

# **PARTISANSHIP, POLITICS AND IMPLICATIONS FOR INVESTORS**

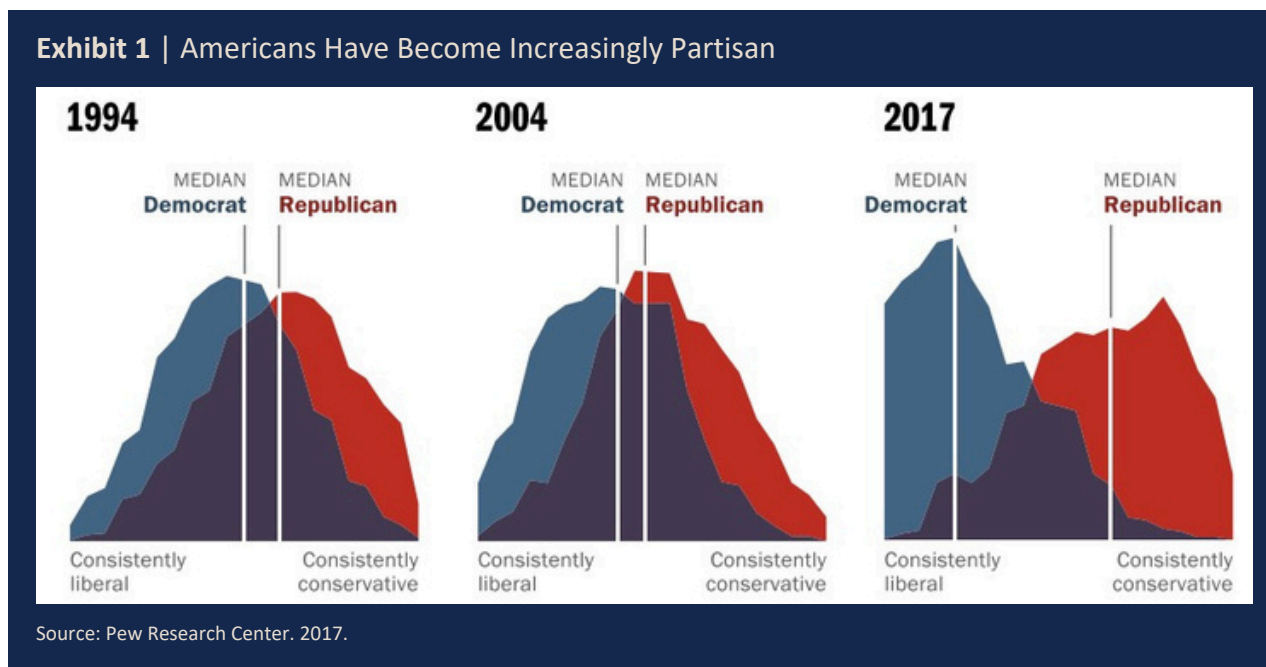
**UC San Diego**  
RADY SCHOOL OF MANAGEMENT  
The Brandes Center

by Barry Gillman, CFA

“Are Republican or Democratic values important in valuing an investment asset?” asked Dr. Joey Engelberg, Professor of Finance at UC San Diego’s Rady School of Management, when presenting his new and timely research to The Brandes Center Advisory Board in September 2024.

Presumably not, he noted, otherwise you’d expect to see this topic on the CFA exam syllabus! However, research shows that increasingly, the widening divide in the U.S political spectrum is impacting financial behavior, and possibly how investors are regulated.

Engelberg cited Pew Research voter surveys that provide clear evidence of the polarization between Democrats and Republicans, especially since 2004. See Exhibit 1.



He pointed out that not only has the gap between their political values widened significantly, but it’s getting personal.

“Republicans and Democrats increasingly don’t like each other,” said Engelberg, noting that thirty years ago, around one-fifth of Democrats and Republicans reported “very unfavorable” views of people supporting the other party but in the latest survey (2022) that proportion had risen to over a half (62% of Republicans and 54% of Democrats held very unfavorable views of each other).

Readers on both sides of the aisle may have personally experienced this animosity. Engelberg cited an intriguing 2016 study by Chen and Rohla that aimed to measure the time spent on Thanksgiving Day with friends and family, and how it was influenced by political views.

Combining cell-phone location data and voter rolls, they found that Thanksgiving Day visits into “opposition territory” were notably shorter (by an average 40 minutes) than visits to family and friends in locations that shared the same political values.

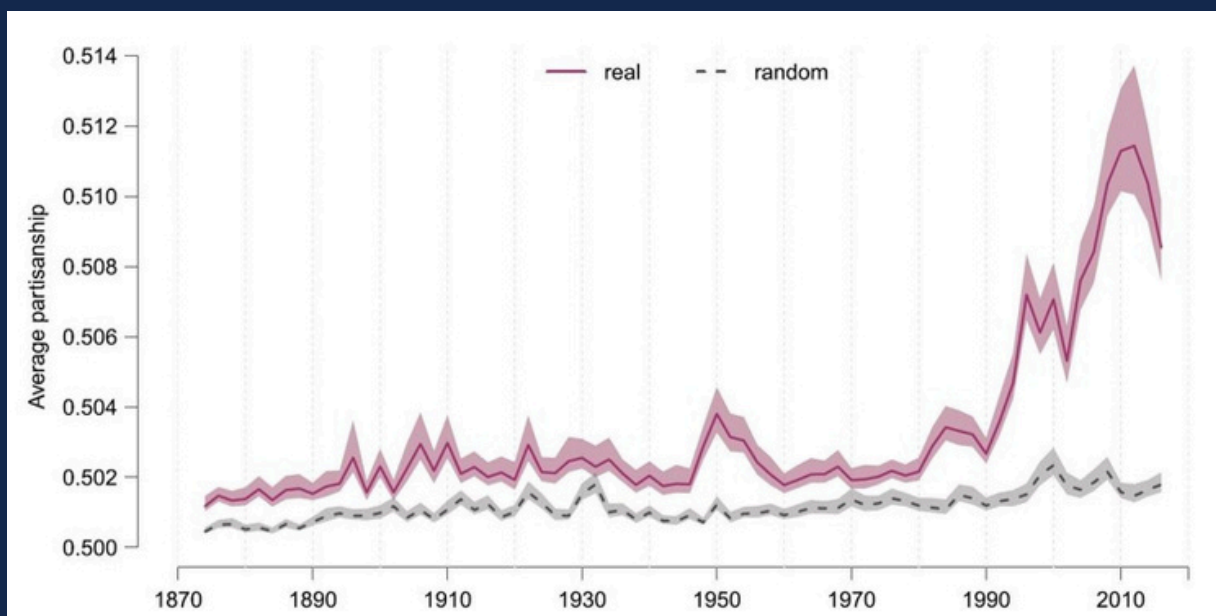
And it’s not just a difference of views that divides the parties. Engelberg explained that Democrats and Republicans actually speak differently. Specifically, he noted there are some phrases that are much more popular with Democrats and others used more by Republicans.

As a result, language technology analysis can figure out from the phrases used (for example in a speech or conversation) whether that person is likely a Democrat or Republican.

Some of these phrases may reflect the topics that each party likes to discuss (e.g., “climate change” and “public health” figure often in Democrat speeches, and “American energy” and “government spending” often feature in Republican ones).

But on some emotive issues, it’s the actual phrasing that changes. Engelberg noted that whereas Democrats typically might refer to “estate tax,” Republicans may use “death tax” for the same topic. It's now possible to measure these differences over time by analyzing records of political speeches. The results confirmed a dramatic increase since 1990 in the polarization between political viewpoints. See Exhibit 2.

**Exhibit 2 | Partisanship as Measured by Language Has Risen Sharply**



Source: Gentzkow, Shapiro and Taddy. 2019. The 'real' series is from actual data and the 'random' series is from hypothetical data in which each speaker's party is randomly assigned with the probability that the speaker is Republican equal to the average share of speakers who are Republican in the sessions in which the speaker is active. The shaded region around each series represents a pointwise confidence interval.

Engelberg discussed how these partisan divides also show up in investor opinions. He explained that since 1990, voters' views on whether the economy is favorable have been strongly influenced by whether "their party" is in power, and these opinions appear to shift quickly immediately after one party loses a Presidential election.

Additionally, a 2015-2020 study showed Partisan Republicans became more bullish on US equities than others after the 2016 election, and maintained this stance, especially at the start of the COVID-19 pandemic. See Exhibit 3.

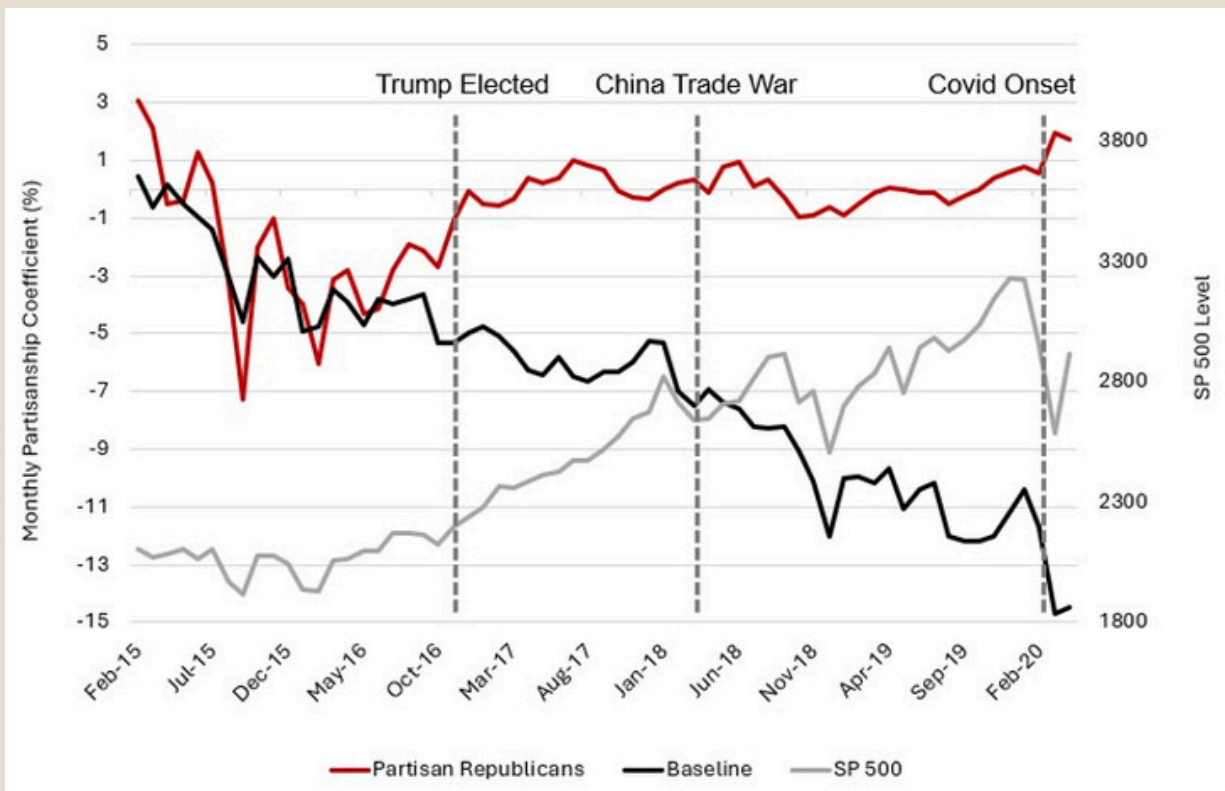
In the study cited in Exhibit 3, Partisan Republicans were identified by language analysis of their social media postings on the stock market.

The red and black lines contrast the relative bullishness of those Partisan Republicans versus all others posting similarly. The coefficient on the left axis is indicative of optimism when above zero, and pessimism below zero.

The gap between Partisan Republican optimism and the pessimism of all others widened after the 2016 election and persisted into 2020. Notably, that gap widened further at the onset of the COVID pandemic in early 2020.

Engelberg separately noted that partisan divides also impact activity. Individuals are relatively more likely to start new businesses or to file for new patents when the party they support is in power.

**Exhibit 3 | Partisan Republicans: More Optimistic About US Equities in 2016 Through Early 2020**



Source: Cookson, Engelberg and Mullins. 2020.

His research also raised a cautionary note about the structure of financial regulation in the United States. The language analysis used in studies of political speeches can also be used in other spheres, including examining public pronouncements by financial regulators. He contrasted the SEC Commissioners and the Governors of the Federal Reserve. Both bodies are designed to be independent, with time-tested protections built in to protect from political interference.

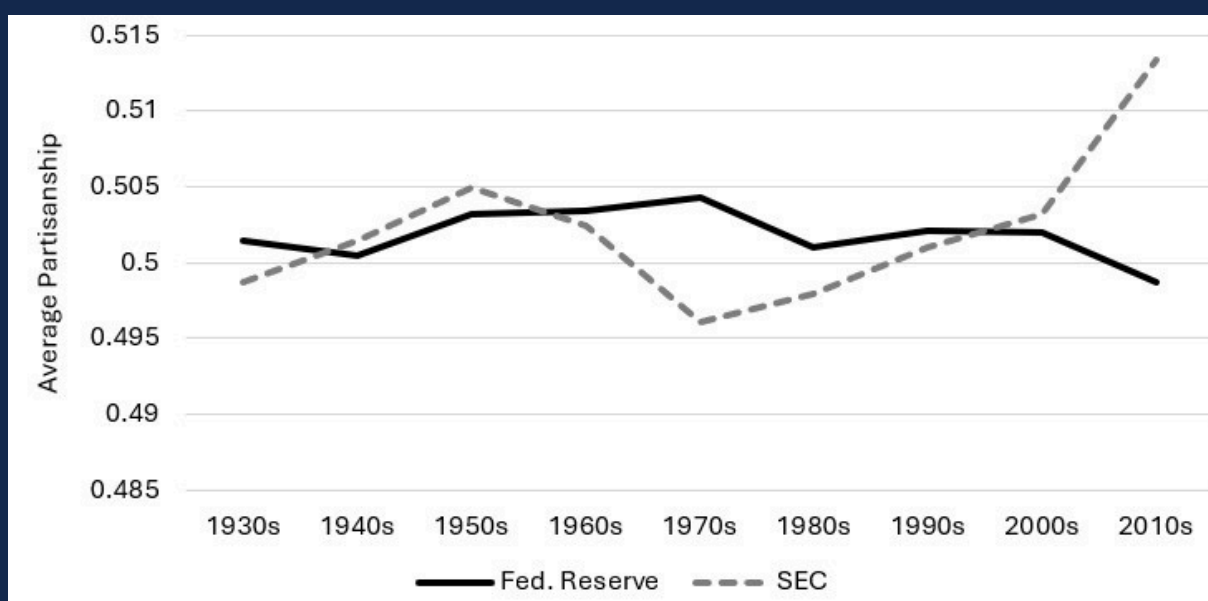
Engelberg quotes former SEC Commissioner A.A. Sommers in a 1996 speech, “Had anyone sat through every meeting while I was on the Commission, that person could never have told which of the Commissioners were Republicans and which were Democrats.” He notes that this is no longer the case, asking, “To what extent do financial regulators sound like politicians?”

Based on Exhibit 4, Sommers’ comments are still true of the Fed Governors, with no sign of political partisanship. But the SEC Commissioners show a different picture, with partisanship at an all-time high.

Engelberg notes that this has led to more dissenting opinions along party lines. Given that there are five SEC Commissioners, he notes that in more than 95% of recent 3 to 2 decisions, the dissenting two have been from the same party.

At this important time in the election cycle, Engelberg’s work offers a broader, cautionary lesson on how political partisanship has increasingly shaped *investment* views and decisions.

**Exhibit 4 | Partisanship Among SEC Commissioners at All-Time High Since the 1930s**



Source: Engelberg, Henriksson, Manela and Williams. 2023

Investors are accustomed to taking political forces into account when making investment decisions, whether in pursuit of returns or in risk management. However, Engelberg's research documents the increasingly partisan nature of politics and regulatory structures.

We suspect this is already resulting in an injection of more emotional content into many of those investor decisions. We have long held the view that allowing emotion to dominate rational analysis can lead to expensive mistakes in an investment context.

The 2024 Presidential election will soon be history, but it seems likely that the lessons from the research will continue to be relevant well into the future.

## References

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