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

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2022 AFA, Student Poster

Motivation

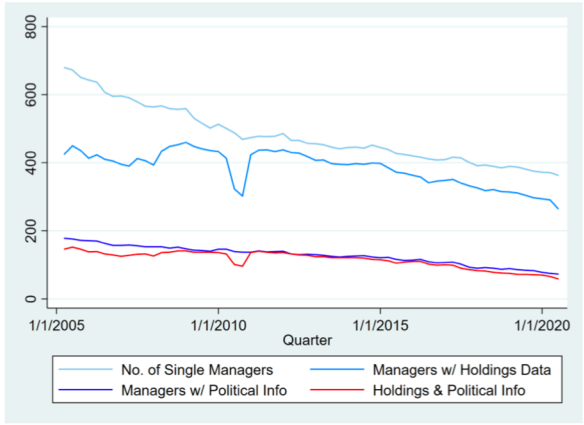
- Rise in political polarization in the US society
- Does political alignment affect **economic expectations** and create **in-group favoritism**?
- Past literature documents economic expectation bias for credit rating analysts, bankers and company management
- There is also evidence regarding in-group favoritism for mutual funds, news networks and company boards.
- This paper examines these two channels for **mutual fund managers**

Main Results

- **Misaligned managers have a pessimistic outlook**: they underweight small-cap, volatile and value stocks and overweight momentum stocks
- Republican managers increased portfolio beta significantly after the 2016 Trump election
- **There is no evidence for in-group favoritism** once managers without affiliation are removed from the sample
- There is a **partisan bias in holdings of stocks exposed to COVID-19** but limited evidence for past pandemics (H1N1, Ebola and Zika)
- There is also a partisan bias in Brexit-exposed stocks affirming that the bias manifests in politicized topics

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
- A Morningstar-CRSP linktable is used to obtain holdings data from CRSP
- Using FEC data, the final holdings data has donation data for 332/1,341 managers (25%)
- Measure of a stock's exposure to a pandemic is from Hassan et al (2020)



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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

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

Partisan Bias & Pandemics

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