sup>2</sup> Another case out of the scope of the sample is Nixon’s 1971 executive order imposing a 90-day freeze on wages and prices to counter inflation when, for the first time since World War II, the US had government wage and price controls. Nixon also ended the convertibility of US dollars into gold about the same time.

**Figure 1:** This figure presents highlights in the news presented by two leading newspapers. The left graph shows the average placement on a 10-point scale of ideological consistency of each source’s audience. Lists labeling multiple points are ordered from more liberal on top to more conservative on the bottom. The *New York Times* is consistently perceived as more liberal than the *Wall Street Journal*. The right graph shows annual counts of articles containing the words of “bankruptcy” and “hyperinflation” published by the *New York Times* (left blue bar) and *Wall Street Journal* (right red bar) from 2005 to 2014. The data come from Pew Research Center’s survey conducted on March 19–April 29, 2014 and Factiva.

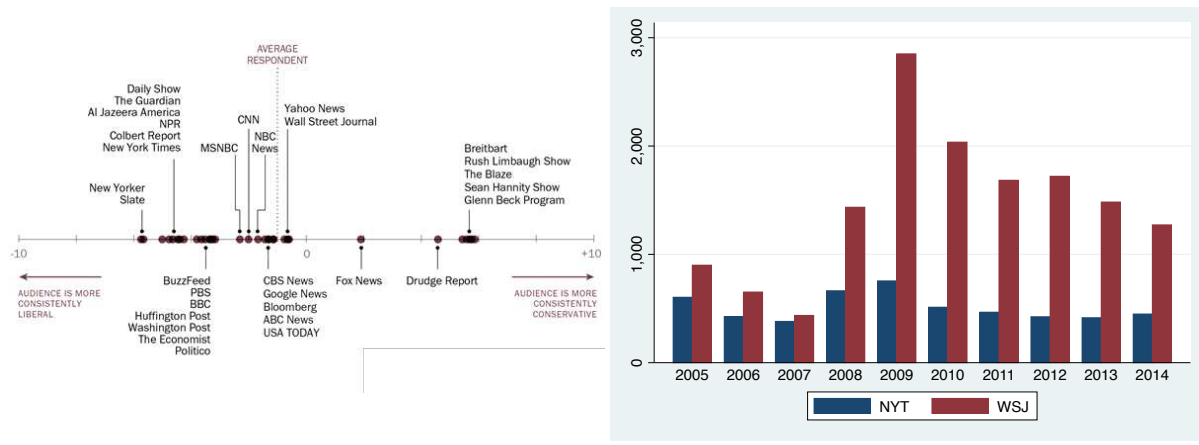
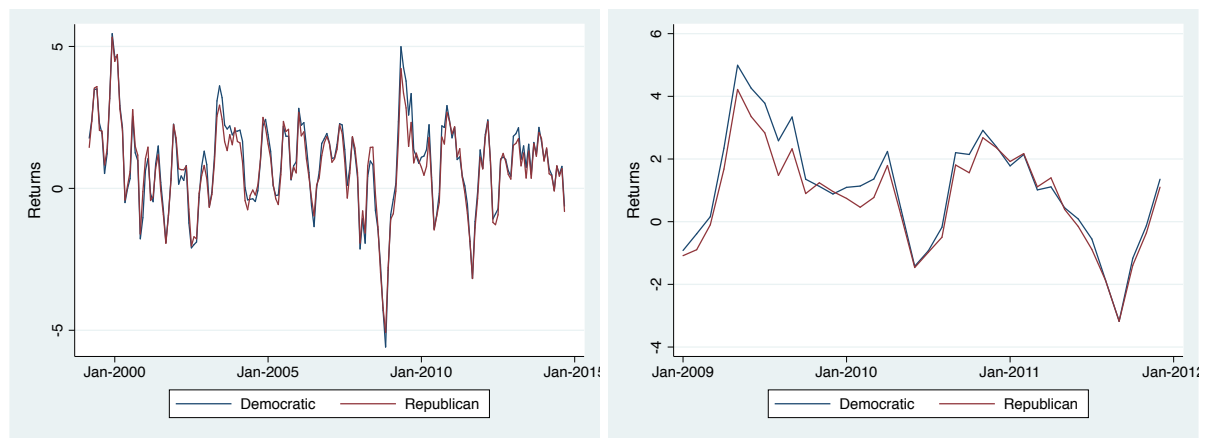


Figure 2 presents average returns of hedge funds by managers’ partisan affiliation for the period 2004-2014 (left graph) and augmented for the period 2009-2011 (right graph). Both plots are almost identical for all periods, but diverge at the end of 2008 and a large part of 2009. The beginning of this period corresponds to the first full month after Obama’s election

**Figure 2:** This figure presents three-month moving average returns of hedge funds broken by managers’ partisan affiliation for the period 2004-2014 (left graph) and augmented for the period 2009-2011 (right graph).



and the disclosure of upcoming policies (December 2008), whereas its duration correlates with the political polarization over central bank policies (until September 2008).

From an asset pricing perspective, differences in return can arise from better management and from different loadings on the pricing factors. This study shows that the difference in performance was driven by active returns (i.e., management strategies or *alphas*) during a particularly turbulent time and not by price loading factors (i.e., portfolio selection strategies or *betas*). These results contrast with previous findings on portfolio preferences and optimism-bias explanations on how political channels affect investment, and suggest that a part of the differential in partisan-driven performance may wash out outside the period of polarization over monetary policy from December 2008 to September 2009.

## 2 Partisan Information and Biases

Political leaning can influence investment performance through rational (information-based) choices and behavioral biases.

### 2.1 Informational Advantage

Political affiliation is likely correlated with access to policy information affecting investment performance (Gao and Huang 2016). Since the period after Obama's election is associated with profound influences of political decisions on the stock market (Acemoglu, Johnson, Kermani, Kwak, and Mitton 2016), fund managers who have a better understanding of the inner workings of the new administration and access to key policy makers (likely Democratic) can gain an informational advantage over other fund managers (likely Republican) in stock trading. Thus, the outperformance of Democratic hedge fund managers during the period from December 2008 to September 2009 could just be the result of heterogeneity in information access.

A purely rational explanation requires that Democratic fund managers on average have better information about political decisions than their Republican counterparts. Heterogeneous access to information surely accounted for a large part of the difference in investment performance in the short run<sup>3</sup> at the onset of the new Democratic administration; in the longer run (say, above two weeks), this explanation poses two caveats. First, the information

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<sup>3</sup> Acemoglu, Johnson, Kermani, Kwak, and Mitton (2016) use one-day and 10-day windows.

advantage hypothesis raises a collective action problem on how hundreds of Democratic fund managers coordinate an investment strategy without the hundreds of Republican fund managers knowing and mimicking the profitable strategy. Successful coordination would require that lobbyists (Gao and Huang 2016) and personal connections (Acemoglu, Johnson, Kermani, Kwak, and Mitton 2016) strictly follow partisan lines (e.g., lobbyists do not mingle with or sell information to members of the opposite party), and that the information does not permeate to the opposite party through alternative channels. Second, it is unclear why the information advantage channel was not salient during other periods.

The mechanism through which politics affects investment strategies should account for how information can have asymmetric effects on different groups of individuals for a relatively long period of time. Behavioral explanations succor and complement rational shortcomings.

## 2.2 Confirmation Bias, Framing, and Cognitive Dissonance

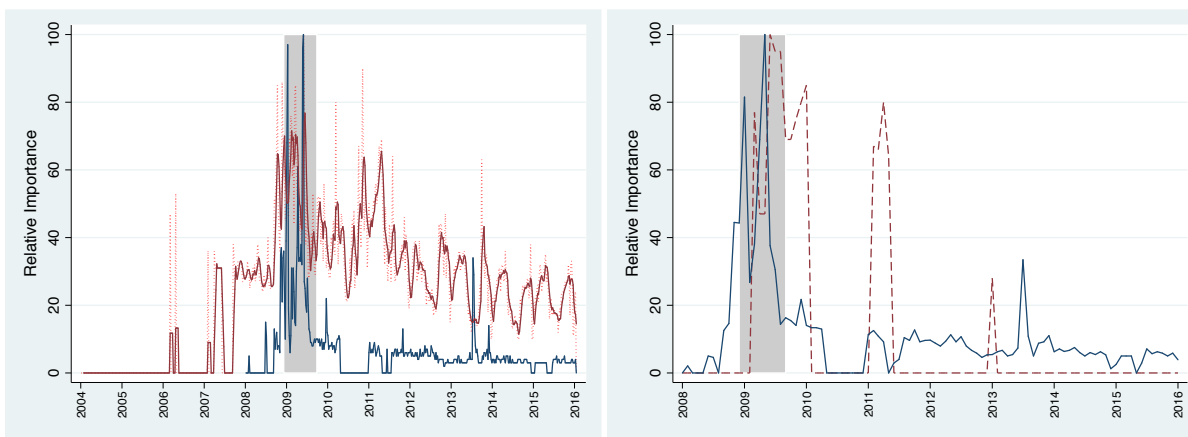
Professionals such as physicians, military officials, and equity hedge fund managers are expected to be immune to facilitatory heuristics. In practice, these professionals are not bias-proofed, especially during tail events (Duchon, Dunegan, and Barton 1989; Tversky and Kahneman 1992). The interplay of confirmation bias, framing, and cognitive dissonance sheds light on the difference in hedge fund managers' performance from December 2008 to September 2009.

Individuals tend to search for, interpret, and recall information in a way that confirms their preexisting beliefs (Plous 1993). This tendency is stronger for emotionally charged and deeply entrenched political beliefs (e.g., people follow news outlets that support their view of the world). There is evidence of right-wing media resolutely highlighting the extreme economic risks at the onset of Obama's presidency (see Figure 2). *Confirmation bias* could have led Republican fund managers to overconfidence (Nickerson 1998), and to weigh up the costs of being wrong and ignore evidence that their strategies will lose money (Pompian 2011).

The rational theory of choice assumes description invariance: equivalent formulations of a choice problem give rise to the same preference order (Arrow 1982). There is substantial evidence, however, that variations in the *framing* of options (e.g., in terms of gains or losses) yield systematically different preferences (Tversky and Kahneman 1981, 1986). The same problem framed in different ways—e.g., type of words, medium, and context—produces asymmetric shifts of preferences and risk perception. For example, the univocally negative terms

“bankruptcy” and “hyperinflation” are rarely used regarding the American economy; yet, their use in right-wing media increased from December 2008 further into 2009 (see Figure 3).

**Figure 3:** This figure presents the relative importance of searches of particular words in Google that are indicative of investing climate. I chose the terms “bankruptcy” and “hyperinflation” for their extreme and univocally negative connotation. The left graph shows weekly data of relative importance of “bankruptcy” (solid blue line) and “hyperinflation” (dotted red line) and four-week moving average of “hyperinflation” (solid red line) in all categories and “Web Searches” from 2004 to 2015. The right graph shows monthly data of relative importance regarding “bankruptcy” (solid blue line) and “hyperinflation” (dashed red line) in the “Business & Industrial” category in “News Search” from 2008 to 2015. The gray areas delimit the period from December 2008 to September 2009. Data are from Google Trends.



When there is an inconsistency between observations and behaviors, unconscious changes take place to eliminate the dissonance: sometimes, beliefs are adapted to match evidence; more often, facts that do not match beliefs are silenced (Festinger 1957). This cognitive dissonance mechanism is built in our minds to lower discomfort from the discrepancy between empirical evidence and past choices. Furthermore, individuals trade strong beliefs for rational behavior when there are weaker beliefs attached to the latter. The theory of cognitive dissonance has been applied to consumer behavior (Erlach, Guttman, Schönbach, and Judson 1957) and job security (Akerlof and Dickens 1982). A hedge fund manager’s investment evaluations and choices are arguably no less anxiety-producing than the choice of a new car or job and can be correlated with her choice of a political party. At that time many Republicans who followed right-wing media adhered to the perspective of economic collapse, even when capital markets started to recover in early 2009. During the same period, Democrats presented a moderate attitude.



While the behavioral bias' start can be traced to major policy shifts, its time span is difficult to predict *ex ante*. The patten of the news narrative and managers performance mimics a social epidemic (Shiller 2017): the stronger the informational dissonance is and the more subjects are affected, the longer the endurance of the effect will be. It is not possible to replicate experimentally the events and circumstances that led to a divergence in performance by Democratic and Republican equity hedge fund managers. Instead, I substantiate the likelihood of the political cognitive dissonance explanation by running a series of randomized *quasi*-experiments on partisan affiliation and time windows, and showing that partisan affiliation was conducive to differential results for a long period only when asymmetric framing was salient. In other circumstances, the differences in framing were not strong enough to trigger cognitive biases.

### 3 Data

#### 3.1 Hedge Fund Data

I downloaded live and dead hedge fund performance data (including historical returns and Assets Under Management [AUM]) and principals' information for 1999-2014 from Hedge Fund Research.<sup>4</sup> I study only US equity hedge funds; international and foreign funds were excluded. Funds with keywords such as foreign country names, "emerging," "options," "international," "derivative," "convertible," "global," and "private equity" in their strategy description were also excluded.

I assigned appropriate benchmarks (called "bogeys") to each fund based on the fund's strategy. For example, if the strategy is "Fundamental Growth" or description implies that the fund is mainly investing in growth stocks, then the S&P Total Return Growth Index was used as the bogey; if the strategy is "Fundamental Value" or description implies that the fund is mainly investing in value stocks, then S&P Total Return Value Index was used as the bogey. If the main strategy is not included as above, such as "Multi-Strategy," or "Equity Market Neutral," the bogey was set to be S&P Total Return Index.

I then used time series regressions to measure the market exposures as well as excess returns for each fund. Using the results from previous steps and a single-factor linear regression model, market exposure (*beta*) and excess return (*alpha*) were calculated for each fund.

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<sup>4</sup> See: <https://www.hedgefundresearch.com/>.

### 3.2 Political Data

The Federal Election Commission through its Individual Contributor Search<sup>5</sup> reports contributions made by individuals, Native American tribes, partnerships, sole proprietorships, limited liability companies (LLCs), and contributions by the candidate to all political committees including Independent Expenditure-Only Political Committees (Super PACs) and Political Committees with Non-Contribution Accounts (Hybrid PACs). The reports contain each contributor’s name, location (city, state, and ZIP code), employer, committee name, date, and amount contributed.

Similarly to Hong and Kostovetsky (2012), I identified the political affiliation of fund principals by political contributions. It is very unlikely for a principal to contribute to a partisan campaign “strategically,” e.g., against their beliefs with the aim of getting favors in the future. These contributions were relatively small and the contributors’ base is wide. Therefore, I assume that contributions reveal true beliefs and partisan affiliation.

I only have one observation of principals’ names per hedge fund; thus, I assume that the principals remain the same across the time span of the data sample. To keep the data univocal I excluded a few cases where fund principals switched partisan leaning and contributed to both parties over time.

### 3.3 Matching

I looked up hedge fund principals by name at the Federal Election Commission’s Individual Contributor Search. I identified a match when the first and last name, state, and company corresponded across the two datasets. The match relied on the steam of the company name to allow for different syntaxes. To increase the number of matches, I matched location by neighboring states:

- (a) NYC area: NY-CT-NJ
- (b) Boston area: MA-RI-NH-ME-VT
- (c) DC area: DC-MD-VA
- (d) Chicago area: IL-IN-MI-WI
- (e) LA/SF areas: CA-NV-AZ

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<sup>5</sup> See: <http://www.fec.gov/finance/disclosure/norindsea.shtml>.

and treated these states as “equals.” A handful of entries that were not matched automatically (about 5,000 names) were matched by hand.

The final dataset contained more than two million fund-month observations with the following fields: Fundid, Fundname, Lastname, Firstname, City, State, Country, Partyaffiliation, Level (1 = same state for manager and fund; 2 = neighboring states), Mainstrategy, Date, and Performance. Overall, 264,222 observations were identified as uniquely Democratic, 262,332 observations were identified as uniquely Republican, and 1,621,053 observations were deleted as ambiguous (different managers contributed to more than one party) or where managers contributed to independent candidates (378 observations).

### 3.4 Identification

I dropped observations for which there was no performance calculated and focused on equity hedge funds, which constitute above 39% of the observations in the sample (see Table 1). Equity hedge fund managers are arguably the most talented and quickest to read market trends. Therefore, any change in their perception of the market will be promptly translated into their investment strategies.

Table 2 presents the summary statistics of money managers’ performance and affiliation. The sample shows a large variance in terms of performance, but is balanced in terms of partisan affiliation, year (see Table 3), and state composition (see Table 4 and Figure 4).

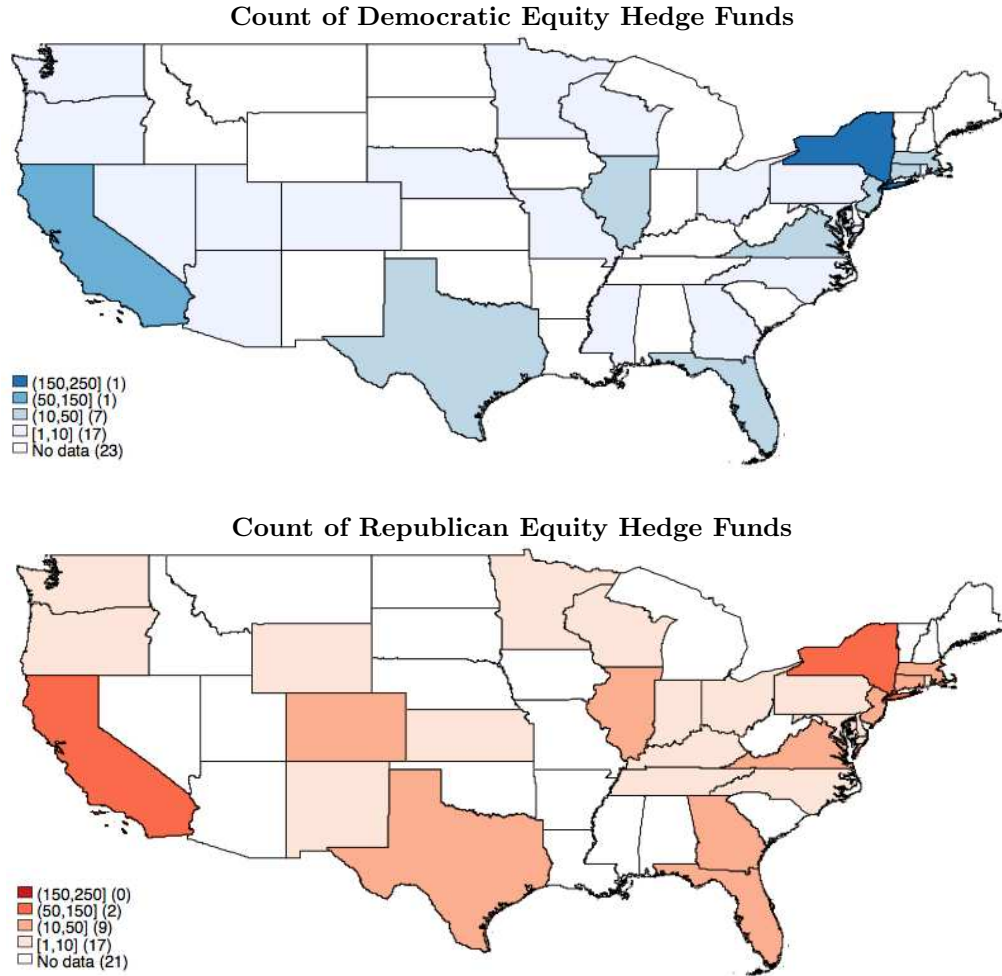
The unconditional correlation between left- and right-wing managers is strong for all periods but several months from December 2008 to September 2009 (see Figure 2). My hypothesis is that the conjunction of the financial crisis and politically polarized news during that period had an asymmetric impact on hedge fund managers’s perception. The timing is not arbitrary: Obama was elected 44th president of the United States on November 4, 2008. During the next weeks, the transition team was formed and the cabinet nominees announced. December 2008 is, thus, the first full month that captures the effects of the future president and his policy.

To capture the differential effect of party affiliation in politically polarized periods, I conducted difference-in-difference regression tests with the following specification:

$$\begin{aligned}
 Performance_{j,t} = & \alpha + \beta_1 Democratic Manager_j + \beta_2 Democratic President_t \\
 & + \beta_3 Shock_t + \beta_4 [Democratic Manager_j \times Shock_t] + \beta_5 S\&P\ 500\ Return_t + \epsilon
 \end{aligned}
 \tag{1}$$

where  $Performance_{j,t}$  is the monthly return of fund  $j$  at time  $t$ ,  $Democratic Manager_j$  is a

**Figure 4:** This figure presents the count of funds identified as strictly Democratic (top map) and strictly Republican (bottom map) by state. I also identified 41 Democratic equity hedge funds from Alaska, which is displaced for legibility constraints. States with no data are states where either equity hedge fund managers did not make contributions or teams were split in partisan contributions (i.e., on average partisan-neutral funds).



dummy variable equal to 1 when equity hedge fund manager  $j$  was identified as Democratic,  $Democratic\ President_t$  is a dummy variable equal to 1 when the US President at time  $t$  was Democratic,  $Shock_t$  is a dummy variable equal to 1 during the informational temporary shock from December 2008 to September 2009, and zero outside this time window,  $S\&P\ 500\ Return_t$  is the S&P 500 Return Index at time  $t$ , and  $\epsilon$  is the error term.

The variable of interest is the interaction term  $\beta_4$ , which captures the effect of being a Democratic equity hedge fund manager during the informational shock in comparison to Republican equity hedge fund managers.

### 3.5 Results

Table 5 summarizes the results of the regressions. The strongest predictor of equity hedge fund managers is the S&P 500 Return Index—i.e., hedge fund managers hardly outperform the market. Overall, I find that Democratic equity hedge fund managers perform slightly better than Republican equity hedge fund managers and all equity hedge fund managers perform slightly better under a Democratic president (Model 1).

The most striking results, however, are related to recent events. During the first months of the Obama administration, equity markets recovered at a fast pace, but not all took advantage of the recovery. Between December 2008 and September 2009, Democratic equity hedge fund managers outperformed their Republican peers by 0.73 percentage points monthly (Model 2). When adding state fixed effects (Model 3), the explanatory power (measured by  $R^2$ ) rises marginally, suggesting that there are no strong regional effects.

The results remain stable when I narrow the analyzed period to 2008-2010 (Model 4). The estimates are robust to fund status (live versus dead) controls and clustering at the fund level (Model 5). According to this restricted regression, Democratic equity hedge fund managers outperformed their Republican peers by 72 basis points monthly.

## 4 Robustness

At the current state of the art, behavioral patterns are the “residual” explanation when rational explanations fail. In this section, I present robustness tests and *quasi*-experiments that reinforce the causal channel to the political cognitive bias argument.

### 4.1 Geographical Selection Biases

Di Giuli and Kostovetsky (2014) showed differences in firm-level social investments depending on the political leaning of the managers and whether the firm is headquartered in Democratic or Republican-leaning state. Alternatively, the results could be driven by outlier states with an over-representation of managers of one party that outperform (Democrats) or underperform (Republican) compared to the mean by partisan affiliation.

To address these issues, I rerun the regression only for states with large and balanced representation of both equity hedge fund managers affiliated with both parties. Table 6 presents results for equity hedge fund managers from CA, CT, FL, IL, MA, NJ, NY, PA, TX, and VA;

Table 7 shows results narrowed to managers located in CA, CT, IL, MA, NY, and TX (arguably, states with a sophisticated financial infrastructure). The results remain stable (or are even stronger) when I narrow the geographical scope to states with large and politically balanced representation.

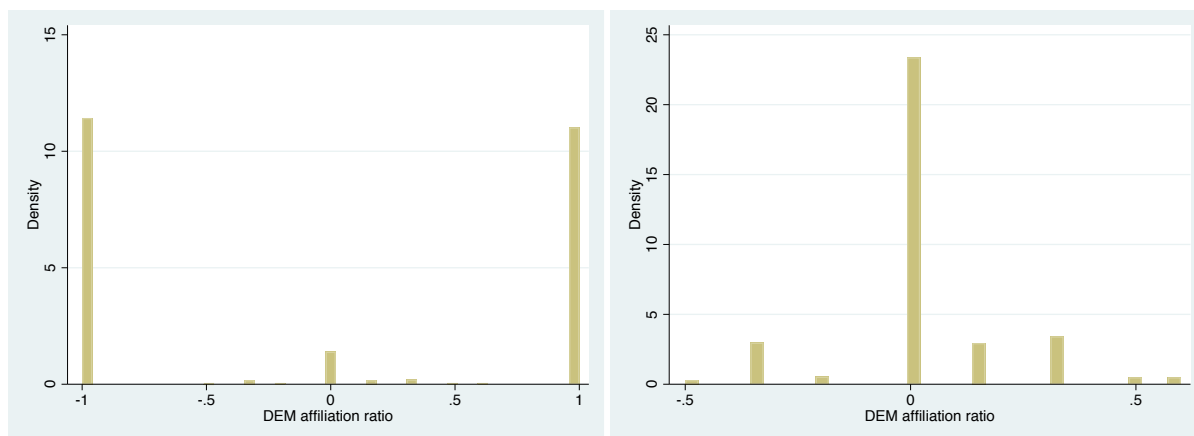
## 4.2 Mixed “Purple” Teams

By design, I restricted the analysis to funds for which managers were univocally identified as one-sided partisan; i.e., I did not analyze funds for which managers contributed to more than one party. The case of a selection bias could potentially arise: It may be that the best Republican equity hedge fund managers are in teams with Democratic managers, so their results are not captured in my estimates.

I now turn to mixed teams and construct a variable *Democratic Affiliation Ratio* equal to the number of identified Democratic managers minus the number of identified Republican Managers, divided by the number of identified partisan managers. Thus, this variable runs from  $-1$  for strictly Republican teams to  $+1$  for strictly Democratic teams.

Since most of the funds in the sample are strictly Democratic or Republican (see the left histogram in Figure 5) which I analyzed in Sections 3.4 and 3.5, I drop strictly partisan teams and focus on the *Democratic Affiliation Ratio* between  $-1$  and  $+1$  (see the right histogram in Figure 5).

**Figure 5:** This figure presents the histogram of Democratic affiliation ratio (equal to the number of identified Democratic managers minus the number of identified Republican managers, divided by the number of identified partisan managers) for the whole sample (left histogram) and for funds with mixed teams, i.e., with at least one manager affiliated with each party (right histogram).



To capture the effect of mixed partisan teams in politically polarized periods, I regress of the following specification:

$$\begin{aligned}
 Performance_{j,t} = & \alpha + \beta_1 DEM\ ratio\ no\ shock_{j,t} + \beta_2 DEM\ ratio\ no\ shock_{j,t}^2 \\
 & + \beta_3 DEM\ ratio\ shock_{j,t} + \beta_4 DEM\ ratio\ shock_{j,t}^2 + \beta_5 S\&P\ 500\ Return_t + \epsilon
 \end{aligned}
 \tag{2}$$

where  $Performance_{j,t}$  is the monthly return of fund  $j$  at time  $t$ ,  $DEM\ ratio\ (no)\ shock_{j,t}$  is the ratio of Democratic managers—as described above—in fund  $j$  at time  $t$  during “(no) shock” periods,  $S\&P\ 500\ Return_t$  is the S&P 500 Return Index at time  $t$ , and  $\epsilon$  is the error term. I added square terms to the ratio of Democratic managers to capture eventual non-linearities, e.g., that balanced teams achieve better results than mixed teams.

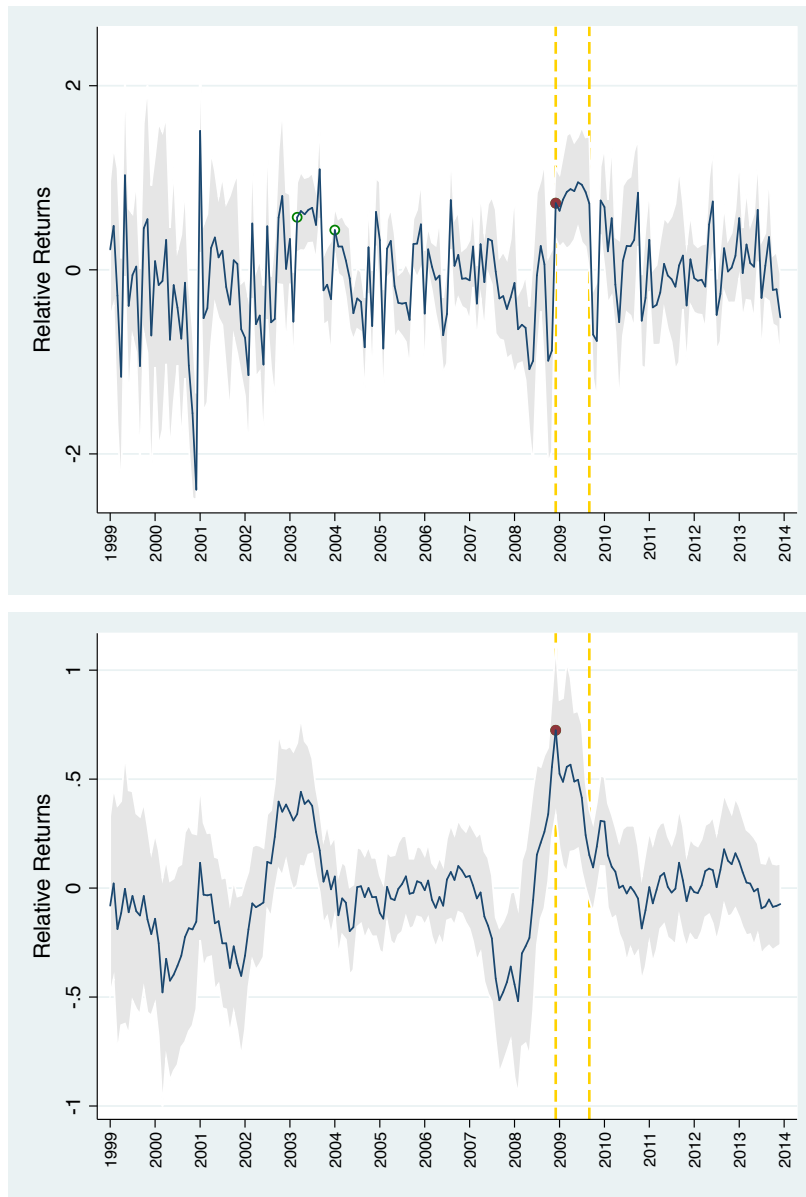
Results presented in Table 8 show that there is no differential effect of mixed teams when there are more Democratic or Republican members in their composition, i.e., politically ambiguous funds cannot be distinguished from Republican and Democrat funds in the 10 month period.

### 4.3 Placebo Time Windows

The identified 10-month period between December 2008 and September 2009 could have had homologous periods. If this time window is not unique, one should then expect similar results for other time windows of different or similar duration. I run the most restrictive regression—which includes state and fund status fixed effects, as well as clustering standard errors at the fund-level (see Table 5, Model 5)—for varying time-span windows and for all possible 10-month windows. Results of the interaction coefficient of subsequent windows and Democratic affiliation (overall 180 regressions) are shown in Figure 6.

During the analyzed 16 years, there is only one 10-month period—namely, from December 2008 to September 2009—when Democratic equity hedge fund managers outperformed their Republican counterparts by at least 10 basis points at a significance level of 1% or lower that it was by chance; there is no such period for Republican equity hedge fund managers. There are only two periods of five months (from May to September 2003 and from January to May 2004) outside the reference time window when Democratic equity hedge fund managers outperformed Republican equity hedge fund managers by at least 10 basis points at a significance level of 1%; there is no five-month period when Republican equity hedge fund managers outperformed Democratic equity hedge fund managers.

**Figure 6:** This figure shows the point estimates of the interaction term in equation (1) of forward-looking moving windows and Democratic affiliation. The blue line represents the performance of Democratic managers relative to Republican managers. In the top graph, the window is adjusted to the time span that managers affiliated with one party outperformed the managers of the other party; in the bottom graph, the time window is fixed at 10 months. The gray area represents the 95% confidence intervals. The green circles represent the beginning of five subsequent months of managers affiliated with one party outperforming the managers of the other party by at least 10 basis points at 1% significance level. The red dot represents the beginning of 10 subsequent months of managers affiliated with one party outperforming the managers of the other party by at least 10 basis points at 1% significance level. The yellow dashed vertical lines delimit the period from December 2008 to September 2009. Data are from Hedge Fund Research and the Federal Election Commission. The sample period is 1999-2014.





After implementing the Šidák adjusted  $p$ -values correction for multiple (simultaneous) comparisons, the coefficient attached to the time window from December 2008 to September 2009 remains statistically significant at the 5% level and all other periods become statistically insignificant.<sup>6</sup> In other words, the analyzed window from December 2008 to September 2009 is the *only period* where the difference in performance between Democratic and Republican equity hedge fund managers is statistically significant.

The magnitude of the cumulative difference in returns between Democratic and Republican managers is also striking. The period from December 2008 to September 2009 is also the only one when the relative performance exceeded 50 basis points, which compounds to more than 7.2% (8.7% on an annual scale). Figure 7 shows the estimates of cumulative relative returns by partisan affiliation. The top graph displays cumulative relative returns: above the timeline for Democratic managers and below the timeline for Republican managers. The bottom funnel plot presents the cumulative relative returns and the standard errors: positive for Democratic managers and negative for Republican managers. The oblique dot lines represent the critical values of the  $t$ -statistics in absolute values equal to 1.96, 2.576, and 3.291, thus yielding the significance levels at 5%, 1%, and 0.1% respectively (in gradual shadows of blue for Democratic managers and red for Republican managers).

In both charts, the cumulative relative difference in returns for the period from December 2008 to September 2009 singles out for its economic and statistical significance.

#### 4.4 Partisan Affiliation Shuffling

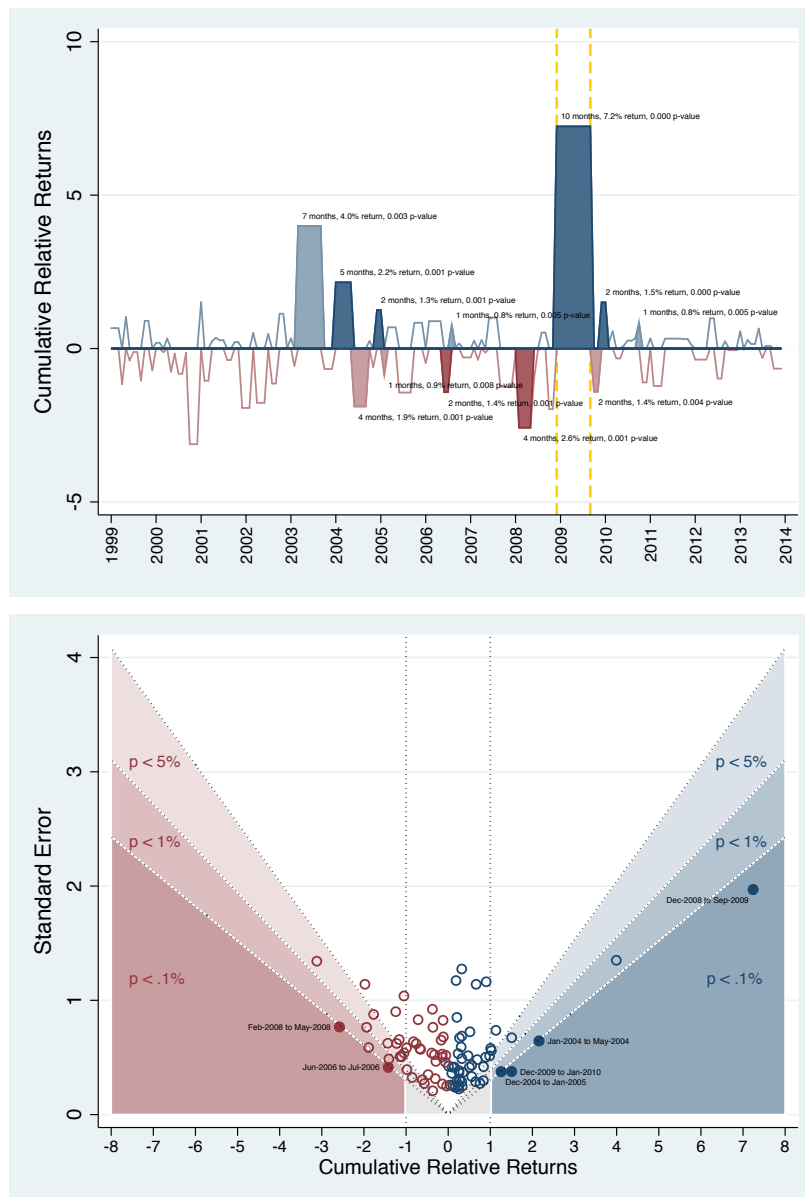
A perfect experiment would randomly assign equity hedge fund managers to different unexpected risks, political circumstances, and news, and then analyze their performance depending on their political affiliation. This experiment is not feasible at the moment. Instead, I reverse-engineer the actual setup and “randomize” the political affiliation. Should the differences persist for randomized groups, then the political affiliation explanation would vanish.

I performed Monte Carlo simulations, shuffling partisan affiliation in different ways. In

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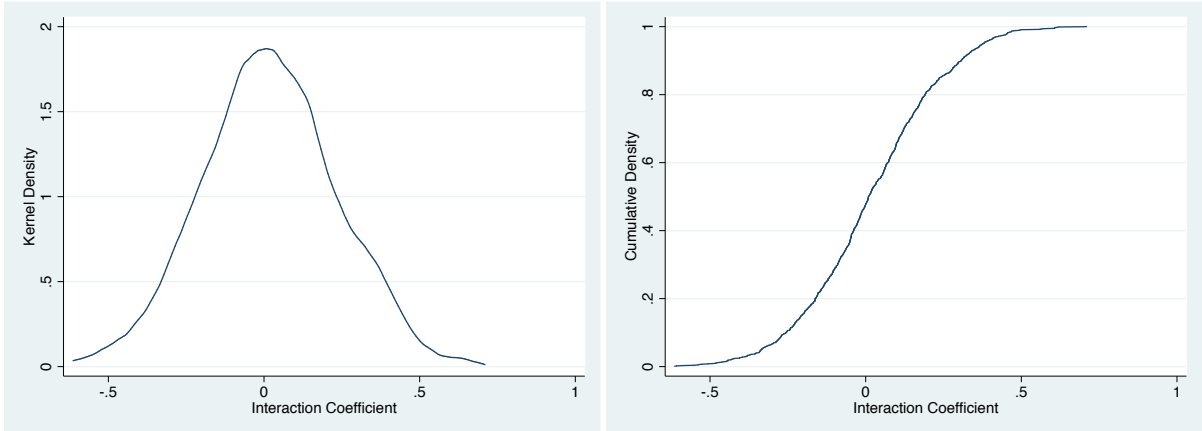
<sup>6</sup> The Šidák adjusted  $p$ -value for the estimate of interest equals  $1 - (1 - p\text{-value})^n = 1 - (1 - .0002488)^{180} = .043797$ ; the mean  $p$ -value of the remaining windows is .9459, with a standard deviation of .1709, and minimum of .116. Analogously, the Bonferroni adjusted  $p$ -value for the estimate of interest equals  $\min(1, p\text{-value} \times n) = \min(1, .0002488 \times 180) = .0447795$ ; the mean  $p$ -value of the remaining windows is .9636, with a standard deviation of .1447, and minimum of .124.

**Figure 7:** This figure shows the estimates of cumulative relative returns by partisan affiliation. The top graph displays cumulative relative returns: above the timeline for Democratic managers and below the timeline for Republican managers. The light-shadowed areas represent the periods were the cumulative relative returns difference is significant at 1% level and the solid areas represent the periods were the cumulative relative returns difference is significant at 0.1% level. The yellow dashed vertical lines delimit the period from December 2008 to September 2009. The bottom graph plots the cumulative returns for Democratic managers relative to Republican managers and the standard errors. The oblique dot lines represent the critical values of the  $t$ -statistics in absolute values equal to 1.96, 2.576, and 3.291, thus yielding the significance levels at 5%, 1%, and 0.1% respectively (in gradual shadows of blue for Democratic managers and red for Republican managers). Data are from Hedge Fund Research and the Federal Election Commission. The sample period is 1999-2014.



the first simulation, I randomly replaced half of Democratic managers with Republican managers, thus each group resulted in a balanced mix of Democratic and Republican equity hedge fund managers as the members of the initial groups (with a  $\pm 1\%$  tolerance). I then run the full regression (as in Table 5, Model 5) and stored the coefficient of the interaction of shuffled Democratic affiliation during the analyzed time window from December 2008 to September 2009. I run this procedure 1,000 times, randomly re-shuffling partisan affiliation in each iteration. Figure 8 shows the Kernel distribution and cumulative density functions of the interaction coefficient ( $\beta_4$  from equation 1) with shuffled affiliations during the analyzed time window from December 2008 to September 2009.

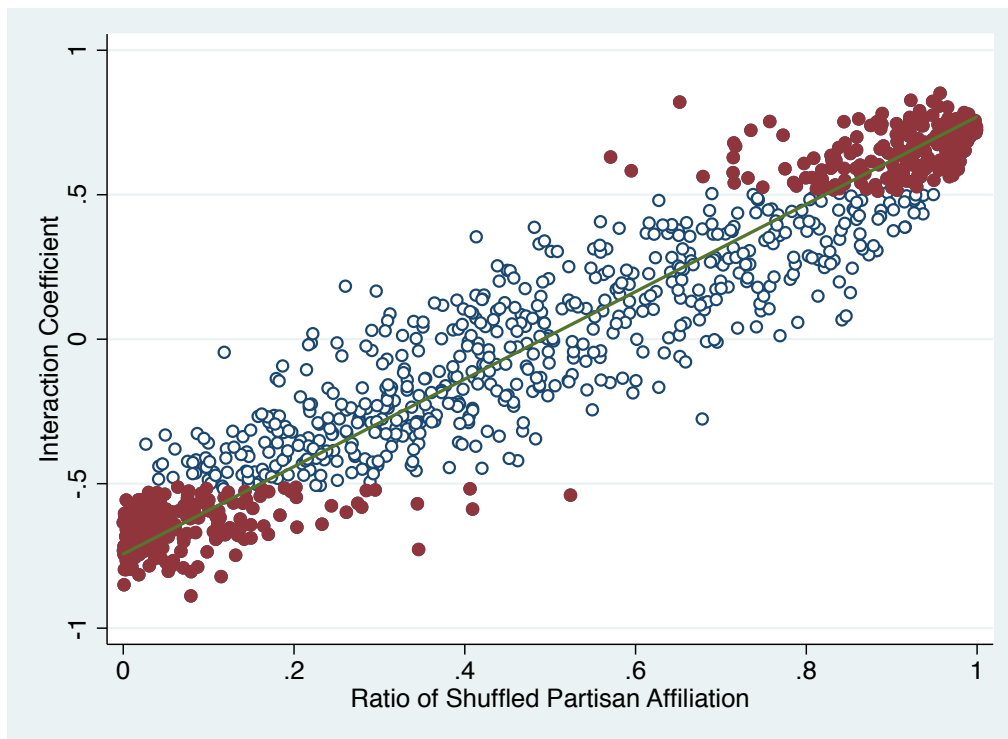
**Figure 8:** This figure presents the Kernel distribution function (left graph) and cumulative density function (right graph) of the interaction coefficient of 1,000 randomly shuffled affiliations during the analyzed time window from December 2008 to September 2009. In each iteration, half of the Democratic equity hedge fund managers were replaced by Republican equity hedge fund managers. The treatment and the control groups contain a balanced mix of randomly assigned Democratic and Republican managers.



As expected, random treatment groups with equally shuffled partisan affiliations do not show significant differences from random control groups. The mean of the interaction coefficient is 0.018, with a standard deviation of 0.21. Only 16 observations (1.6%) showed coefficients higher than 0.5 at a 1% significance level. The combined probability of an estimate as high and significant as in the baseline estimation, shown in Model 5 in Table 5, was zero. In other words, the significant difference in performance between Democratic and Republican equity hedge fund managers in the period of December 2008–September 2009 was hardly by chance or driven by outliers.

To confirm these results, I next run a similar simulation, allowing for a random ratio of partisan switches. Whereas previously the replacement ratio was 1/2, in this simulation a Democratic ratio equal to zero means that all Democratic equity hedge fund managers were replaced by Republicans, and a ratio of 1 means that all Democrats remain “truly Democrats” in the treatment group and *vice versa*. Figure 9 plots the ratio of shuffled partisan affiliation and the interaction coefficient of shuffled Democratic equity hedge fund managers during the analyzed period from December 2008 to September 2009.

**Figure 9:** This figure plots 1,000 randomly shuffled partisan affiliations and the interaction coefficient of shuffled Democratic equity hedge fund managers during the analyzed period from December 2008 to September 2009. The ratio of partisan affiliation replacement was random, where 0 represents all affiliations switched and 1 represents no replacement. Blue empty markers show coefficients not significant at the 1% level. Red markers show coefficients significant at the 1% level. The green line fits values at 1% significance.

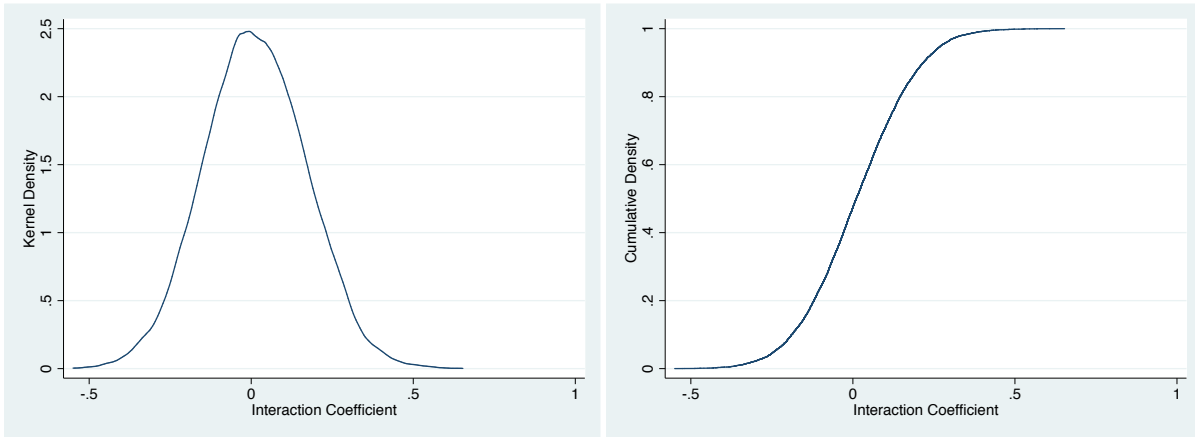


Statistically significant estimate points cluster at the extremes of the spectrum, i.e., when Democrats remain Democrats and Republicans remain Republicans, or everybody switches affiliation. The regression of the interaction coefficient and ratio of shuffled partisan affiliation shows an  $R^2$  of 0.91, i.e., very high and robust at 0.1% significance.

Finally, I randomly replaced half of Democratic managers with Republican managers in

each month; i.e., I allowed half of the managers to artificially “switch” affiliations each month. I run this procedure 10,000 times, randomly re-shuffling partisan affiliation. Figure 10 shows the Kernel distribution and cumulative density functions of the interaction coefficient of shuffled affiliation during the analyzed time window from December 2008 to September 2009.

**Figure 10:** This figure presents the Kernel distribution function (left graph) and cumulative density function (right graph) of the interaction coefficient of 10,000 randomly shuffled affiliations during the analyzed time window from December 2008 to September 2009. In each iteration, half of the Democratic equity hedge fund managers were replaced by Republican equity hedge fund managers at the monthly level (i.e., hedge fund managers were allowed to change affiliation multiple times). The treatment and the control groups contain a balanced mix of randomly assigned Democratic and Republican managers.



Random treatment groups with equally shuffled partisan affiliation groups by month do to not show significant differences. The mean of the interaction coefficient is 0.013, with a standard deviation of 0.158. Only 18 observations (0.18%, i.e., less than two in one thousand) showed coefficients higher than 0.5 at a 1% significance level, and none (zero) was as high and significant as in the baseline estimation shown in Model 5 in Table 5.

The results of these simulations provide support that the significant difference in performance between Democratic and Republican equity hedge fund managers observed from December 2008 to September 2009 was not by chance or driven by outliers, but can be attributed to characteristics related to the partisan affiliation of the managers.

## 5 Alternative Explanations

There is no direct statistical evidence for the political cognitive dissonance argument. In this section, I present a series of tests that demean alternative explanations.

## 5.1 Portfolio Profiles

Differences in equity hedge fund returns can arise due to different loadings on the pricing factors. It is plausible that certain pricing factors were more prominent during the turbulent period from December 2008 to September 2009 than at other times, and that managers with different political attitudes load on these factors differently. For example, perhaps Democratic-leaning managers are more prone to invest in companies with good worker protection and stronger unions, and perhaps these companies then happened to perform relatively better during these times. In other words, the difference in performance would be rather related to different portfolio selection strategies (*betas*) than to better management (*alphas*).

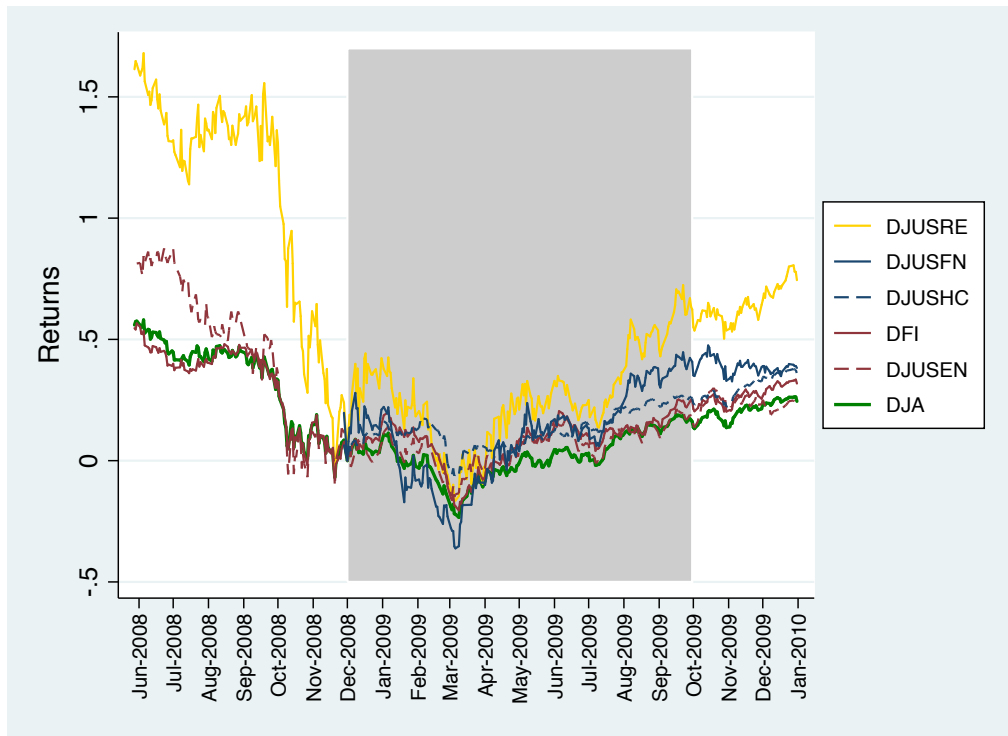
A complementary explanation of differential Democratic versus Republican performance could be the persistence in portfolio composition. Republican managers adopt and maintain more conservative corporate policies, i.e., lower levels of corporate debt, lower capital and research and development (R&D) expenditures, and less risky investments (Hutton, Jiang, and Kumar 2014). Conversely, Democratic mutual fund managers hold less of their portfolios in “socially irresponsible” companies—e.g., tobacco and defense firms, and companies with bad employee relations or diversity records—in comparison to Republican managers (Hong and Kostovetsky 2012). The Obama election platform was associated with limiting American military interventions, fostering sustainable energy policies, and promoting affordable medical insurance. It is possible that Republicans, instead of adapting their investments to the likely new policies, stuck to their current portfolios for ideological motives or overreacted shortening certain industries, which resulted in their worsened performance.

The asset-level portfolio composition private information and not available to test these hypotheses. Nevertheless, there is vague evidence supporting them. First, there is no statistical difference in mid- and long-term *alphas* of Democratic and Republican funds in from 1999 to 2014 other than from December 2008 to September 2009 (cf. Table 5)

Second, there is no statistical difference in mid- and long-term *betas* along 16 years—from January 1999 to December 2014—between Democratic and Republican managers (see Potthoff (1974) analysis in Table 9, Panel C). During the period from December 2008 to September 2009 both Democratic and Republican funds present lower *betas*; their difference slightly increases from 0.03 to 0.06, but remains statistically not different from zero.

Third, between December 2008 and September 2009 real estate stocks and healthcare stocks outperformed defense and oil & gas stocks. Financial stocks performed better overall during this 10-month time window, but only after recovering in mid-March 2009 (see Figure 11). Also, real estate stocks sharply fell from mid-2008 until December 2008. The difference in performance between Democratic and Republican equity hedge funds only from December 2008 to September 2009, therefore, cannot be attributed to consistently different portfolio preferences between the groups. For example, should that have been the case, portfolios holding real estate stocks before December 2008 would have underperformed. The data seem to suggest that Democratic hedge fund managers believed in the recovery of real estate and financial markets in December 2008, much earlier than Republican managers.

**Figure 11:** This figure shows the performance several indices: Dow Jones Composite (DJA) in thick green; Dow Jones U.S. Real Estate Index (DJUSRE) in yellow; AMEX Defense Index (DFI) in red; Dow Jones U.S. Oil and Gas Index (DJUSEN) in dashed red; Dow Jones U.S. Financials Index (DJUSFN) in blue; and Dow Jones U.S. Health Care Index (DJUSHC) in dashed blue. DJUSFN and DJUSHC data series start in December 2008. All indices' returns are normalized and zeroed on December 1, 2008. The gray area delimits the period from December 2008 to September 2009. Data are from Bloomberg.



The Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub.L. 111203, H.R. 4173) of July 2010 requires the registration at the SEC of hedge funds that manage over \$100 million,<sup>7</sup> but the detailed portfolio composition remains private information.

## 5.2 Social Networks and Insider Trading

Hedge fund managers could have contributed to partisan committees to buy favors (e.g., policy changes and insider information). In the sample, however, the contributions are relatively small and the contributors' base wide, which makes eventual collusion hard. Rather than buying favors, these contributions express partisan preference. If any, research suggests that Republicans are prosecuted more often than Democrats for insider information (Ahern 2017).

Alternatively, Democrats' social networks could have proven more valuable from December 2008 to September 2009 (Pool, Stoffman, and Yonker 2015; Gao and Huang 2016). At times of intense legislative activity, for example, connections at the Capitol can serve to anticipate the implications of key legislation on businesses. Secretively coordinating hundreds of equity hedge fund managers across several states for such a long period, however, seems to be hardly plausible.

Also, the optimistic attitude of Democrats may have been reinforced by source dependence.<sup>8</sup> In the case at hand, Democratic equity hedge fund managers may have felt more competent when the political and policy decision-making center is closer to their beliefs.

Again, there is no evidence of this matter. There is no correspondence between control in Congress (see Figure 12) and the number of consecutive months when equity hedge fund managers affiliated with one political party outperformed their peers from the other political party (cf. Figure 6). On the contrary, the other significantly long periods of performance separation falls from May to September 2003 and from January to May 2004. At the time, Democratic equity hedge fund managers outperformed Republican ones, but Congress (both the Senate and the House) and the White House were controlled by Republicans.

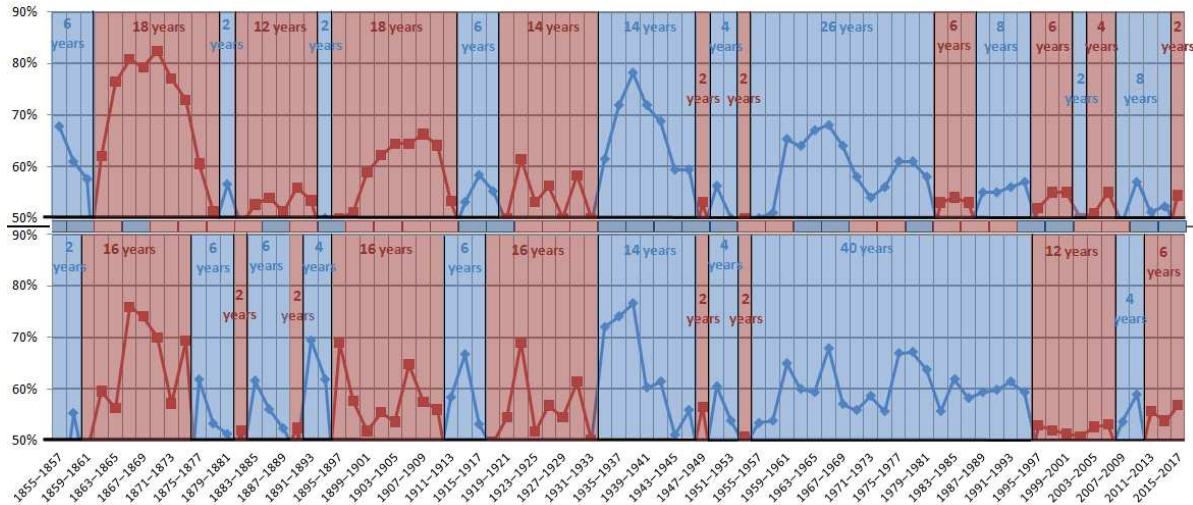
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<sup>7</sup> See, e.g., Chair Mary Jo White, "Five Years On: Regulation of Private Fund Advisers After Dodd-Frank," Keynote Address at the Managed Fund Association 2015 Conference, New York, NY, October 16, 2015. Available at: <https://www.sec.gov/news/speech/white-regulation-of-private-fund-advisers-after-dodd-frank.html> (accessed June 26, 2016).

<sup>8</sup> I.e., people often prefer a bet on a vague probability event in their area of competence over a bet on a matched chance clear probability event, which is related to the attribution of credit and blame (Heath and Tversky 1991).



**Figure 12:** This figure shows the combined control of the U.S. House of Representatives and control of the U.S. Senate. Each horizontal block equals two years (one session of Congress). On the scale, every other session of Congress is shown (i.e., 2009–2011 is all of 2009 and 2010, the newly elected take office in January 2011; i.e., 2007 is election year 2006). The upper block shows the majority party in the Senate, the lower block shows the majority party in the House, and the middle block shows the party in the White House (mid-terms are the line in the middle of each one-term ‘block’). The left scale represents the percentage of seats in the Senate and the House, correspondingly. The Democratic party is in blue; the Republican party is in red. Data are from “Party in Power — Congress and Presidency — A Visual Guide to the Balance of Power in Congress.” USpolitics.about.com (accessed May 28, 2016).



### 5.3 Timely Optimism

The observed results could also be interpreted as optimism bias of Democrats when their candidate was in power Bonaparte, Kumar, and Page (2017), combined with a lucky strike of markets recovering in early 2009. According to this hypothesis, should the president had been a Republican or markets had not recovered, the aftermath could have been different.

The data do not allow to check the counterfactuals in 2009. To address this limitation, I checked equity hedge fund managers’ performance at other risky events under a Republican administration contained in the time series: namely, the terrorist attack on the World Trade Center on September 11, 2001 and the Iraq’s invasion of March 20–May 1, 2003. If equity hedge fund managers follow the party leadership during crises, then one should expect Republican managers outperforming Democratic managers.

The data does not support this hypothesis:

- (a) In August and September 2001, Republican equity hedge fund managers performed better than Democratic managers; but in October and November, Democratic managers per-

formed better than Republican managers;

(b) From March to September 2003 (7 months straight), Democratic hedge fund managers performed better than Republican managers.

In both cases the evidence shows that managers performed opposite to what a timely optimistic bias would suggest: Under Republican presidential leadership, Republican equity hedge fund managers performed worse after risky events than their Democratic counterparts.

## 5.4 Fund Flows

It is possible that fund managers were not politically biased, but investors were. After Obama's election, maybe Republican investors panicked and withdrew funds, forcing funds into fire sales that accounted for the difference in performance.

This explanation seems unlikely for several reasons. First, it would require a perfect alignment of thousands of Republican and Democratic investors in different funds. These funds are similar in their investor composition and investors often pool funds in more than one fund. Second, it would require that Republican investors be matching to Republican-run funds; otherwise, Democratic fund managers may arguably advise against selling, particularly if their profit and reputation are at risk. Third, it would require that funds' lockup requirements and withdrawal restrictions do not apply to the same extent to Democratic and Republican equity hedge funds.

I do not have the monthly records of assets under management by fund to test how flows reacted in the analyzed period. From the global data and talks with hedge funds, there were portfolio realignments, but without vast withdrawals from some hedge funds and stoic withholdings in other hedge funds.

## 6 Conclusions

This study documents large, significant, and persistent higher returns of Democratic equity hedge fund managers compared to their Republican peers from December 2008 to September 2009. The difference in performance is robust to several regression specifications, placebo time windows, and randomly shuffled partisan affiliation. Back-of-the-envelope calculations

suggest that, given the \$380 billion in equity hedge funds' assets under management in 2009,<sup>9</sup> the estimated 72 basis points difference in monthly performance between Democratic and Republican managers accrued \$13.7 billion in relative losses for investors in funds managed by the later.

I argue that it is likely that the divergence in political parties' interpretation of central bank policy following Obama's election sparked cognitive biases. Rationally, both Democratic and Republican managers were equally aware of the political need to offer differing interpretations by the parties, and both should have ignored them. While all equity hedge fund managers were exposed to the same data, managers' investment decisions were affected by confirmatory bias and the framing dominant in their politically affine circles. The argument that the managers have intrinsically differing portfolio or risk preferences is not supported in other uncertain times: when there was no such interpretation divergence, their fund performance was roughly similar.

A major limitation of the study is the uniqueness of the monetary and political state of affairs that led to a divergence in performance by Democratic and Republican equity hedge fund managers at the onset of the Obama's presidency. On the one hand, this setup is cumbersome to replicate credibly in a laboratory experiment; on the other hand, data constraints prevent from distinctly disentangling the psychological mechanisms and behavioral biases at play. The causal linkage between political cognitive biases and performance is thus reduced to *quasi*-experimental counterfactuals and the rejection of alternative explanations.

Political cognitive biases appear to be an important driver in the financial industry, even for highly trained professionals. The difference in performance by hedge fund managers is an indication of the extent to which ideology can affect the processing of information, whose effects become salient during abnormal situations. Further work needs to be done on the measurement and mitigation of political biases in politically sensitive decision-making areas.

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<sup>9</sup> See: "Hedge Funds Hit a High Note 2009 Industry Review," Credit Suisse, Tremont Hedge Fund Index, January 2010. Available at: [http://www.hedgeindex.com/hedgeindex/documents/CS Tremont 2009 Industry Review v8.pdf](http://www.hedgeindex.com/hedgeindex/documents/CS_Tremont_2009_Industry_Review_v8.pdf) (accessed June 3, 2016).

**Table 1:** This table presents funds' breakdown by their main strategy. Data are from Hedge Fund Research.

<b>Hedge Fund Strategies</b>			
Main Strategy	Freq.	Percent	Cum.
Equity Hedge	73,485	38.66	38.66
Event-Driven	21,148	11.12	49.78
Fund of Funds	35,847	18.86	68.64
Macro	26,204	13.78	82.42
Relative Value	33,420	17.58	100.00
Total	190,104	100.00	

**Table 2:** This table presents summary statistics of performance of the equity hedge fund managers by partisan affiliation. Fund performance is the monthly performance in percentage points of hedge funds. Democratic or Republican variables represent the political affiliation of fund managers by their partisan contribution. Data are from Hedge Fund Research and Federal Election Commission. The sample period is 1999-2014.

<b>Summary Statistics of Performance</b>					
	count	mean	sd	p5	p95
Democratic	36,078	0.84	4.64	-6.65	8.42
Republican	37,407	0.73	4.57	-6.89	8.20
Total	73,485	0.78	4.61	-6.79	8.31

**Table 3:** This table presents the count of equity hedge fund managers in the sample by year and partisan affiliation. Data are from Hedge Fund Research and Federal Election Commission. The sample period is 1999-2014.

**Count of Observations by Partisan Affiliation and Year**

Year	Affiliation		Total
	Democratic	Republican	
1999	1,874	1,908	3,782
2000	2,128	2,062	4,190
2001	2,195	2,082	4,277
2002	2,203	2,392	4,595
2003	2,297	2,576	4,873
2004	2,334	2,594	4,928
2005	2,486	2,763	5,249
2006	2,522	2,695	5,217
2007	2,711	2,824	5,535
2008	2,619	2,773	5,392
2009	2,532	2,581	5,113
2010	2,311	2,471	4,782
2011	2,182	2,358	4,540
2012	2,164	2,180	4,344
2013	2,076	1,890	3,966
2014	1,444	1,258	2,702
Total	36,078	37,407	73,485

**Table 4:** This table presents the count of equity hedge fund manages in the sample by state and partisan affiliation. Data are from Hedge Fund Research and Federal Election Commission. The sample period is 1999-2014.

**Count of Observations by Partisan Affiliation and State**

State	Affiliation		Total
	Democratic	Republican	
AK	41	0	41
AZ	18	0	18
CA	5,448	7,799	13,247
CO	164	404	568
CT	2,173	3,468	5,641
DC	0	417	417
DE	0	19	19
FL	997	1,174	2,171
GA	20	839	859
IL	2,472	2,279	4,751
IN	0	526	526
KS	0	220	220
KY	0	373	373
MA	1,714	3,044	4,758
MD	79	372	451
MN	208	607	815
MO	91	0	91
MS	63	0	63
NC	406	86	492
NE	142	0	142
NJ	712	735	1,447
NM	0	56	56
NV	72	0	72
NY	17,080	9,772	26,852
OH	747	37	784
OR	105	27	132
PA	785	565	1,350
RI	71	8	79
TN	0	372	372
TX	1,413	3,305	4,718
UT	68	0	68
VA	500	541	1,041
WA	189	63	252
WI	300	179	479
WY	0	120	120
Total	36,078	37,407	73,485

**Table 5:** This table presents results from difference-in-differences linear regression estimations of fund performance on managers' political affiliation with a treatment period from December 2008 to September 2009 (Models 2–5). The dependent variables are hedge funds' monthly returns. Democratic manager is a dummy variable equal to one if the fund is univocally linked to a manager that contributed to a Democratic candidate or committee. The interaction terms capture the performance of Democratic managers during the event. Controls include S&P500 returns and state fixed effects. Data are from Hedge Fund Research, Federal Election Commission, and Compustat. The sample period is 1999-2014. Heteroskedasticity-robust standard errors are reported in parenthesis; \* denotes significance at 10%, \*\* significance at 5%, and \*\*\* significance at 1%.

<b>Managers' Political Affiliation and Fund Performance</b>					
	(1)	(2)	(3)	(4)	(5)
	1999-2014	1999-2014	1999-2014	2008-2010	1999-2014
Democratic Manager	0.109*** (0.0389)	0.0667* (0.0375)	0.0481 (0.0402)	-0.113 (0.0909)	0.0476 (0.0398)
Democratic President	0.0516 (0.0393)	-0.0179 (0.0416)	-0.0167 (0.0416)		-0.0183 (0.0461)
Dec2008-Sep2009		0.332*** (0.126)	0.344*** (0.126)	0.693*** (0.130)	0.344*** (0.126)
Dec2008-Sep2009 × Dem Manager		0.728*** (0.197)	0.724*** (0.197)	0.833*** (0.234)	0.724*** (0.197)
S&P 500 Return	0.441*** (0.0154)	0.439*** (0.0153)	0.439*** (0.0153)	0.420*** (0.0198)	0.439*** (0.0153)
State fixed effects	No	No	Yes	Yes	Yes
Fund status fixed effects	No	No	No	No	Yes
Observations	73485	73485	73485	15287	73485
Adjusted $R^2$	0.179	0.181	0.181	0.263	0.181
Clustered at fund ID	Yes	Yes	Yes	Yes	Yes

**Table 6:** This table presents results from difference-in-differences linear regression estimations of fund performance on managers' political affiliation with a treatment period from December 2008 to September 2009 (Models 2–5). The dependent variables are hedge funds' monthly returns. Democratic manager is a dummy variable equal to one if the fund is univocally linked to a manager that contributed to a Democratic candidate or committee. The interaction terms capture the performance of Democratic managers during the event. Controls include S&P500 returns and state fixed effects. Data are from Hedge Fund Research, Federal Election Commission, and Compustat. The sample period is 1999-2014. Geographical scope is limited to states with more than 1,000 equity hedge fund managers and balanced partisan representation: CA, CT, FL, IL, MA, NJ, NY, PA, TX, and VA. Heteroskedasticity-robust standard errors are reported in parenthesis; \* denotes significance at 10%, \*\* significance at 5%, and \*\*\* significance at 1%.

**Managers' Political Affiliation and Fund Performance**  
(CA, CT, FL, IL, MA, NJ, NY, PA, TX, and VA)

	(1)	(2)	(3)	(4)	(5)
	1999-2014	1999-2014	1999-2014	2008-2010	1999-2014
Democratic Manager	0.104** (0.0406)	0.0648* (0.0393)	0.0354 (0.0405)	-0.103 (0.0920)	0.0342 (0.0400)
Democratic President	0.0672* (0.0397)	-0.0150 (0.0420)	-0.0141 (0.0421)		-0.0186 (0.0465)
Dec2008-Sep2009		0.483*** (0.130)	0.491*** (0.130)	0.802*** (0.136)	0.492*** (0.130)
Dec2008-Sep2009 × Dem Manager		0.673*** (0.205)	0.666*** (0.204)	0.785*** (0.243)	0.666*** (0.204)
S&P 500 Return	0.444*** (0.0159)	0.442*** (0.0158)	0.442*** (0.0158)	0.434*** (0.0198)	0.442*** (0.0158)
State fixed effects	No	No	Yes	Yes	Yes
Fund status fixed effects	No	No	No	No	Yes
Observations	65976	65976	65976	13684	65976
Adjusted $R^2$	0.184	0.186	0.186	0.282	0.186
Clustered at fund ID	Yes	Yes	Yes	Yes	Yes



**Table 7:** This table presents results from difference-in-differences linear regression estimations of fund performance on managers' political affiliation with a treatment period from December 2008 to September 2009 (Models 2–5). The dependent variables are hedge funds' monthly returns. Democratic manager is a dummy variable equal to one if the fund is univocally linked to a manager that contributed to a Democratic candidate or committee. The interaction terms capture the performance of Democratic managers during the event. Controls include S&P500 returns and state fixed effects. Data are from Hedge Fund Research, Federal Election Commission, and Compustat. Geographical scope is limited to states with more than 4,500 equity hedge fund monthly observations and balanced partisan representation: CA, CT, IL, MA, NY, and TX. The sample period is 1999-2014. Heteroskedasticity-robust standard errors are reported in parenthesis; \* denotes significance at 10%, \*\* significance at 5%, and \*\*\* significance at 1%.

**Managers' Political Affiliation and Fund Performance**  
(CA, CT, IL, MA, NY, and TX)

	(1)	(2)	(3)	(4)	(5)
	1999-2014	1999-2014	1999-2014	2008-2010	1999-2014
Democratic Manager	0.129*** (0.0424)	0.0876** (0.0407)	0.0563 (0.0424)	-0.141 (0.0976)	0.0543 (0.0420)
Democratic President	0.104** (0.0419)	0.0254 (0.0445)	0.0269 (0.0445)		0.0197 (0.0494)
Dec2008-Sep2009		0.424*** (0.138)	0.431*** (0.138)	0.753*** (0.144)	0.433*** (0.138)
Dec2008-Sep2009 × Dem Manager		0.719*** (0.214)	0.711*** (0.213)	0.895*** (0.255)	0.711*** (0.213)
S&P 500 Return	0.450*** (0.0166)	0.448*** (0.0165)	0.448*** (0.0165)	0.441*** (0.0206)	0.448*** (0.0165)
State fixed effects	No	No	Yes	Yes	Yes
Fund status fixed effects	No	No	No	No	Yes
Observations	59967	59967	59967	12326	59967
Adjusted $R^2$	0.188	0.190	0.190	0.290	0.190
Clustered at fund ID	Yes	Yes	Yes	Yes	Yes

**Table 8:** This table presents results from linear regression estimations of fund performance on mixed Democratic-Republican teams with a treatment period from December 2008 to September 2009. The dependent variables are hedge funds' monthly returns. Democratic ratio is the number of hedge fund managers identified as Democratic minus the number of managers identified as Republican, divided by the number of managers with partisan affiliation identified. Square terms capture non-linear effects. Controls include S&P500 returns, state fixed effects, and fund status. Data are from Hedge Fund Research, Federal Election Commission, and Compustat. Models 2, 4, and 6 are constrained in time to 2008-2010. Models 3 and 4 are constrained to funds located in CA, CT, FL, IL, MA, NJ, NY, PA, TX, and VA. Models 5 and 6 are further constrained to funds located in CA, CT, IL, MA, NY, and TX. The sample period is 1999-2014. Heteroskedasticity-robust standard errors are reported in parenthesis; \* denotes significance at 10%, \*\* significance at 5%, and \*\*\* significance at 1%.

<b>Mixed Partisan Teams and Fund Performance</b>						
	(1)	(2)	(3)	(4)	(5)	(6)
	1999-2014	2008-2010	1999-2014	2008-2010	1999-2014	2008-2010
Democratic ratio $\times$ no-shock	-0.386 (0.358)	0.177 (0.953)	-0.390 (0.357)	0.175 (0.953)	-0.409 (0.356)	0.0457 (0.967)
Democratic ratio $\times$ no-shock sqr	0.186 (0.780)	-0.787 (1.851)	0.221 (0.782)	-0.779 (1.850)	0.228 (0.783)	-0.692 (1.903)
Democratic ratio $\times$ shock	-4.136*** (1.485)	-3.595** (1.701)	-4.140*** (1.483)	-3.598** (1.699)	-3.955** (1.544)	-3.343* (1.741)
Democratic ratio $\times$ shock sqr	-0.597 (2.412)	0.515 (3.142)	-0.580 (2.417)	0.510 (3.146)	-0.672 (2.399)	0.383 (3.143)
S&P 500 Return	0.404*** (0.0466)	0.398*** (0.0574)	0.405*** (0.0478)	0.399*** (0.0587)	0.417*** (0.0463)	0.413*** (0.0584)
State fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Fund status fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Observations	6630	1470	6350	1428	5863	1392
Adjusted $R^2$	0.197	0.293	0.200	0.296	0.213	0.310
Clustered at fund ID	Yes	Yes	Yes	Yes	Yes	Yes

**Table 9:** This table presents results from linear regression estimations of fund volatility (*betas*) on managers' political affiliation. The dependent variables are hedge funds' monthly returns. Panels A and B present the *betas* of funds managed by Democrats and Republicans, respectively. Panel C presents the results from the Potthoff (1974) analysis of comparing the regression coefficients from independent samples—Democratic versus Republican fund managers—reported in Panels A and B. Democratic manager is a dummy variable equal to one if the fund is univocally linked to a manager that contributed to a Democratic candidate or committee. The interaction terms in Panel C capture the difference in *betas* of Democratic managers. Controls include state fixed effects and fund status fixed effects. Data are from Hedge Fund Research, Federal Election Commission, and Compustat. The sample period is 1999-2014. Heteroskedasticity-robust standard errors are reported in parenthesis; \* denotes significance at 10%, \*\* significance at 5%, and \*\*\* significance at 1%.

<b>Panel A: <i>Betas</i> of Funds Managed by Democtrats</b>				
	(1)	(2)	(3)	(4)
	1999-2014	1999-2014	2008-2010	Dec2008-Sep2009
S&P 500 Return	0.458*** (0.0217)	0.458*** (0.0218)	0.464*** (0.0278)	0.354*** (0.0312)
State fixed effects	No	Yes	Yes	Yes
Fund status fixed effects	No	Yes	Yes	Yes
Observations	36078	36078	7462	2141
Adjusted $R^2$	0.189	0.190	0.280	0.194
Clustered at fund ID	Yes	Yes	Yes	Yes

<b>Panel B: <i>Betas</i> of Funds Managed by Republicans</b>				
	(1)	(2)	(3)	(4)
	1999-2014	1999-2014	2008-2010	Dec2008-Sep2009
S&P 500 Return	0.426*** (0.0218)	0.427*** (0.0218)	0.410*** (0.0291)	0.309*** (0.0331)
State fixed effects	No	Yes	Yes	Yes
Fund status fixed effects	No	Yes	Yes	Yes
Observations	37407	37407	7825	2173
Adjusted $R^2$	0.170	0.171	0.232	0.169
Clustered at fund ID	Yes	Yes	Yes	Yes

<b>Panel C: Potthoff Analysis of <i>Betas</i> by Partisan Affiliation</b>				
	(1)	(2)	(3)	(4)
	1999-2014	1999-2014	2008-2010	Dec2008-Sep2009
S&P 500 Return	0.426*** (0.0218)	0.426*** (0.0218)	0.411*** (0.0290)	0.301*** (0.0328)
S&P 500 Return $\times$ Dem Manager	0.0327 (0.0308)	0.0322 (0.0308)	0.0521 (0.0400)	0.0619 (0.0459)
State fixed effects	No	Yes	Yes	Yes
Fund status fixed effects	No	Yes	Yes	Yes
Observations	73485	73485	15287	4314
Adjusted $R^2$	0.179	0.180	0.255	0.181
Clustered at fund ID	Yes	Yes	Yes	Yes

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