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PRESIDENTIAL POWER AND STOCK RETURNS

Abstract:

Recent studies highlight positive effect of political connections on firm performance and stock returns. This paper shows that the positive effect of political connections on the cross-sectional stock returns disappears in the weak presidency period, defined as the last two years before the presidential party change, or period of low job approval ratings. The extent of the presidential party's control over the Congress does not affect our main result. The result is driven by small firms, who typically do not have financial resources to hedge away political risks, and by the firms located in the states where residents more strongly support the president. Additional test suggests that the industries that rely on heavy government expenditure use a variety of political strategies to maintain the value of their political capital even during the weak presidency period.

Keywords:

Political geography; political connections; policy risk; returns; performance; Presidential Power; Presidential job approval rating

JEL Classification: G10, G11, G14