Presidential Politics, Stocks, Bonds, Bills, and Inflation

Some new differences identified.

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Journalists often link stock market performance and the party affiliation of the President of the United States, but the notion that the stock market performs better during Republican than Democratic administrations has been dispelled by a number of studies (see Huang [1985], Niederhoffer, Gibbs, and Bullock [1970], Siegel [1998], and Smith [1992]). These studies present evidence that long-term stock market returns are not significantly different in Republican or Democratic administrations.

We extend this research in three ways. First, we examine the returns to several alternative asset classes. Specifically, we employ two alternative stock indexes, a large-stock and a small-stock index, and several different debt indexes. The published analyses focus on the equity market and, in particular, large stock indexes. Second, both nominal and real returns are examined to determine the influence that inflation has on the results. Considering the influence of inflation is important, given that alternative economic policies influence the inflation rate. Finally, we update previous research and consider the elections through 1996.

PREVIOUS EVIDENCE

Several studies examine the short-term stock market performance surrounding a presidential election, and find support for the view that the market prefers the election of a Republican president. For example, Niederhoffer, Gibbs, and Bullock [1970] report that in the days

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and weeks following Republican presidential victories the stock market fares much better than following Democratic victories. Riley and Luksetich [1980] find consistently positive cumulative average residuals for the stock market in the weeks following the election of a Republican president, while they find consistently negative cumulative average residuals after a Democratic victory. Reilly and Drzycimski [1976] and Siegel [1998] support these results.

Researchers have also examined the relationship between longer-term stock market performance and presidential elections. These studies have generally tested for two different types of stock return patterns — election cycle return patterns and presidential party return patterns. The rationale for the election cycle patterns is that incumbents have an incentive to stimulate the economy prior to an election.

For example, Stovall [1992] suggests that the Federal Reserve may be more accommodating and apply an "easier" monetary policy prior to an election. Allvine and O'Neill [1980] find that from 1948 to 1978, S&P 400 returns averaged 0.6% and 0.7% for the first and second years of a presidential administration, but 22.1% and 9.2% for the third and fourth years. Huang [1985] reports similar patterns for the 1832 through 1979 period.

Tests for differences in returns based on the president's party affiliation are motivated by the claim that the economic policies of the president influence stock returns. In contrast to the analysis of short-term returns, the returns for these tests are measured during the president's actual time in office. This procedure avoids the influence of any movement in prices that is due to *anticipated* changes in economic policy.

Smith [1992] finds that between 1921 and 1991 average annual S&P 500 returns were 2.5% higher during Democratic administrations than Republican administrations. This difference, however, is not statistically significant. Stovall [1992] finds similar results for the period 1901-1992, as he reports that the average change in the Dow Jones Industrial Average during a Republican term was 30.5% versus 34.9% for a Democratic term. These results are generally consistent with the findings of Huang [1985].

DATA AND METHODOLOGY

We examine annual return data from January 1929 through December 1996. Returns are analyzed on the S&P 500, a small-stock index, long-term corporate bonds, intermediate- and long-term government bonds, and U.S. Treasury bills. The returns are obtained from *Stocks, Bonds, Bills, and Inflation* [1997].

This time period covers presidents elected in seventeen different elections, eight Republican and nine Democratic. The study period starts in 1929 because the Ibbotson data are available only from 1926, and we want to include data only for full four-year administrations.

In addition to nominal returns, we also present inflation-adjusted returns. If inflation is significantly higher during Democratic or Republican administrations, nominal returns do not properly reflect the real returns actually earned by investors.

Like Huang [1985], we present annual, calendar-year return data, corresponding to the years each presidential administration is in office. The returns do not, therefore, include any "announcement period" effect of an election result. We examine returns during actual presidential administrations in order to determine whether the findings support or refute the contention that the economic policies of an administration have an influence on the security markets.

RETURNS IN REPUBLICAN AND DEMOCRATIC ADMINISTRATIONS

Exhibit 1 presents mean annual returns for six asset classes and inflation. Both parametric (t-test) and nonparametric (Wilcoxon) test results are reported for the differences in returns. The S&P 500 return is considerably higher during Democratic administrations, although the tests indicate that this return difference is not statistically significant. Such a finding has led researchers to conclude that there are no stock return patterns associated with the party affiliation of the president.

The results for the small-stock index, however, indicate that returns to small-cap stocks are substantially higher during Democratic administrations. The returns to small stocks are over four times higher in Democratic than Republican administrations, and the annual return difference is over 20 percentage points. This difference is both economically and statistically significant.

Contrary to the findings for the equity indexes, the returns for the debt indexes are markedly higher during Republican administrations. The returns to the debt indexes are over twice as high during Republican than Democratic administrations, with annual return differences of approximately 5 percentage points for the intermediate- and long-term bond indexes.

While the return differences are much smaller in

EXHIBIT 1
UNADJUSTED PARTY RETURNS (AVERAGE ANNUAL RETURNS)

Index	Party	N	Nominal Return (%)	Percentage Point Difference	Parametric t-Statistic	Wilcoxon Test Statistic
S&P 500	Democratic	36	14.55	5.70	1.167	–1.161
	Republican	32	8.85			
Small Stocks	Democratic	36	27.20	20.58	2.538**	–2.451**
	Republican	32	6.62			
Long-Term Corporate Bonds	Democratic	36	3.65	–4.92	–2.360**	2.119**
	Republican	32	8.57			
Long-Term Government Bonds	Democratic	36	2.95	–5.30	–2.410**	2.156**
	Republican	32	8.25			
Intermediate-Term Government Bonds	Democratic	36	3.23	–4.68	–3.548***	3.213***
	Republican	32	7.91			
U.S. Treasury Bills	Democratic	36	2.52	–2.74	–3.693***	3.821***
	Republican	32	5.26			
Inflation	Democratic	36	4.03	1.30	1.181	0.068
	Republican	32	2.74			

N = Number of years.
***Significant at the 1% level.
**Significant at the 5% level.

absolute terms for the bond indexes than the stock indexes, the bond results are highly statistically significant due to the much lower variation in bond returns. Finally, inflation is higher during Democratic administrations, although the difference is not statistically significant.

The significance of the Wilcoxon test statistics strengthens the findings. The Wilcoxon test is robust to the presence of outliers, and hence indicates that the return differences are not the result of a few unusual observations. Instead, the evidence indicates that the returns to small stocks are consistently higher in Democratic administrations, while bond returns consistently dominate in Republican administrations.

The economic significance of the differences is further supported by the real returns reported in Exhibit 2. As with the nominal returns, the real (inflation-adjusted) stock returns are higher during Democratic administrations, while real debt returns are higher during Republican administrations. Again, the only non-statistically significant difference is in the S&P 500, and even here, real returns are almost twice as high during Democratic administrations. The mean real return on small stocks is 22.66% during Democratic administrations compared to only 3.70% during Republican administrations.

The most striking results in Exhibit 2 are the real returns to the debt market indexes during Democratic administrations. Once adjusted for inflation, *none* of the returns on debt are positive during Democratic administrations. Thus, the average real return realized by a debt investor during Democratic presidencies is *negative*, while positive real returns are earned during Republican administrations.

Exhibit 3 reports the mean annual returns for each half of a presidential term. The return results for the S&P 500 are similar to those reported by Allvine and O'Neill [1980] and Huang [1985]. That is, stock returns for the last two years of presidential terms are higher than during the first two years. The non-parametric test indicates that the difference is statistically significant; the parametric test statistic is not significant. This same pattern prevails in both Republican and Democratic administrations, although the difference is greater and more significant during Democratic administrations.

While small-stock returns are considerably higher during the last half of a presidential term, the return differences are not significant in the overall sample or for either party. In contrast to the equity returns, returns on debt instruments tend to be higher during the first two years of presidential terms, although the differences are not statistically significant.

EXHIBIT 2
INFLATION-ADJUSTED PARTY RETURNS (AVERAGE ANNUAL RETURNS)

Index	Party	N	Real Return (%)	Percentage Point Difference	Parametric t-Statistic	Wilcoxon Test Statistic
S&P 500	Democratic	36	10.43	4.49	0.920	–0.940
	Republican	32	5.94			
Small Stocks	Democratic	36	22.66	18.96	2.373**	–2.316**
	Republican	32	3.70			
Long-Term Corporate Bonds	Democratic	36	–0.12	–6.00	–2.530**	2.476**
	Republican	32	5.88			
Long-Term Government Bonds	Democratic	36	–0.80	–6.36	–2.558**	2.347**
	Republican	32	5.57			
Intermediate-Term Government Bonds	Democratic	36	–0.58	–5.77	–3.595**	3.133***
	Republican	32	5.19			
U.S. Treasury Bills	Democratic	36	–1.34	–3.90	–4.329***	3.619***
	Republican	32	2.57			

N = Number of years. The inflation-adjusted return is calculated as (1 + nominal return)/(1 + inflation rate) – 1.
***Significant at the 1% level.
**Significant at the 5% level.

EXHIBIT 3
UNADJUSTED PRESIDENTIAL HALF-TERM RETURNS (AVERAGE ANNUAL RETURNS)

Index	Party	N	Years 1 and 2 Nominal Return (%)	Years 3 and 4 Nominal Return (%)	Percentage Point Difference	Parametric t-Statistic	Wilcoxon Test Statistic
S&P 500	Overall	34	7.89	15.84	–7.96	–1.647	–1.883*
	Democratic	18	9.30	19.80	–10.49	–1.717*	–1.566
	Republican	16	6.30	11.40	–5.10	–0.666	–1.150
Small Stocks	Overall	34	12.03	23.01	–10.98	–1.312	–1.601
	Democratic	18	23.63	30.78	–7.15	–0.600	–0.870
	Republican	16	–0.01	14.27	–14.28	–1.422	–1.526
Long-Term Corporate Bonds	Overall	34	6.48	5.45	1.03	0.478	0.031
	Democratic	18	3.96	3.34	0.61	0.301	0.395
	Republican	16	9.32	7.82	1.51	0.390	–0.358
Long-Term Government Bonds	Overall	34	6.19	4.70	1.49	0.652	0.619
	Democratic	18	3.21	2.68	0.53	0.221	0.617
	Republican	16	9.54	6.97	2.57	0.663	0.094
Intermediate-Term Government Bonds	Overall	34	5.88	4.98	0.90	0.628	0.619
	Democratic	18	2.85	3.61	–0.76	–0.626	–0.633
	Republican	16	9.29	6.53	2.76	1.134	0.660
U.S. Treasury Bills	Overall	34	3.96	3.66	0.30	0.373	0.270
	Democratic	18	2.04	3.00	–0.96	–0.998	–0.728
	Republican	16	6.12	4.40	1.72	1.545	1.413
Inflation	Overall	34	3.97	2.89	1.08	0.983	0.196
	Democratic	18	4.15	3.92	0.23	0.152	0.000
	Republican	16	3.76	1.72	2.04	1.258	0.886

N = Number of half-term periods.
*Significant at the 10% level.

CONCLUSIONS

Our results have some implications for portfolio management. While previous researchers find no difference in the performance of the stock market under Democratic or Republican administrations, these studies confine themselves to indexes of large-capitalization stocks. We confirm that the returns to large-cap stocks are not statistically different in Republican or Democratic administrations. Our findings, however, indicate that the returns to small-cap stocks are substantially higher during Democratic administrations. The returns to small stocks during Democratic administrations are over four times higher (an annual return difference of about 2,000 basis points).

Our study also extends the research by investigating the performance of the bond market in different party administrations. In contrast to the equity results, the returns to the bond indexes are shown to be significantly higher during Republican administrations. All maturities of bonds are shown to provide returns that are over twice as high during Republican versus Democratic administrations. Furthermore, once the returns are adjusted for inflation, we show that the real returns to all the bond indexes are negative during Democratic administrations, but quite positive during Republican administrations.

We also reexamine the relationship between stock returns in the first and the second halves of presidential terms. Our findings generally support prior research that shows that stock returns are significantly higher in the second half of the term. The return differences persist across parties, but are stronger during Democratic administrations. Finally, we find no statistically significant differences in bond returns between the first and the second halves of presidential terms.

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