

Tactical asset allocation and presidential elections

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Abstract

Over the past 75 years, common stocks performed better under Democrats, while U.S. government bonds and Treasury (T) bills performed better under Republicans. Using a mean-variance framework, we find that Democrats provide better risk-reward opportunities for portfolios weighted toward stocks, while Republicans provide better tradeoffs for portfolios weighted toward government bonds and T-bills. More recently, Republicans provide better portfolio opportunities than Democrats for a bond-stock allocation range typical of diversified investors. Moreover, when segmenting the value stock (style) premium by political party, we find that Republicans provide better risk-reward tradeoffs than Democrats for portfolios of value stocks, bonds, and bills. © 2006 Academy of Financial Services. All rights reserved.

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1. Introduction

The issue of tactical asset allocation (TAA) around calendar events, such as U.S. presidential elections, is a controversial one for investors.¹ At the heart of the matter is whether or not the capital market is efficient in the sense that security prices fully reflect the information content of known events. If so, then calendar events, such as presidential elections, are irrelevant to current investment decision making because security prices already reflect the information content of any perceived patterns or cyclicity. Conversely, if investors evaluate the investment consequences of calendar events in a somewhat ineffi-

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cient market, or if the outcomes of presidential elections impact the returns on various asset classes, then a series of questions emerge that are relevant to tactical investing.

Applied to U.S. presidential elections, a prominent four-year calendar event, these active investing questions are as follows: Are asset prices impacted by a four-year presidential election cycle? If so, what are the effects on different asset classes (stocks, bonds, bills, etc.) according to the political party elected into office? More important, as presidential elections come and go, should investors depart from their long-term or strategic asset allocation to pursue a TAA posture?

Our initial focus is on whether asset returns vary by the political party in office. If asset prices are related to presidential elections, then investors will want to consider information pertaining to election outcomes in making asset allocation decisions. Tactical investing around a four-year election calendar would hold the possibility of earning superior returns (α). Anecdotal evidence suggests that many investors follow expected election outcomes closely.

We update the results of prior studies from 1929 through the 2004 election. Consistent with prior evidence on movements in asset prices around presidential elections, we find that returns on large- and small-company common stocks are higher under Democratic administrations, although the results are statistically different only for small-company stocks. The returns on long-term government bonds and Treasury (T) bills are higher under Republican administrations. Post-1960, only the results for T-bonds are statistically significant.

We then argue that the TAA decision around presidential elections should be addressed in the context of an efficient frontier analysis of portfolio opportunities rather than the traditional stock-only or bond-only allocations studied in prior literature. To our knowledge, this is the first paper in the literature that addresses asset returns around presidential elections in a mean-variance efficient frontier framework. We find that the efficient frontier is sensitive to presidential time periods, with Democrats providing a broader (to equal) set of risk-reward opportunities over the long term, while Republicans provide better opportunities over the past quarter century when considering bond-stock allocations typical of diversified investors. Moreover, when segmenting the value stock (style) premium by political party, we find that Republicans provide better risk-reward tradeoffs over Democrats when looking at portfolios of value stocks, bonds, and bills.²

The remainder of the paper is organized as follows: In Section 2, we review the established literature on asset prices around U.S. presidential elections. In Section 3, we present our empirical findings on returns on broad asset classes and examine tactical asset allocation around presidential elections in a mean-variance efficient frontier framework. In Section 4, we consider the TAA implications of other return phenomena, particularly the value stock (style) premium segmented by four-year election periods. A summary and conclusion, including the relevance of our empirical finding to investors, is then presented in Section 5.

2. Asset prices and presidential elections

The notion that presidential elections and their outcomes may affect the economy and asset prices is not new. Nordhaus (1975) and MacRae (1977) articulate the idea of a political

business cycle based on the incentives for politicians to stimulate the economy before presidential elections. Grier (1987) argues that Federal Reserve monetary policy is consistent with accommodating a political business cycle. Allvine and O'Neill (1980) note that John F. Kennedy was the first president to pursue overt and systematic policies aimed at controlling the level of aggregate economic activity. Allvine and O'Neill also present evidence of a four-year cycle in the stock market during the postwar period and provide weak evidence that stock prices rise over the two years before a presidential election. This effect is more pronounced in the latter period, 1961 through 1978 versus 1948 through 1978, consistent with 1960 being the first year of a more actively managed economy.

U.S. presidential elections may also impact other markets. Dobson and Dufrene (1993) examine the impact of U.S. presidential elections on international security markets. They find evidence of a significant structural change in the relation between international markets and the U.S. market around presidential elections. International markets become more highly correlated with the Standard and Poor's (S&P) 500 in the month surrounding the election.

The issue of which political party is "better" for investors has also been studied. The results of these studies are mixed. Niederhoffer, Gibbs and Bullock (1970) and Riley and Luksetich (1980) find that stock returns are higher around the time that a Republican is elected to office. Expanding upon Allvine and O'Neill (1980), Huang (1985) presents evidence of a pattern in common stock returns over the four-year presidential election cycle and over different party administrations. Looking at subperiods from 1932 through 1980, he finds that returns during the last two years of a presidential cycle are higher than returns over the first two years. He finds that this effect is more pronounced for Democrats and, similar to Allvine and O'Neill (1980), it is more pronounced in the more recent period (1961–1980).

Stovall (1992) and Johnson and Chittenden (1999) also present evidence of higher returns during the last two years of a presidential election cycle. Johnson and Chittenden (1999) also examine returns on broad asset classes from 1929 to 1996 in the years surrounding presidential elections and segment these results by political party. They find that the returns on small-cap stocks are higher under Democratic administrations, while returns on bonds are higher under Republican administrations. These results hold for both nominal and real returns, as inflation is not significantly different under either party.

Santa-Clara and Valkanov (2003) examine the behavior of monthly returns from 1927 to 1998 and argue that the observed stock market premium under Democratic administrations cannot be explained by a business cycle risk premium or equity risk differential, thus resulting in a "presidential puzzle" as to why such an effect might occur. Beyer, Jensen and Johnson (2004) find higher T-bill returns under Republican administrations. They argue that shifts in Federal Reserve monetary policy dominate political party and political gridlock in explaining stock and bond returns, although Fed policy may be related to political party.³

Most of this literature focuses on examining returns on large-company stocks and other asset classes segmented by political party in power. None of these studies considers asset allocation around presidential elections in a mean-variance efficient frontier framework. We employ such a framework in this study.

Table 1
Returns on asset classes by presidential party

Time period	Large-company stocks	Small-company stocks	Long-term government bonds	T-bills
1929–2004				
All	11.66%	17.39%	5.83%	3.78%
Democrat	14.94%	25.53%	3.68%	2.79%
Republican	8.02%	8.35%	8.21%	4.89%
<i>t</i> -statistic	1.51	2.29**	–2.14**	–3.01***
1929–1960				
All	11.15%	17.11%	3.15%	1.12%
Democrat	15.35%	27.49%	3.22%	0.48%
Republican	4.16%	–0.20	3.04%	2.18%
<i>t</i> -statistic	1.26	1.82*	0.09	–5.92***
1961–2004				
All	12.04%	17.60%	7.77%	5.72%
Democrat	14.54%	23.58%	4.14%	5.09%
Republican	9.95%	12.62%	10.80%	6.24%
<i>t</i> -statistic	0.57	1.46	–2.03**	–1.37

Note: Returns are average returns for four-year presidential election cycles, calculated using data from Ibbotson Associates.

* Statistically significant at the 10% level using a two-tailed *t*-test for difference in means; ** Statistically significant at the 5% level using a two-tailed *t*-test for difference in means; *** Statistically significant at the 1% level using a two-tailed *t*-test for difference in means.

3. Empirical results: tactical asset allocation around presidential elections

In this section, we first analyze the relation between political party and post-election returns for several broad asset classes, including large-company stocks, small-company stocks, long-term government bonds, and T-bills, providing updated results through the 2004 election. We then examine the tactical asset allocation implications of investing around presidential elections in a mean-variance efficient framework.

3.1. Presidential elections and returns on major asset classes

We examine the behavior of U.S. capital markets after presidential elections for the period 1929 through 2004, using return data on several asset classes from Ibbotson Associates (2005). We examine the returns on four asset classes (large-company stocks, small-company stocks, long-term U.S. government bonds, and T-bills) for the entire period and for subperiods 1929 through 1960 and 1961 through 2004. The results are shown in Table 1.

For the entire 1929–2004 period, the average annual return on large-company stocks was 11.66%, averaging 14.94% during Democratic administrations and 8.02% during Republican administrations. The difference is not statistically significant. Small-company stocks averaged returns of 17.39% during this period, averaging 25.53% during Democratic administrations and 8.35% under Republicans. The small-company stock return difference is statistically significant at the 5% level. In turn, the average returns on long-term government

bonds and T-bills were statistically higher under Republican administrations than under Democrats (8.21% vs. 3.68% for long-term government bonds, and 4.89% vs. 2.79% for T-bills). These empirical results are similar to those of Johnson and Chittenden (1999).⁴

We also analyze the returns for two subperiods: 1929 through 1960 (before the acknowledgment of active management of the economy around presidential elections) and 1961 through 2004. From 1929 to 1960, returns on large-company stocks are not statistically different under either party; although the average return differences are noticeably higher under Democratic administrations, while returns on small-company stocks are significantly higher under Democrats. Returns on long-term government bonds are statistically indistinguishable, while T-bill returns were significantly higher under Republican administrations.

From 1961 to 2004, the average return difference for large- and small-company stocks is higher under Democratic administrations, although a narrowing of the gap is evident for large- and small-company stocks. Differences were not statistically different. Long-term government bonds and T-bills were higher under Republican administrations, with the difference for T-bonds being statistically significant.

Summarizing, we find that the political party effect on common stocks and bonds reported in prior studies largely holds, with some decline in statistical significance over time.⁵ The continuation of higher small-company stock returns under Democratic administrations and higher long-term government bond and T-bill returns under Republican administrations is consistent with Beyer et al. (2004). Historically, Republicans are perceived as having a more pro-active stance against inflation, while Democrats pursue more expansionary monetary policies.

3.2. Tactical asset allocation implications in a mean-variance framework

Prior studies and our updated results show that the average return on common stocks is higher under Democratic than Republican administrations, while the average return on bonds and bills are higher under Republicans. This finding gives some credence to the notion that active investors should increase their stock allocations (relative to bonds and bills) under Democratic administrations and increase their bond and bill allocations under Republican administrations. However, it is important to emphasize that the judicious mix of stocks, bonds, and bills in a portfolio, whether or not segmented by presidential election periods, is impacted by risk and diversification considerations as measured by own volatilities and correlations. From a portfolio management perspective, a more complete measure of whether Democrats or Republicans are actually “better” for investors requires an efficient frontier analysis of opportunities based on average returns, standard deviations, and correlations among asset classes.

In this context, Fig. 1 shows two respective portfolio frontiers of large-company stocks, long-term government bonds and T-bills based on long-term return data over the 1926 to 2004 period.⁶ The figure reveals that Democratic administrations provide a broader set of risk reward opportunities, with seven-of-ten points on the long-term Democrat frontier providing more efficient opportunities than those observed on the Republican frontier (measured relative to intersecting frontiers at about 7.5% standard deviation).

A closer look at Fig. 1 reveals that efficient allocations to large-company stocks under

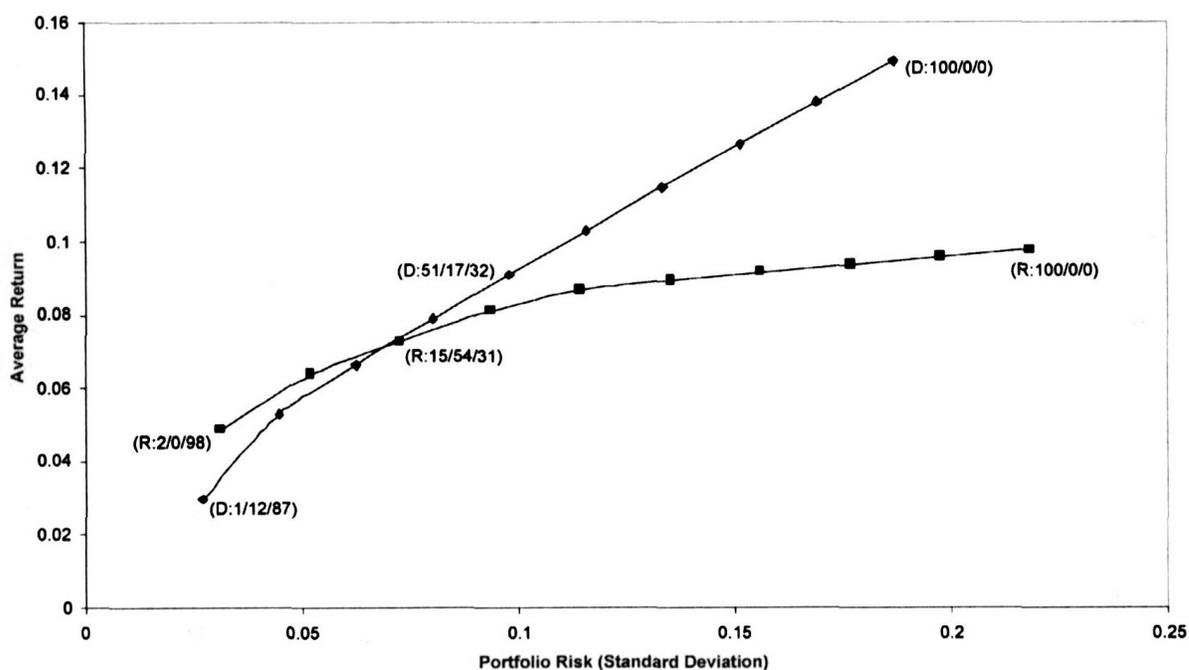


Fig. 1. Efficient frontier: % stocks/gov bonds/T-bills: Democrats (D) versus Republicans (R) 1926 through 2004.

Democratic administrations are generally higher than those under Republican administrations. For instance, at the intersecting frontiers, the stock allocation on the Democrat frontier is about 35%, while the allocation to stocks on the Republican frontier is only 15% (or 85% government bonds and T-bills). The fact that two-of-ten portfolio opportunities (points) on the long-term Republican frontier provide better risk reward opportunities than on the Democrat frontier seems because of the relatively high return on bonds and bills under Republicans combined with a comparably lower correlation on stocks and bills under Republicans. This occurs despite the higher correlation in returns among stocks and bonds and bonds and bills under Republican administrations.

Specifically, Panel A of Table 2 shows that the historical correlation (1926–2004) between large-company stock and long-term government bond returns is 0.08 under Democratic administrations and 0.21 under Republican administrations. In addition, the long-term correlation among government bond and T-bill returns is -0.02 under Democrats and 0.31 under Republicans. With lower correlation in asset returns under Democrats, these correlations point to somewhat better long-term diversification opportunities under Democratic administrations. However, Panel A of Table 2 shows that the correlation among stocks and bills under Republicans is lower than that observed among these asset classes under Democratic administrations.

3.3. A closer look at the long-term efficient frontier by presidential party

Given that return data from Ibbotson Associates begins during the middle of a presidential election cycle, 1926 in particular, it is worth assessing the long-term efficient frontier

Table 2
Correlation in asset class returns by presidential party

	Large cap	Gov. bonds	T-bills
Panel A: Historical correlation in stocks, bonds, and bills (1926–2004)			
Democrat			
Large-cap stocks	1.0000		
Government bonds	0.0829	1.0000	
T-bills	0.0614	−0.0244	1.0000
Republican			
Large-cap stocks	1.0000		
Government bonds	0.2087	1.0000	
T-bills	−0.0177	−0.3108	1.0000
Panel B: Correlation in stocks, bonds, and bills: Carter (1977–1980)–Clinton (1992–2000); Reagan (1981–1988)–Bush I (1989–1991)			
Democrat			
Large-cap stocks	1.0000		
Government bonds	0.2028	1.0000	
T-bills	0.2550	−0.2728	1.0000
Republican			
Large-cap stocks	1.0000		
Government bonds	0.5977	1.0000	
T-bills	−0.2653	0.0484	1.0000

Note: Panel A and B correlations are based on returns for large-cap stocks, government bonds, and T-bills obtained from Ibbotson Associates.

beginning in 1929. However, given that 1929 is the start of a steep decline in the U.S. stock market, culminating in a four-year annualized return of -22.7% on large company stocks through 1932, it is worth looking at portfolio opportunities by political party *both* with and without the Great Depression collapse of the stock market.

In this regard, we discuss the average return and portfolio risk findings for the 1929 to 2004 period, while we illustrate in Fig. 2 the efficient frontier for stocks, bonds, and bills during the 1933 to 2004 period. The former period begins with a Republican president, namely Herbert Hoover, while the latter period includes a Republican president beginning in 1953, Dwight D. Eisenhower. The same Democratic president, Franklin D. Roosevelt, is included near or at the outset of both long-term periods under investigation.

Not surprisingly, since the 1929 to 1932 stock market collapse occurred during a Republican president, the efficient frontier over the 1929 to 2004 period is largely inferior (not shown) to the Democrat frontier shown in Fig. 1. This reinforces our earlier observation that over the long run, Democratic administrations offer a broader set of risk reward opportunities than Republican administrations. That being said, it is interesting to note that the comparative frontiers shown in Fig. 2 point to an equal set of efficient combinations of stocks, bonds, and bills, with Democrats providing efficient portfolio opportunities at relatively high levels of risk tolerance (equities) and Republicans providing more efficient combinations of stocks, bonds, and bills at relatively lower levels of risk tolerance.

This is evidenced in Fig. 2, covering the 1933 to 2004 period, at the point of intersecting frontiers (see portfolio five on both frontiers at about 10% standard deviation) with stocks comprising 36% of portfolio five on the Republican frontier and some 51% on the Democrat

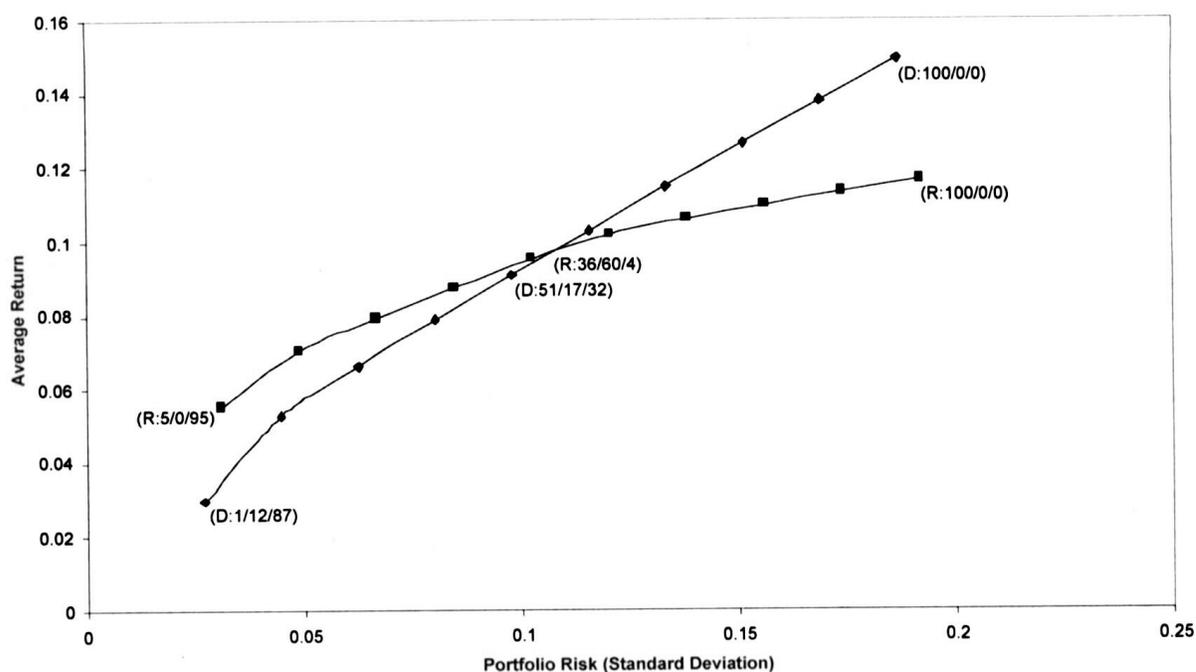


Fig. 2. Efficient frontier: % stocks/gov bonds/T-bills: Democrats (D) versus Republicans (R) 1933 through 2004.

frontier. Alternatively, portfolio five on the Republican frontier consists of 64% bonds and bills, while portfolio five on the Democrat frontier is comprised of 49% bonds and bills. This again points to higher and efficient equity allocations under Democrats and higher bond and bill allocations under Republicans.

On balance, the long-term efficient frontiers shown in Figs. 1 and 2 reveal that Democratic administrations provide investors with a broader (Fig. 1) -to-equal (Fig. 2) set of risk reward opportunities. The actual portfolio selected by investors is of course a matter of risk tolerance, with the idea that over varying presidential regimes investors hold a greater proportion of equities under Democratic administrations and a greater proportion of bonds and bills under Republican administrations.

3.4. A recent look at the efficient frontier by presidential party

In an attempt to assess the consistency of the long-term portfolio efficiency findings by presidential party, we provide a look at the efficient frontier over the past quarter century. The recent results are shown in Fig. 3. Fig. 3 spans two twelve-year periods of Democratic and Republican presidencies, including James E. Carter (1977–1980) to William J. Clinton (1993–2000) and Ronald Reagan (1981–1988) to George H. W. Bush (Bush I, 1989–1992). The figure presents a noticeably different asset allocation picture by presidential years over the past quarter century; particularly, the two twelve-year periods covering Carter–Clinton and Reagan–Bush I. While (as before) a stock-only portfolio provides better average returns under Democratic administrations, the Republican frontier dominates the Democrat frontier over a bond-stock allocation range that diversified investors might actually choose.

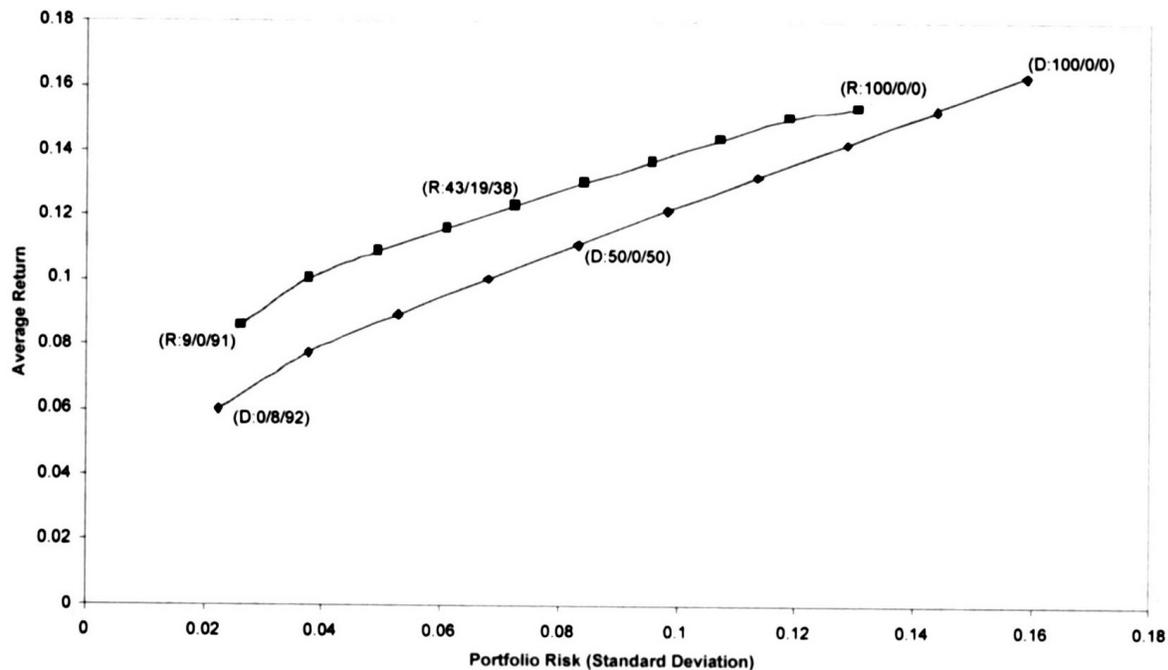


Fig. 3. Efficient frontier: 12-year periods Democrats (D) (Carter–Clinton) versus Republicans (R) (Reagan–Bush I) % stocks/gov bonds/T-bills.

Indeed, Fig. 3 shows that along the 5–80% stock component of the Democrat frontier, the corresponding Republican mix of stocks, bonds, and bills provide a better risk-reward tradeoff. Hence, when comparing portfolio frontiers under Democratic and Republican presidents over the past quarter century, we see somewhat of a reversal of fortunes, wherein the Democrat frontier provides relatively inferior investment opportunities, excepting at the extremes of risk tolerance such as 90–100% equities and less than 5% equities.⁷

A closer inspection of Fig. 3 reveals that the source of improved portfolio opportunities under Republican administrations over the past quarter century begins with the large average return difference, at 8.07% (14.37–6.3%), on government bonds under Republican versus Democratic administrations. This has the effect of positioning the Republican frontier at a higher starting point in the presence of a relatively small spread between large company stock returns under Democrats and Republicans. From a risk management (diversification) perspective, this is reinforced by a large negative correlation among stocks and bills under Republicans, despite the fact that bonds and stocks are still more highly correlated under Republican administrations.

Specifically, Panel B of Table 2 shows a continuing lower correlation between returns on long-term government bonds and large-company stocks under Democrat presidents, at 0.20, versus a higher correlation under Republican presidents, at 0.60. Also, the correlation between government bond and T-bill returns is noticeably lower, at -0.27 and 0.05 , under Democratic versus Republican presidents. However, Panel B of Table 2 shows that the correlation among stocks and bills is -0.27 versus 0.26 under Republican versus Democratic administrations. With a relatively higher average return on bonds and bills under Republicans (starting point), this gives Republican administrations a portfolio edge over the past

quarter century because the curvature in the Republican frontier is at least the same if not greater than that observed in Fig. 3 for the Democrat frontier.

4. Empirical results: value versus growth

To further investigate the opportunities for tactical asset allocation around U.S. presidential elections, we examine another return phenomena segmented by presidential party, notably, the value stock (style) premium. In this context, it is well known [for examples, see Fama & French (1992) and Grant (1995)] that “value” stocks with high book-to-price ratio and/or high dividend yield have outperformed the low yield “growth” stocks over long periods of time. The portfolio style question that we address is whether the value stock premium is a phenomenon of Democratic or Republican administrations.

The idea that value stocks might outperform growth stocks under Republican administrations is consistent with a public (or media) perception that Republicans cater to the financial needs of large- and well-established companies (often referred to as “Old Economy” companies) while Democrats cater to large- and small-growth-oriented companies (so-called “New Economy” companies). Moreover, if Republicans do provide better returns on bonds and bills, then companies having “fixed income” characteristics (such as high dividend-paying and/or tangible-asset value stocks) would show relatively better performance than growth stocks under Republican administrations. In turn, if Democrats are more pro-active on the growth side, then stocks of large- and small-growth companies would be expected to perform better under Democratic administrations.

As emphasized before, we believe that the TAA decision should be examined in the context of annualized returns (a reflection of wealth accumulation) and own volatilities and correlations (a reflection of risk and diversification opportunities). In this regard, Fig. 4 presents two value-style portfolio frontiers, each based on 12 years of Democratic and Republican presidencies; specifically, Reagan–Bush I from 1981 to 1988 and 1989 to 1992, and Carter–Clinton from 1977 to 1980 and 1993 to 2000. Each frontier is constructed using portfolio inputs (average returns, standard deviations, and correlations) for large-company value stocks, long-term government bonds, and T-bills over the past quarter century.

While the average return on value stocks is about the same for Democratic and Republican presidents, Fig. 4 shows that a style-based mix of value stocks, bonds, and bills favors the Republicans. That is, over the past quarter century, the risk-reward tradeoff is everywhere better under Republican administrations than under Democratic ones; specifically, Reagan–Bush I versus Carter–Clinton.

Upon combining our asset allocation findings in recent decades, Figs. 3 and 4, we see that Republican presidents have not only provided better portfolio tradeoffs in a range of stocks, bonds, and bills that diversified investors might actually choose (Fig. 3), but they have also provided better opportunities in a world where value “wins.” Again, the efficient frontier improvement under Republican administrations over the past quarter century seems because of the large difference in average returns on government bonds under Republican (Reagan–Bush I) versus Democratic administrations (Carter–Clinton) and the relatively lower correlation between value stocks and T-bills.

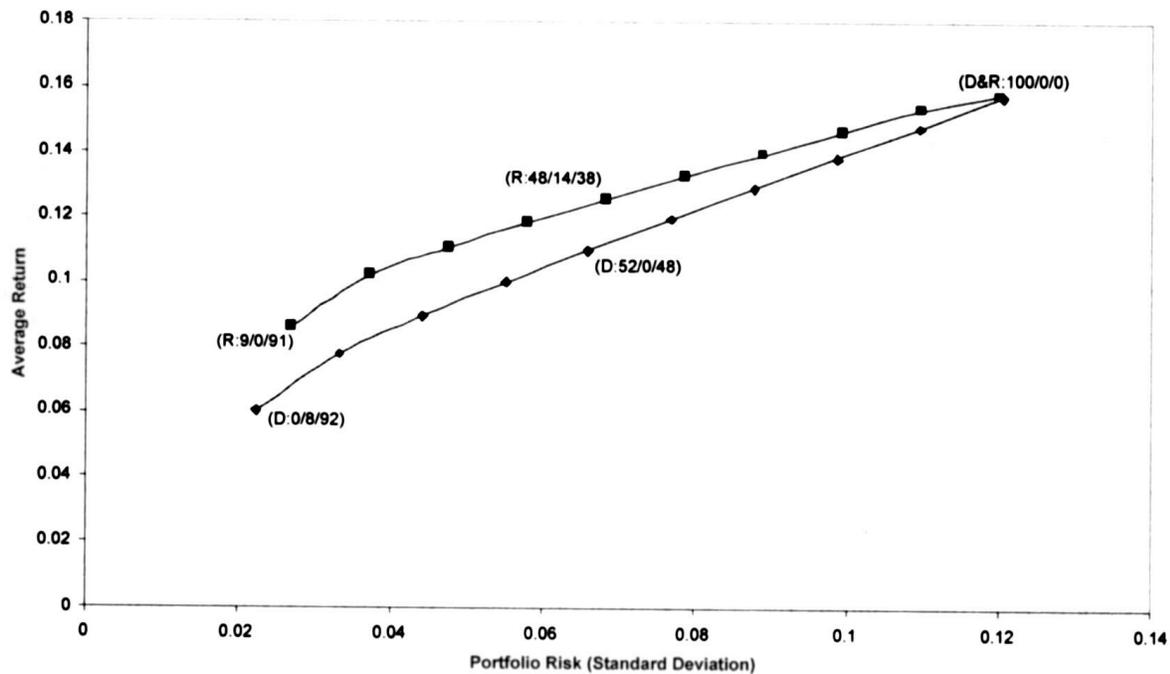


Fig. 4. Efficient frontier: 12-year periods Democrats (D) (Carter–Clinton) versus Republicans (R) (Reagan–Bush I) % value stocks/gov bonds/T-bills.

This risk management argument is offset by a slightly higher correlation in asset returns for large-cap value stocks and government bonds under Republicans than Democrats (0.53 vs. 0.50) and the higher correlation in government bonds and bills under Republican versus Democratic administrations that we noted before in Panel B of Table 2. However, the correlation between value stocks and bills under Republican administrations is noticeably lower than the correlation among value stocks and bills under Democratic administrations, at -0.18 and 0.24 , respectively.

Another consideration on the question of asset returns, presidential elections, and TAA is industry effects, which investors may interpret as a subclassification of equity style. That active investors should be concerned with industry-based considerations around presidential elections is supported by Kim (2004) and Knight (2004). In this context, Knight finds that during the 2000 presidential election the stock prices of Bush II (George W. Bush) favored firms and industries performed better than Gore-favored firms and industries when the probability of a Bush victory went up. For example, tobacco stocks went up during a prospective Bush victory (where probabilities were assessed from political futures prices on the Iowa electronic market), while the stocks of Microsoft competitors and alternative energy sources went down.⁸ While further industry research is necessary, the alpha-generating results around U.S. presidential elections seem promising.

5. Summary and conclusion

While several prior studies have examined returns on large company stocks and other asset classes around presidential elections, none have utilized a mean-variance efficient

frontier approach. We utilize a mean-variance framework and find that the efficient frontier is sensitive to the time period, with Democrats providing a broader (to equal) set of portfolio opportunities over the long run, while Republicans have provided a more efficient set over the past quarter century in an asset allocation range typical of diversified investors. When segmenting the value stock (style) premium over the past quarter century by political party, we find that Republicans provide a better risk-reward tradeoff over Democrats when looking at portfolio combinations of value stocks, bonds, and bills. This equity style result should be of interest to active investors relying on past relations between U.S. presidential elections and asset prices to make TAA decisions.

As with most studies of past performance and relations in capital markets, these results and their implications for investors should be taken with some caveats. Investors should keep in mind the familiar adage that past performance is not necessarily an indicator of future results; in our case, *ex post* efficient frontier analyses need not imply similarly-positioned *ex ante* return and risk management (diversification) opportunities.

Our results on efficient frontiers, shown in Figs. 1 through 4, span multiple time periods and suggest shifting frontiers over different periods. The data in Figs. 3 and 4 spans the past quarter-century, covering two Democratic administrations (Carter–Clinton) and two Republican administrations (Reagan–Bush I). The efficient portfolio opportunities under Republican presidents seem largely because of the relatively high average returns on bonds and bills, giving the Republican frontier a higher starting point in average return versus risk space. Asset return correlations (large-company stocks and government bonds and government bonds and T-bills) are generally lower under Democratic administrations, suggesting better diversification opportunities under Democrat presidents, but this risk benefit is mitigated by the fact that return correlations among stocks and bills are generally lower under Republican presidents. Given the noted differences between the long-term and the more recent results, investors should be cautious when interpreting these results and projecting future results.

In practice, investors seeking tactical asset allocation opportunities should consider the results of presidential elections, tempered by traditional factors such as the time period and other well-known market phenomenon. Future research opportunities include monitoring these return and portfolio effects over time and exploring further intricacies of TAA opportunities around presidential elections. It may also be worth extending this type of political portfolio analysis to other economies.

Notes

1. TAA is generally viewed as a temporary departure from a long-term or strategic asset allocation mix of assets to take advantage of perceived market inefficiencies. Since presidential elections, the focus of our study, are largely independent of investors' long-term planning horizons, we employ TAA terminology when describing the asset allocation implications of the four-year presidential election calendar. For a more institutional view of tactical versus strategic asset allocation, see Anson (2004). He argues that strategic asset allocation is the domain of investment committees (pension

- funds, endowments, foundations) and is beta generating, while tactical asset allocation is the domain of investment managers and is alpha generating.
2. We employ traditional equity style labels for value and growth stocks. However, we recognize that equity style is, in more fundamental terms, a reflection of sector or industry characteristics. We are aware of other equity style interpretations such as the economic profit (EVA) approach (Abate, Grant & Stewart, 2004), which defines the “style” of a company by its fundamental ability to create wealth.
 3. Other studies have focused on predicting the results of presidential elections. See, for example, Renshaw and Trahan (1990, 1991) and He, Renshaw and Szelest (1998), using economic data, Knight (2004), using election futures listed on the IOWA electronic market (see www.biz.uiowa.edu/iem), and Li and Born (in press), using polling data. Li and Born find that uncertainty over election outcomes impacts stock market returns and volatility.
 4. Johnson and Chittenden (1999) examine the 1929–1996 period but do not examine any subperiods within this time.
 5. While our discussion proceeds as if the direction of causality runs from presidential election cycles (or the party in office) to asset returns, we recognize that returns around presidential elections may be impacted by other economic and monetary influences along the lines suggested by Beyer et al. (2004). We cannot be certain of the direction of causality, i.e., are higher T-bill returns in Republican administrations a result of the new administration, or is the administration in power because of low interest rates (recession) before the previous election? We examine T-bill returns under Democratic and Republican administrations (similar to Table 1) but by lagged party, i.e., which party was in power before the election. The results (available upon request) are generally consistent and weaker than the results reported in Table 1.

Additionally, we examine the differences in T-bill returns segmented by whether or not the incumbent party was reelected, for both years subsequent to the election and lagged years. The results again are generally weaker than the results reported in Table 1. T-bill returns are slightly higher subsequent to elections when the incumbent party is not reelected for the 1929 to 2004 period and are not significantly different for any subperiods. Lagged returns are significantly higher when the incumbent party is not reelected. Taken together, the strongest differences in T-bill returns are for Republicans over Democrats in the four years following elections, suggesting that Republican administrations generate higher returns on T-bills. We thank an anonymous referee for suggesting these additional tests.

6. In this section, we use total return data from Ibbotson Associates since inception in 1926 through the 2004 election.
7. Without getting into Sharpe ratio details, it seems apparent in Figure 3 that any reasonable risk-free rate of interest over a planning horizon, say 10, 15, or 20 years, would result in a capital market line (CML) that favors Republican presidents. Depending on the intercept, the longer-term CML for Democrat and Republican administrations could have mixed results in Figures 1 and 2, while a capital market line in Figure 4 (discussed shortly) would favor Republicans.

8. As a more historical example, the Reagan Revolution (1981–1988) heralded a period of deregulation of industries, falling inflation, and rising business and consumer confidence. The abnormal rise in stock prices that occurred during the Reagan tenure was joined with the downsizing/restructuring of large industrial companies that constitute “Corporate America.” In turn, the above-average return on stocks that occurred during the Clinton years (1992–2000) was associated with companies that benefited from deregulation of the financial services and telecommunications industries, along with new-age growth opportunities in the technology sector.

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