Aalto University
School of Economics

Master's Programme in Master's Programme in Finance

Beyond Individual Connections

Coordinated Political Activity Between Hedge Funds and Portfolio Firms

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Master's Thesis
2025

Aalto University
School of Economics

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Title Beyond Individual Connections — Coordinated Political Activity Between Hedge Funds and Portfolio Firms

Degree programme Master's Programme in Finance

Major Finance

Supervisor and advisor Prof. Juha Joenväärä

Date 24 June 2025 **Number of pages** 36+1 **Language** English

Abstract

This thesis examines whether political connections provide measurable financial benefits to hedge funds and the companies whose stocks they hold. Using a comprehensive dataset of political contributions from 1998 to 2022, matched with quarterly 13F holdings and hedge fund performance data, I investigate whether stocks of politically active companies and funds achieve superior returns. I introduce a novel approach by analyzing joint political activity between hedge fund management companies and the firms whose stocks they hold.

Cross-sectional portfolio analysis shows that stocks of politically connected companies generate 54 basis points higher annual returns than stocks of non-connected companies. However, panel regressions that examine individual companies over time while controlling for company and time fixed effects show negative coefficients. This suggests that within-company variation in political activity may reflect strategic engagement during difficult periods rather than value creation. The contradiction between cross-sectional and time-series results likely reflects selection effects, where larger, growth-oriented companies are more likely to engage politically for reasons unrelated to the connection benefits themselves.

The main findings from this thesis are that political connection effects are concentrated among smaller companies and disappear when controlling for company size, the intensity of political donations does not affect stock returns, suggesting threshold rather than continuous benefits, and there is limited evidence for coordination synergies when both hedge fund management companies and portfolio companies are politically active.

Keywords Political Connections, Hedge Funds, 13F Holdings, Returns, Political Activity

Aalto-yliopisto
Kauppakorkeakoulu

Tekijä Elias Huttunen

Työn nimi Koordinoitu poliittinen toiminta hedge-rahastojen ja portfolioyhtiöiden välillä

Koulutusohjelma Rahoituksen maisteriohjelma

Pääaine Rahoitus

Työn valvoja ja ohjaaja Prof. Juha Joenväärä

Päivämäärä 24.6.2025 **Sivumäärä** 36+1 **Kieli** englanti

Tiivistelmä

Tämä tutkimus tarkastelee, tarjoavatko poliittiset yhteydet taloudellisia hyötyjä hedge-rahastoille ja niiden omistamille osakkeille. Tutkimus käyttää kattavaa aineistoa poliittisista lahjoituksista USA:ssa vuosilta 1998–2022, yhdistettynä 13F-omistustietoihin ja hedge-rahastojen tuottoihin. Tätä dataa käyttäen tutkin saavuttavatko poliittisesti aktiiviset yritykset ja rahastot parempia tuottoja. Käytän uudenlaista tapaa analysoimalla rahastojen ja niiden portfolioyhtiöiden yhteistä poliittista toimintaa.

Portfoliotason analyysi osoittaa, että poliittisesti verkostoituneet yritykset tuottavat 0.54% korkeampia vuosituottoja kuin ei-verkostoituneet yritykset. Paneelireggressiot, jotka kontrolloivat yritys- ja aikakohtaisia vaikutuksia, näyttävät negatiivisia kertoimia, mikä viittaa siihen, että yrityksen sisäinen vaihtelu poliittisessa aktiivisuudessa saattaa heijastaa strategista osallistumista vaikeina aikoina pikemminkin kuin arvonluontia. Tämä ristiriita eri metodeja käyttäen heijastelee todennäköisesti valikoitumisefektejä, joissa suuremmat, kasvuhakuiset yritykset osallistuvat todennäköisemmin poliittiseen toimintaan syistä, jotka eivät liity itse yhteyksien tuomiin hyötyihin.

Tämän tutkielman päälöydökset ovat: poliittisten yhteyksien vaikutukset keskittyvät pienempiin yrityksiin ja häviävät yrityksen kokoa kontrolloitaessa, poliittisten lahjoitusten intensiteetti ei vaikuta tuottoihin, mikä viittaa, että suhteet ovat tärkeämpiä kuin absoluuttinen lahjoitusten määrä, ja rajallinen näyttö koordinaatiosta, kun sekä yritykset että rahastot ovat poliittisesti aktiivisia.

Avainsanat Poliittiset yhteydet, Hedge-rahastot, 13F-omistukset, Tuotot, Poliittinen aktiivisuus

Contents

1 Introduction

Lockheed Corporation's stock price jumped 2.5% on September 2, 1983, the first trading day after Senator Henry Jackson's death, highlighting a truth about American politics and business: connections matter. The aerospace company, a consistent contributor to Jackson's successor Sam Nunn, saw its market value surge by millions in a single day. Meanwhile, Boeing, that had a long-standing relationship with Jackson as "The Senator from Boeing", experienced no abnormal stock movement Roberts (1990). While political influence has long been suspected to translate into financial gains, the mechanisms through which political relationships generate returns remain opaque. This opacity is particularly pronounced in the world of hedge funds, where sophisticated investors deploy vast resources to gain any informational edge—including political intelligence.

This thesis investigates whether political connections provide measurable financial benefits to both hedge funds and the stocks they hold in their portfolios. Specifically, I examine whether hedge fund management companies and the companies whose stocks they own coordinate their political activities to enhance investment returns.

Hedge fund managers constantly seek the highest returns possible, and they recognize that political connections represent a significant source of value for companies, particularly during periods of economic uncertainty Ovtchinnikov and Pantaleoni (2012). Financial contributions to political candidates constitute strategic investments that can lead to enhanced operating performance for specific industry clusters where elected officials wield substantial policy influence. This thesis examines whether political engagement provides measurable financial benefits to both hedge fund management companies and the companies whose stocks they hold, and whether these entities coordinate their political activities.

The value creation mechanism through political connections operates through two primary channels. First, companies leverage these relationships to influence future policy decisions that directly impact their industries. Industries operating in sensitive or highly regulated sectors, including firearms manufacturing, pharmaceuticals, and fossil fuels, utilize political relationships to shape legislation, secure government contracts, and obtain favorable regulatory outcomes. These influences frequently translate into competitive advantages and enhanced profitability Gao and Huang (2016).

Second, political connections serve as conduits for gaining privileged information about future political decisions, enabling informed trading strategies based on this knowledge Gao and Huang (2016). This advantage proves particularly valuable in the financial industry, where participants benefit from subsequent stock price movements. Hedge funds with political ties can anticipate policy shifts, allowing them to adjust their portfolios strategically to maximize returns.

The empirical analysis reveals that stocks of politically connected companies generate higher raw returns than stocks of non-connected companies, with connected companies earning 1.58 percent monthly compared to 1.48 percent for non-connected companies, representing a difference of 10 basis points per month. However, the relationship becomes more complex when examined through panel regressions that control for company and time fixed effects, where political connections show negative coefficients, suggesting that within-company variation in political activity may reflect strategic engagement during difficult periods.

When both a hedge fund management company and its portfolio companies are politically active, this intersection effect demonstrates strong annual performance averaging 1.37 percent compared to 1.09 percent for generally connected companies, though the evidence for coordination synergies in panel regressions remains mixed. The effects show important heterogeneity across company sizes and political parties, with connection benefits concentrated among smaller companies and significant asymmetries between Democratic and Republican affiliations.

This thesis investigates a fundamental question in finance: do political connections generate measurable financial benefits for hedge funds and the companies whose stocks they invest in? Using a comprehensive dataset spanning from 1998 to 2022, I examine whether political engagement through campaign contributions translates into superior stock returns. The analysis addresses three central questions. First, do political connections predict stock returns? I compare the returns of stocks where either the company or a hedge fund holding the stock is politically active versus stocks without such connections. Second, does coordination between companies and hedge funds enhance returns? I examine whether stocks experience superior performance when both the company and a hedge fund holding the stock are simultaneously politically active—what I term the intersection effect. Third, how do political connection effects vary across company characteristics and political parties? I analyze whether benefits differ across company size, over time, and between Republican versus Democratic political affiliations.

Hedge fund management companies are the entities that operate hedge funds and may themselves make political donations. A company is considered politically connected if either the company itself made political donations in the past 12 months, or a hedge fund management company holding that company's stock made political donations in the same period. The intersection effect captures cases where both the company and a hedge fund holding its stock are simultaneously politically active.

The empirical strategy employs two complementary approaches that examine different aspects of the political connection-return relationship. Portfolio analysis constructs monthly portfolios based on political connection status and compares returns across connected and non-connected stocks. This approach addresses whether, at any given time, stocks of politically connected companies outperform those of non-connected companies. Portfolio analysis captures the cross-sectional variation that an investor could exploit by selecting stocks based on political connection status. Panel regression analysis examines individual companies over time using panel regressions with company and time fixed effects. This approach controls for unobservable company characteristics and addresses whether, within the same company, periods of political activity predict better subsequent stock performance. Panel analysis isolates the causal effect of political connections by comparing the same company during politically active and inactive periods.

This research makes three important contributions to the literature. First, I provide the first systematic analysis of joint political activity between hedge fund management companies and their portfolio companies, introducing the novel intersection measure that captures simultaneous political engagement. Previous studies examine either corporate political contributions Cooper, Gulen, and Ovtchinnikov (2010) or hedge fund political activity Gao and Huang (2016) in isolation. Second, I document important heterogeneity in political connection effects across company size and party affiliation, revealing that benefits concentrate among smaller companies and vary significantly between Democratic and Republican connections. Third, I reconcile conflicting evidence between portfolio-level and company-level analyses by demonstrating how selection effects and strategic timing of political engagement can explain seemingly contradictory results. This methodological insight has implications for interpreting political connection studies more broadly.

The remainder of this thesis is organized as follows. Section 2 reviews the relevant literature on political connections in financial markets, hedge fund political activity, and coordinated political engagement. Section 3 describes the data sources, matching methodology, and variable construction. Section 4 presents the main empirical results. Section 5 discusses the economic significance of the findings, addresses robustness concerns, and explores alternative interpretations. Section 6 concludes and suggests directions for future research.

2 Literature review

2.1 Political connections in financial markets

The literature examining how political connections affect financial markets has evolved substantially in recent decades. Early research focused primarily on explicit political connections formed when politicians join corporate boards Faccio (2006) or when former government officials assume executive positions Goldman, Rocholl, and So (2009). These studies generally documented that political connections correlate with higher company valuations, particularly in countries with weak governmental oversight or elevated corruption levels Fisman (2001); Khwaja and Mian (2005); Ferguson and Voth (2008).

Contemporary research has expanded to consider implicit political connections formed through political contributions and lobbying activities, driven by improved data availability in the United States. Cooper, Gulen, and Ovtchinnikov (2010) demonstrate that corporate political contributions correlate favorably with future stock returns, while Brown and Huang (2020) present evidence that access to political decision makers associates with positive abnormal returns. Hill et al. (2013) similarly show that both corporate political contributions and lobbying expenditures correlate positively with future financial performance.

The mechanisms through which political connections create value operate through multiple channels. Value creation emerges from preferential access to government contracts Goldman, Rocholl, and So (2013), regulatory relief that reduces compliance burdens and augments profits Yu and Yu (2011), and access to government bailouts during financial crises Acemoglu et al. (2016). Tahoun (2014) corroborate this narrative by demonstrating that politicians' ownership stakes in companies influence government spending toward these companies, creating direct channels for political favoritism.

2.2 Hedge funds and political information

Research specifically examining hedge funds' political activities remains more limited compared to the extensive literature on corporate political connections. Gao and Huang (2016) provide comprehensive analysis demonstrating how hedge funds exploit political connections, showing that funds with lobbyist connections earn significant abnormal returns on politically sensitive stocks. This suggests that these funds gain access to valuable political information through their lobbyist networks.

Hedge funds face fewer regulatory constraints than other institutional investors, providing greater flexibility in their investment strategies and enabling them to capitalize more effectively on political connections. Hedge funds typically charge performance-based fees Agarwal, Daniel, and Naik (2009), creating strong incentives to maximize returns through all available channels. These funds often employ sophisticated strategies, including leverage and short selling, which amplify the value of any informational advantage.

Gargano, Rossi, and Wermers (2017) demonstrate that hedge funds systematically gather political information through Freedom of Information Act requests, maintaining advantages over other market participants even after the STOCK Act of 2012, which restricted congressional information sharing by lobbyists Gao and Huang (2016).

2.3 Coordinated political activity

Research examining how companies coordinate their political activities to maximize influence reveals important strategic considerations. Chakraborty, Evans, and Fahlenbrach (n.d.) demonstrate that companies within the same lobbying network coordinate their political contributions, effectively amplifying their collective influence beyond what individual companies could achieve. This coordination allows companies to bypass individual contribution limits, as supported by Fouirnaies and Hall (2018).

Coordinated lobbying efforts operate through professional lobbyists who represent multiple clients, creating information channels across companies. However, the literature contains a gap in documenting how different types of market participants—specifically hedge funds and the companies they invest in—might coordinate their political activities. This thesis addresses this gap by examining joint political activity between hedge funds and their portfolio companies, assessing whether such coordination enhances the returns to political connections.

While previous studies examine either corporate political contributions Cooper, Gulen, and Ovtchinnikov (2010) or hedge fund political activity separately, they fail to capture the strategic coordination between financial investors and their portfolio companies. The novel intersection measure in this thesis fills this gap by identifying instances where both a hedge fund management company and its portfolio company are simultaneously politically active within a 12-month window.

3 Research material and methods

3.1 Data sources and construction

This study integrates multiple comprehensive datasets to examine the relationship between political connections and financial performance. The primary data sources include quarterly institutional ownership data from WhaleWisdom, political contribution and lobbying data from OpenSecrets.org, hedge fund performance data from leading industry databases, and financial fundamentals from CRSP and Compustat.

Quarterly institutional ownership data derives from WhaleWisdom's compilation of mandatory 13F filings submitted to the Securities and Exchange Commission. Per SEC regulations, investment managers controlling over 100 million dollars in assets must file Form 13F, revealing their equity holdings. This provides comprehensive coverage of institutional ownership for publicly traded securities.

Political contribution and lobbying data originate from OpenSecrets.org, which maintains a comprehensive dataset of financial contributions made by companies and individuals to political candidates, political action committees, and 527 groups. Each political contribution record includes company-level identifiers such as Central Index Key codes and sector classifications, enabling precise integration with financial datasets. The dataset also encompasses lobbying expenditures, providing insights into direct policymaker engagement.

Hedge fund performance data comes from leading industry databases, including TASS, HFR, BarclayHedge, Eurekahedge, Morningstar, HFM, and PivotalPath. These databases provide comprehensive information on hedge fund performance, including returns, assets under management, and fund-level metadata. While some hedge fund performance data represents voluntary reporting and may suffer from reporting biases, many funds maintain strong incentives to disclose performance voluntarily to attract investors Cassar et al. (2018).

3.2 Data integration and matching process

Combining political donation data with financial market data requires careful matching across different data sources that use varying identifier systems and naming conventions. The integration process follows three main steps: exact identifier matching, name-based fuzzy matching, and manual verification of large donors.

When available, I use precise financial identifiers including CUSIPs, PERMNOs, and CIK codes to match companies across the political donations database and the 13F holdings data. This ensures accurate linkage for companies that appear consistently across databases.

For entities without common identifiers, I implement a name-matching algorithm using the Jaro-Winkler distance measure. This process standardizes entity names by converting to uppercase, removing punctuation, eliminating common corporate suffixes such as Inc., Corp., or LLC, and accounting for subsidiary relationships. For example, Apple Computer Inc. and APPLE INC would be recognized as the same entity despite formatting differences.

The analysis creates several categories of political engagement to examine different dimensions of political activity. Company Active indicates companies that made political donations in the past twelve months. Fund Active identifies hedge fund management companies that made political donations in the past twelve months. Connected represents stocks of companies where either the company or a hedge fund holding the stock is politically active. Intersection captures stocks of companies where both the company and a hedge fund holding the stock are politically active within the twelve-month window.

The twelve-month persistence window captures the lasting nature of political relationships. Political connections provide benefits that extend beyond the immediate donation period, as relationships with political figures and access to policy information typically persist for extended periods. For example, a company that donates to a senator in January may continue to benefit from that relationship throughout the year through ongoing access or favorable consideration of the company's interests.

A critical component of data preparation involves removing duplicate donations using unique DonationID identifiers while preserving the time series structure. This ensures that each political contribution appears only once in the analysis while allowing companies and funds to appear in multiple time periods, preserving the panel structure necessary for the empirical analysis.

3.3 Sample characteristics and coverage

Table 1 presents the overall characteristics of the sample following deduplication. The dataset comprises 2.67 million unique stock donation observations and 194,000 unique fund donation observations spanning the period from 1962 to 2022. A total of 10,279 unique stocks and 2,211 unique funds made political contributions during the sample period.

The temporal distribution of political donations reveals distinct patterns in political engagement over time. Table 2 presents the annual distribution of political donations from 2000 to 2022, illustrating these cyclical patterns corresponding to United States election cycles. This combined table merges the information from the previous Tables 2 and 3, showing both the donation activity and unique donor counts in a single comprehensive view.

Table 1: Sample Overview and Political Activity

Panel A: Sample Coverage		
	Stocks	**Funds**
Total Unique Donation Observations	2,671,415	193,995
Unique Entities Making Donations	10,279	2,211
Total Donation Amount	$46.0 billion	$3.5 billion
Average Donation Amount	$17,131	$18,238
Median Donation Amount	$1,000	$1,000
Panel B: Political Affiliation		
Republican Donations	277,101 (55.1%)	23,121 (64.0%)
Democratic Donations	225,655 (44.9%)	13,032 (36.0%)
Republican Total Amount	$1.3 billion (33.8%)	$146.4 million (68.7%)
Democratic Total Amount	$2.6 billion (66.2%)	$66.8 million (31.3%)

This table presents summary statistics for the political donation sample. Panel A shows the overall sample coverage for stocks and funds separately. Panel B presents the breakdown by political party affiliation, showing both the number of donations and total amounts. Percentages in Panel B are calculated relative to donations with identified party affiliation.

Table 2: Annual Political Donation Activity and Unique Donors (2000-2022)

Year	Stock Donations			Fund Donations		
	N Donations	**Unique Donors**	**Total ($M)**	**N Donations**	**Unique Donors**	**Total ($M)**
2000	60,615	1,023	182.80	3,758	48	6.00
2001	40,564	916	65.20	2,908	45	4.80
2002	60,262	1,110	120.00	3,879	65	6.90
2003	47,752	1,646	104.40	3,964	226	16.30
2004	73,918	2,212	459.30	5,245	399	40.80
2005	55,192	1,731	142.30	4,340	272	11.70
2006	71,835	1,945	217.70	5,077	313	18.10
2007	61,712	1,828	158.30	4,657	272	16.10
2008	63,013	2,080	164.50	4,152	335	13.90
2009	65,726	2,075	171.70	4,598	339	13.50
2010	87,435	2,225	377.10	5,469	386	25.50
2011	71,362	1,787	210.00	4,894	267	19.40
2012	94,427	2,102	683.70	5,596	316	21.80
2013	75,517	1,860	222.10	5,325	267	19.90
2014	90,815	1,997	370.30	6,239	321	36.30
2015	74,968	1,130	207.40	5,136	52	12.20
2016	85,262	1,166	656.60	5,063	55	13.60
2017	94,812	2,546	276.50	7,753	432	27.80
2018	130,028	3,252	499.60	11,551	576	77.70
2019	99,474	2,722	291.30	8,906	436	25.80
2020	128,225	3,377	729.80	12,083	588	172.70
2021	113,498	3,413	319.70	11,148	648	27.60
2022	82,784	2,369	399.60	6,989	334	21.70

This table combines political donation activity and unique donor counts from 2000-2022. Total amounts are in millions of dollars.

The distribution of donation sizes reveals important patterns in political engagement intensity. Table 3 demonstrates that while the majority of donations are relatively small, larger donations account for the vast majority of total contribution amounts. This concentration pattern appears consistent across both stock and fund donations, with donations exceeding 25,000 dollars representing only 8.5 percent of stock donations but 87.5 percent of total contribution amounts.

Table 3: Distribution of Political Donations by Size

Panel A: Stock Donations

Size Bracket	N Donations	Total Amount	% of N	% of Amount
\$0-250	372,649	\$25.5 million	13.95%	0.06%
\$250-500	308,416	\$147.5 million	11.55%	0.32%
\$500-1K	779,747	\$773.0 million	29.19%	1.68%
\$1K-2.5K	501,554	\$1.1 billion	18.78%	2.33%
\$2.5K-5K	335,877	\$1.5 billion	12.57%	3.33%
\$5K-10K	53,623	\$486.0 million	2.01%	1.06%
\$10K-25K	92,088	\$1.7 billion	3.45%	3.72%
\$25K+	227,461	\$40.0 billion	8.51%	87.50%

Panel B: Fund Donations

Size Bracket	N Donations	Total Amount	% of N	% of Amount
\$0-250	33,305	\$2.6 million	17.17%	0.07%
\$250-500	22,623	\$10.9 million	11.66%	0.31%
\$500-1K	51,077	\$50.7 million	26.33%	1.43%
\$1K-2.5K	38,194	\$81.4 million	19.69%	2.30%
\$2.5K-5K	25,190	\$115.3 million	12.98%	3.26%
\$5K-10K	3,211	\$30.3 million	1.66%	0.86%
\$10K-25K	6,625	\$122.8 million	3.41%	3.47%
\$25K+	13,770	\$3.1 billion	7.10%	88.30%

This table presents the distribution of unique political donations by size bracket. Panel A shows stock donations while Panel B shows fund donations. The size brackets represent donation amounts in U.S. dollars. Percentages are calculated relative to total unique donations and total amounts respectively within each panel.

3.4 Political connection classification methodology

In the analysis I define a twelve-month persistence window after a donation has occurred to classify entities as politically active, capturing the lasting nature of political relationships beyond the immediate donation period. This choice reflects that the political connections provide benefits that extend beyond the moment of contribution, as relationships with political figures and access to policy information typically persist for extended periods.

The analysis has several connection categories to try to better gauge different dimensions of political engagement. *Firm Active* indicates firms that made political donations in the past twelve months. *Fund Active* identifies funds that made political donations in the past twelve months. *Connected* represents firms where either the firm or an investing fund is politically active. *Intersection* captures firms where both the firm and an investing fund are politically active within the twelve-month window.

This classification system enables examination of both individual and coordinated political activity. The intersection category is particularly important for understanding whether synergies exist between company-level and fund-level political engagement.

3.5 Portfolio construction and performance measurement

The study constructs calendar-time portfolios following standard asset pricing methodology to examine performance differences between politically connected and non-connected entities. At the beginning of each month, companies and funds are classified based on their political activity status observed through the previous month, with portfolio returns calculated for the subsequent month. This approach ensures that all information used for portfolio formation is available to investors at the time of portfolio construction, avoiding look-ahead bias.

Fund portfolio construction aggregates individual fund holdings to the management company level, necessary because political contributions in the dataset often occur at the management company level rather than by individual funds. For each management company, the analysis aggregates 13F stock holdings across all funds under management, creating value-weighted portfolios that represent the company's overall investment positions.

Stock returns undergo winsorization at the one percent and ninety-nine percent levels to mitigate the influence of extreme observations. The analysis employs both equal-weighted and value-weighted portfolio approaches to examine whether connection effects vary with company size. Value-weighted portfolios provide economically meaningful assessments of aggregate performance differences, while equal-weighted portfolios examine whether effects are concentrated among smaller companies.

Performance measurement incorporates multiple approaches to ensure robustness. Raw return comparisons provide initial evidence of performance differences. Fama-French-Carhart four-factor model regressions control for systematic risk exposures to market, size, value, and momentum factors. Daniel-Grinblatt-Titman-Wermers (DGTW) (Daniel et al. (1997)) characteristic-adjusted returns control for differences in size, book-to-market, and momentum characteristics through matching to benchmark portfolios.

4 Empirical results

4.1 Portfolio-level performance analysis

The portfolio-level analysis reveals some performance differences between stocks of politically connected and non-connected companies. Table 4 presents both value-weighted and equal-weighted portfolio returns by political connection status, demonstrating that stocks of connected companies generate higher raw returns than their non-connected counterparts.

Table 4: Portfolio Performance by Political Connection Status and Weighting Method

Portfolio	Weight	N Months	Mean (%)	SD (%)	t-stat	Sharpe	FF Alpha (%)	FF t	DGTW Alpha (%)
Panel A: Value-Weighted Portfolios									
All Firms	VW	300	1.48	4.69	1.10	1.10	0.75	6.46	0.88
Active Firms	VW	289	1.30	6.95	0.65	0.65	0.63	1.98	0.76
Non-active Firms	VW	300	1.48	4.69	1.09	1.09	0.75	6.49	0.88
Connected Firms	VW	289	1.58	6.13	0.90	0.90	0.95	3.89	0.88
Panel B: Equal-Weighted Portfolios									
All Firms	EW	300	0.85	5.63	0.52	0.52	0.04	0.32	1.04
Active Firms	EW	289	1.36	9.14	0.51	0.51	0.35	1.01	0.80
Non-active Firms	EW	300	0.85	5.63	0.52	0.52	0.04	0.32	1.04
Connected Firms	EW	289	1.28	6.49	0.68	0.68	0.39	2.42	0.85
Panel C: Long-Short Strategy (Connected - Not Connected)									
Long-Short	VW	289	0.15	4.31	0.12	0.12	0.22	1.00	–
Long-Short	EW	289	0.40	3.61	0.38	0.38	0.33	2.11	–

This table compares monthly stock returns between politically connected and non-connected companies from 1998-2022. Portfolios are rebalanced monthly based on political connection status. Stocks of connected companies show higher raw returns (1.58% vs 1.48% monthly), but the long-short strategy yields only modest returns with limited statistical significance. The larger effect in equal-weighted portfolios suggests political connections may benefit smaller companies more than larger ones. Active Companies are those that made political donations in the past 12 months. Connected Companies include those where either the company or a hedge fund holding the stock is politically active. FF Alpha represents risk-adjusted returns using the Fama-French three-factor model. DGTW Alpha controls for company size, value, and momentum characteristics.

The portfolio analysis reveals important differences between value-weighted and equal-weighted approaches that provide insight into which types of companies benefit from political connections. In the value-weighted portfolios, which give more weight to larger companies, stocks of connected companies generate only 10 basis points higher monthly returns than stocks of non-connected companies. The resulting long-short strategy earns a modest 15 basis points monthly with limited statistical significance.

However, the equal-weighted portfolios, which treat all companies equally regardless of size, show more substantial differences. Stocks of connected companies earn 1.28 percent monthly compared to 0.85 percent for non-connected companies, yielding a long-short return of 40 basis points. The equal-weighted Fama-French alpha of 33 basis points with a t-statistic of 2.11 is statistically significant, indicating that the connection effect is more pronounced among smaller companies.

Importantly, these performance advantages largely disappear after controlling for company characteristics through DGTW adjustments, suggesting that much of the apparent political connection premium reflects differences in company size, growth characteristics, and momentum rather than direct benefits from political relationships.

4.2 Time series of connection effects

The time series analysis examines how the relationship between political connections and stock returns evolves over different periods and election cycles. Table 5 presents annual returns by connection status from 2000 to 2022, revealing the persistence of return differences between stocks of politically connected and non-connected companies over time.

Table 5: Annual Returns by Political Connection Status (2000–2022)

Year	Connected	Not Connected	Difference	Intersection	N Connected	N Intersection
2000	2.33%	-1.28%	3.61%	-4.97%	100	12
2001	-0.90%	1.22%	-2.12%	2.99%	86	13
2002	-1.54%	-1.07%	-0.48%	-2.62%	88	23
2003	3.25%	4.25%	-1.00%	4.04%	124	23
2004	1.51%	1.55%	-0.04%	4.74%	141	24
2005	2.01%	0.41%	1.60%	5.35%	151	24
2006	1.17%	1.40%	-0.24%	1.55%	200	24
2007	0.14%	-0.31%	0.45%	3.28%	373	38
2008	-3.57%	-4.13%	0.56%	-3.93%	390	35
2009	3.49%	3.65%	-0.16%	4.24%	278	38
2010	3.12%	1.85%	1.27%	4.51%	394	61
2011	-0.13%	-0.71%	0.58%	-1.93%	334	43
2012	1.89%	1.26%	0.63%	1.64%	323	47
2013	3.17%	2.22%	0.94%	2.26%	307	43
2014	1.86%	0.22%	1.64%	3.12%	365	46
2015	-0.48%	-0.62%	0.14%	-0.27%	333	47
2016	1.52%	1.12%	0.40%	0.80%	100	30
2017	1.88%	1.13%	0.75%	2.38%	231	46
2018	-0.53%	-1.14%	0.61%	-1.44%	359	47
2019	2.06%	1.54%	0.51%	2.03%	435	76
2020	2.99%	1.75%	1.24%	2.73%	448	64
2021	2.04%	0.70%	1.34%	2.79%	692	85
2022	-2.12%	-2.33%	0.21%	-1.82%	663	87
Average	1.09%	0.55%	0.54%	1.37%		

This table presents annual mean stock returns by political connection status for the complete sample period using the twelve-month persistence window methodology. Connected stocks are those where either the company or the associated hedge fund management company is politically active within the past twelve months. Intersection denotes stocks where both the company and fund are politically active. All returns are winsorized at the 1 and 99 percent levels. N Connected and N Intersection provide yearly observation counts. The persistent positive difference averaging 54 basis points annually suggests economically meaningful return differences associated with political connections across various market conditions and election cycles.

The time series analysis reveals that stocks of connected companies outperform stocks of non-connected companies in most years, with an average annual difference of 54 basis points. The performance difference shows some variation across election cycles, with larger differences typically observed during election years when political connections may be most valuable. The intersection effect, representing stocks where both the company and hedge fund management company are politically active, shows particularly strong performance in several years.

During crisis periods, such as 2008, stocks of both connected and non-connected companies experienced negative returns, but stocks of connected companies performed slightly better. This pattern aligns with theoretical expectations that political connections may provide some insulation during economic downturns through access to government support or favorable policy treatment.

The number of connected companies and intersection cases has generally increased over time, reflecting growing political engagement among both companies and financial institutions. This trend may reflect increasing recognition of the value of political connections or rising policy uncertainty that motivates greater political engagement.

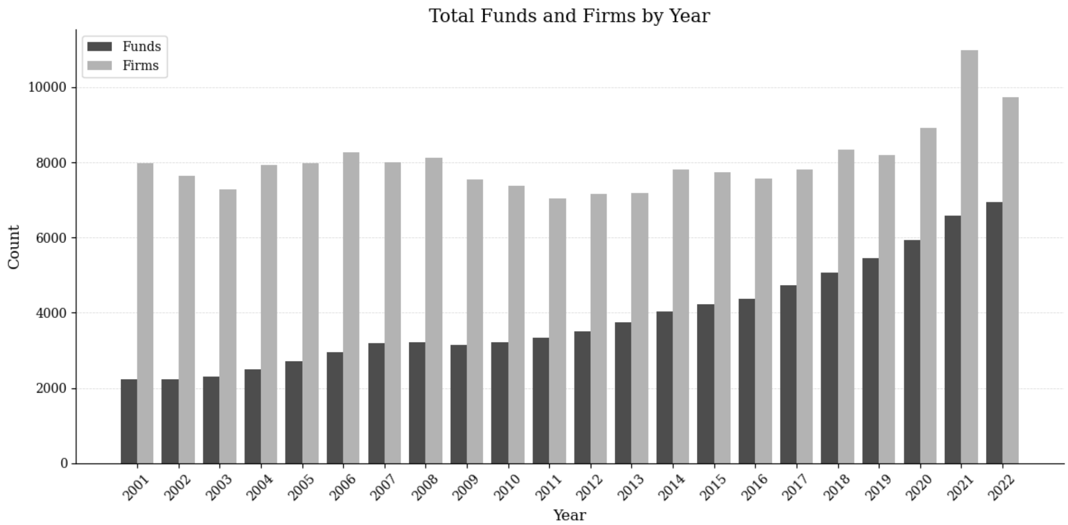

Figure 1: Total companies and hedge fund management companies by political activity type over time. This figure consolidates the data universe used in this study, showing the growth in political engagement among both stocks and funds from 2001 to 2022. The increase in political activity is particularly pronounced after 2016.

4.3 Long-term cumulative performance

To visualize the long-term performance implications of political connections, Figure 2 presents the cumulative returns of value-weighted portfolios of stocks of connected versus non-connected companies over the period from 1998 to 2022. The analysis assumes an initial investment of one dollar in January 1998 and tracks the compound growth of each portfolio through monthly rebalancing based on political connection status.

The cumulative return analysis reveals several important patterns over the three-decade sample period. Both portfolios demonstrate substantial long-term growth, with initial investments of one dollar growing to approximately thirty dollars by 2022, representing compound annual growth rates of approximately eleven percent. The portfolios track each other closely through the late 1990s and early 2000s, suggesting that political connection effects were relatively modest during this period.

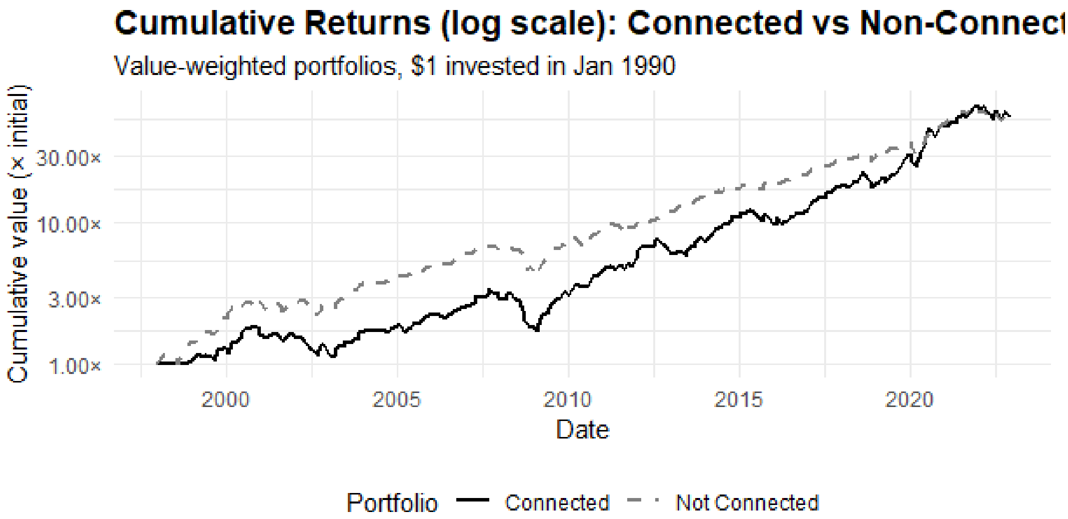

Figure 2: Cumulative Returns of Stocks of Connected versus Non-Connected Companies (1998-2022): This figure displays the cumulative returns of value-weighted portfolios formed based on political connection status using the twelve-month persistence window. The portfolios are rebalanced monthly, with companies classified as connected if either the company or an investing hedge fund management company made political donations within the past twelve months. Both portfolios assume an initial investment of $1 in January 1998. Returns are presented on a logarithmic scale. The solid line represents stocks of politically connected companies, while the dashed line represents stocks of non-connected companies. The convergence and divergence patterns reflect varying effectiveness of political connections across different market and political cycles.

4.4 Panel regression analysis

The panel regression analysis examines the relationship between political connections and future stock returns while controlling for company characteristics and systematic risk factors. Table 6 presents the main regression results using company-month observations with double-clustered standard errors by company and year-month.

The panel regression results present a more complicated picture of the relationship between political connections and future stock returns. The basic specification shows a negative coefficient of 67 basis points for connected companies, which

Table 6: Political Connections and Future Stock Returns

	Dependent Variable: $MthRet_{t+1}$					
	Basic		Party Activity		Party Connections	
	(1a) No Controls	(1b) Controls	(2a) No Controls	(2b) Controls	(3a) No Controls	(3b) Controls
CONNECTED	0.0035*	−0.0067**	0.0047**	−0.0037		
	(0.0015)	(0.0025)	(0.0017)	(0.0028)		
FIRM_ACTIVE_R			0.0018	−0.0005		
			(0.0036)	(0.0048)		
FIRM_ACTIVE_D			−0.0076	−0.0119*		
			(0.0055)	(0.0070)		
CONNECTED_R					0.0035	−0.0077
					(0.0041)	(0.0063)
CONNECTED_D					0.0033	−0.0075
					(0.0063)	(0.0062)
log(Size)		0.0036***		0.0036***		0.0036***
		(0.0006)		(0.0006)		(0.0006)
log(B/M)		−0.0120***		−0.0120***		−0.0120***
		(0.0009)		(0.0009)		(0.0009)
$MthRet_t$		−0.0360***		−0.0360***		−0.0360***
		(0.0106)		(0.0106)		(0.0106)
Year-Month FE	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	2,068,731	1,621,038	2,068,731	1,621,038	2,068,731	1,621,038
R^2	0.102	0.112	0.102	0.112	0.102	0.112
Within R^2	0.000	0.009	0.000	0.009	0.000	0.009

This table examines whether political connections predict future stock returns using panel regressions that control for unobservable company characteristics. While portfolio comparisons suggest positive effects, within-company analysis over time shows negative coefficients for political connections. The dependent variable is one-month-ahead stock returns. CONNECTED indicates either the company or a hedge fund holding the stock donated in the past twelve months. The shift from positive (Column 1a) to negative (Column 1b) coefficients when adding controls suggests that company size drives most apparent political connection benefits. Party-specific analysis reveals asymmetric effects, with Democratic connections showing more negative associations with future returns than Republican connections. All specifications include year-month and two-digit SIC industry fixed effects. Standard errors (in parentheses) are double-clustered by company and year-month. Significance levels: *** p<0.01, ** p<0.05, * p<0.10.

is statistically significant at the five percent level. However, this effect becomes statistically insignificant when party-specific controls are included, suggesting that the aggregate connection effect masks important heterogeneity across political parties.

The party-specific analysis reveals that Democratic company activity associates with negative future stock returns of 119 basis points, significant at the ten percent level, while Republican company activity shows no significant relationship with future stock returns. This asymmetry may reflect market perceptions of different policy approaches between political parties or varying effectiveness of political engagement across party lines.

The control variables exhibit expected relationships with future stock returns. Company size shows a positive and highly significant relationship, consistent with the size effect documented in asset pricing literature. The book-to-market ratio demonstrates a negative relationship, indicating that growth companies outperformed value companies during the sample period. Past returns exhibit negative serial correlation, suggesting short-term reversal effects in monthly stock returns.

4.5 Interaction effects and coordination analysis

The analysis examines whether coordination between companies and hedge fund management companies in their political activities affects the relationship with stock returns. Table 7 explores interaction effects between political connections, company characteristics, and party affiliations.

Table 7: Political Connection Interactions with Firm Characteristics

	Dependent Variable: $MthRet_{t+1}$					
	Firm × Fund		Size Interaction		Party × Size	
	(7a) No Controls	(7b) Controls	(8a) No Controls	(8b) Controls	(9a) No Controls	(9b) Controls
FIRM_ACTIVE	−0.0032	−0.0147*				
	(0.0036)	(0.0057)				
FUND_ACTIVE	0.0053**	−0.0031				
	(0.0017)	(0.0028)				
FIRM_ACTIVE × FUND_ACTIVE	0.0050	0.0085				
	(0.0057)	(0.0080)				
CONNECTED			0.0030	−0.0017		
			(0.0064)	(0.0078)		
Large Firm			0.0146***	0.0026*	0.0146***	0.0026*
			(0.0017)	(0.0013)	(0.0017)	(0.0013)
CONNECTED × Large Firm			−0.0042	−0.0052		
			(0.0068)	(0.0081)		
CONNECTED_R					0.0270**	0.0249
					(0.0094)	(0.0208)
CONNECTED_D					−0.0721***	−0.0640**
					(0.0104)	(0.0215)
CONNECTED_R × Large Firm					−0.0305***	−0.0355*
					(0.0090)	(0.0205)
CONNECTED_D × Large Firm					0.0757***	0.0596**
					(0.0110)	(0.0214)
Controls	No	Yes	No	Yes	No	Yes
Year-Month FE	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	2,068,731	1,621,038	2,068,506	1,621,038	2,068,506	1,621,038
R^2	0.102	0.112	0.104	0.112	0.104	0.112
Within R^2	0.000	0.009	0.002	0.009	0.002	0.009

This table examines interaction effects between political connections and company characteristics. Columns (1)-(2) test whether companies and hedge fund management companies being simultaneously active affects stock returns differently than individual activity. Columns (3)-(4) interact connection status with company size, where Large Firm indicates above-median market capitalization. Columns (5)-(6) explore party-specific effects by company size. Models without controls (a) only include the main effects and interaction terms, while models with controls (b) add log size, log book-to-market ratio, and lagged returns. All specifications include year-month and two-digit SIC industry fixed effects. Standard errors (in parentheses) are double-clustered by company and year-month. Significance levels: *** p<0.01, ** p<0.05, * p<0.10.

The interaction analysis reveals differences in connection effects across company characteristics and political parties. The company-fund interaction specification shows that while individual company activity associates with negative stock returns, the interaction term between company and hedge fund management company activity is positive but statistically insignificant. This suggests that coordination between companies and funds may provide some benefits, though the evidence remains inconclusive.

The party-size interaction specification provides the most striking results. For small companies, Democratic connections associate with significant negative stock returns of 640 basis points, while Republican connections show positive but insignificant effects. However, the interaction terms indicate that these effects reverse for large companies, with Democratic connections becoming less negative and Republican connections becoming more negative for larger companies.

4.6 Donation intensity analysis

To examine whether the intensity of political engagement matters for the connection-return relationship, Table 8 analyzes how donation size affects future stock returns. This analysis tests whether larger political contributions, which may signal stronger political commitment or provide greater access, translate into different return patterns.

The donation intensity analysis reveals that the size of political contributions does not significantly affect the relationship with future stock returns. Among politically active companies, those in higher donation quintiles do not demonstrate significantly different stock returns compared to companies making smaller donations. The coefficients for donation quintiles 2 through 5 are all positive but statistically insignificant, ranging from 19 to 75 basis points.

The continuous measure of donation size, the log of donation amounts, similarly shows no significant relationship with future stock returns. The coefficient of 0.08 basis points is economically negligible and statistically insignificant. This finding suggests that the binary decision to engage politically matters more than the intensity of that engagement.

The analysis of top donors, representing companies in the top 10 percent by total donation amount, shows a negative but insignificant coefficient of 27 basis points. This result indicates that even the most politically active companies by donation volume do not achieve systematically different stock returns compared to other companies in the sample.

These null findings regarding donation intensity are important for understanding the mechanisms through which political connections create value. The results suggest that political connections may operate more through access and relationships established by any level of engagement rather than through a continuous function of financial contributions. This pattern aligns with models where political connections provide threshold benefits—once a company establishes political relationships, additional contributions may yield diminishing marginal returns.

Table 8: Donation Size and Future Stock Returns

	Dependent Variable: $MthRet_{t+1}$					
	Quintiles		Log Amount		Top 10%	
	(4a) No Controls	(4b) Controls	(5a) No Controls	(5b) Controls	(6a) No Controls	(6b) Controls
Donation Quintile 2	0.0061	0.0057				
	(0.0065)	(0.0067)				
Donation Quintile 3	0.0034	0.0019				
	(0.0049)	(0.0048)				
Donation Quintile 4	0.0058	0.0055				
	(0.0046)	(0.0052)				
Donation Quintile 5	0.0094	0.0075				
	(0.0059)	(0.0054)				
log(Donation)			0.0011	0.0008		
			(0.0009)	(0.0008)		
Top 10% Donor					0.0118^{**}	−0.0027
					(0.0038)	(0.0043)
log(Size)		0.0008		0.0007		0.0036^{***}
		(0.0015)		(0.0015)		(0.0006)
log(B/M)		-0.0049^{*}		-0.0051^{*}		-0.0120^{***}
		(0.0026)		(0.0026)		(0.0009)
$MthRet_t$		-0.0898^{**}		-0.0897^{**}		-0.0360^{***}
		(0.0312)		(0.0311)		(0.0106)
Year-Month FE	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	6,963	6,875	6,963	6,875	2,068,731	1,621,038
R^2	0.200	0.239	0.199	0.239	0.102	0.112
Within R^2	0.000	0.011	0.000	0.010	0.000	0.009

This table examines the effect of donation size on future stock returns. Columns (1)-(2) use donation quintiles among active donors, where companies are sorted into five equal groups based on total donation amounts. Quintile 1 (smallest donations) serves as the reference category, meaning all quintile coefficients represent the return difference relative to the smallest donors. For example, a coefficient of 0.0094 for quintile 5 indicates that stocks of companies in the highest donation quintile have returns 0.94% higher per month than stocks of companies in the lowest quintile. Columns (3)-(4) use log of total donation amount as a continuous measure. Columns (5)-(6) identify companies in the top 10% of donors by total amount. Specifications (1)-(4) are restricted to politically active companies only. Models without controls (a) include only the donation size variables, while models with controls (b) add company characteristics. Control variables and fixed effects are as in Table 6. Standard errors (in parentheses) are double-clustered by company and year-month. Significance levels: *** p<0.01, ** p<0.05, * p<0.10.

4.7 Heterogeneity by size

The relationship between political connections and stock returns depends critically on company size. This heterogeneity helps explain why aggregate results may mask important differences across the size distribution and provides insight into which types of companies benefit most from political engagement.

Political connections are concentrated among large companies. Table 9 Panel A reveals a striking concentration of political activity among larger companies. Only 0.02 percent of companies in the smallest size quintile are politically connected, compared to 1.15 percent in the largest quintile. This concentration reflects both the substantial costs of political engagement and the greater potential benefits that large companies may derive from political influence.

The average market capitalizations across quintiles illustrate the magnitude of these differences. Companies in the smallest quintile average 21 million dollars in market value, while those in the largest quintile average nearly 16 billion dollars. Political activity requires significant resources for campaign contributions, lobbying expenditures, and personnel to manage political relationships—investments that may be prohibitive for smaller companies.

Connection effects disappear when controlling for size. Panel B presents regression results by size quintile with full controls. Across all size groups, the connection effect is negative and statistically insignificant when controlling for company characteristics. The magnitudes decrease from negative 60 basis points for the smallest companies to negative 11 basis points for the largest, but none achieve statistical significance.

Size controls reveal the true connection effect. Panel C shows results without controls and reveals a strikingly different pattern. For the smallest companies, political connections associate with positive stock returns of 59 basis points, though this result is based on minimal variation with only 83 connections among 411,247 observations. For larger companies, connection effects become increasingly negative, with the largest companies showing a significant negative effect of 26 basis points.

These results suggest that political connections do not provide systematic benefits once we account for company size. The apparent political connection premium observed in portfolio-level analysis primarily reflects the correlation between political activity and company size, rather than causal benefits from political relationships.

This finding is important for understanding the value of political engagement. Rather than political connections creating value directly, the results suggest that larger companies engage politically for defensive reasons—to protect existing market positions or to manage regulatory risks—rather than to generate excess stock returns. The negative within-company effects may reflect the costs of political engagement or strategic political activity during periods of business difficulty.

4.8 Portfolio and panel regression results

Portfolio-level analysis shows that stocks of connected companies generate higher raw returns than stocks of non-connected companies (1.58 percent versus 1.48 percent monthly). However, panel regressions that examine individual companies over time

Table 9: Political Connections and Returns by Company Size Quintiles

Panel A: Connection Rates by Size Quintile

	Q1 (Smallest)	Q2	Q3	Q4	Q5 (Largest)
N Observations	411,247	412,912	413,418	414,578	416,351
N Connected	83	368	545	919	4,796
% Connected	0.02	0.09	0.13	0.22	1.15
Avg Market Cap ($M)	21,076	95,026	292,975	978,059	15,792,669

Panel B: Connection Effects by Size Quintile (With Controls)

	Dependent Variable: $MthRet_{t+1}$				
	Q1 (Smallest)	Q2	Q3	Q4	Q5 (Largest)
CONNECTED	−0.0060	−0.0018	−0.0031	−0.0017	−0.0011
	(0.0124)	(0.0102)	(0.0060)	(0.0047)	(0.0018)
log(Size)	0.0184***	0.0051**	0.0040*	−0.0004	−0.0024***
	(0.0018)	(0.0016)	(0.0016)	(0.0012)	(0.0006)
log(B/M)	−0.0064***	−0.0112***	−0.0141***	−0.0144***	−0.0104***
	(0.0010)	(0.0012)	(0.0014)	(0.0016)	(0.0013)
$MthRet_t$	−0.0724***	−0.0296**	−0.0126	−0.0165	−0.0159
	(0.0094)	(0.0100)	(0.0119)	(0.0158)	(0.0142)
Year-Month FE	Yes	Yes	Yes	Yes	Yes
Observations	299,520	300,983	305,855	339,320	375,360
R^2	0.105	0.106	0.134	0.152	0.164
Within R^2	0.009	0.006	0.009	0.011	0.008

Panel C: Connection Effects by Size Quintile (No Controls)

	Dependent Variable: $MthRet_{t+1}$				
	Q1 (Smallest)	Q2	Q3	Q4	Q5 (Largest)
CONNECTED	0.0059***	0.0006	−0.0012	−0.0038	−0.0026*
	(0.00001)	(0.0085)	(0.0056)	(0.0038)	(0.0015)
Year-Month FE	Yes	Yes	Yes	Yes	Yes
Observations	299,521	300,990	305,857	339,320	375,361
R^2	0.097	0.101	0.126	0.143	0.157
Within R^2	0.000	0.000	0.000	0.000	0.000

This table demonstrates that political connection effects vary dramatically across company size. Panel A shows that political connections are highly concentrated among large companies, 1.15% of the largest companies are connected versus only 0.02% of the smallest. When controlling for company characteristics (Panel B), connection effects are negative across all size groups, suggesting that apparent political connection benefits primarily reflect company size rather than political relationships. Panel C shows that without controls, only the smallest companies show positive connection effects, but this is based on very few observations (83 connections among 411,247 observations). Size quintiles are formed monthly based on market capitalization. Connected companies are those where either the company or a hedge fund holding the stock donated within the past 12 months. Standard errors (in parentheses) are double-clustered by company and year-month. Note that the extremely small standard error for Q1 in Panel C reflects the minimal variation in connections among the smallest companies. Significance levels: *** p<0.01, ** p<0.05, * p<0.10.

show negative coefficients for political connections when controlling for company and time fixed effects.

The positive portfolio results likely reflect selection effects as companies that choose to engage politically tend to be larger, growth-oriented entities that generate higher stock returns for reasons potentially unrelated to their political activities. Table 10 demonstrates this pattern clearly: companies with both company and hedge fund management company political activity (intersection companies) average 147.9 billion dollars in market capitalization compared to 3.3 billion dollars for non-active companies.

When panel regressions control for company characteristics, particularly size, the apparent political connection benefit disappears or becomes negative. This suggests that most of the political connection premium observed in portfolio comparisons actually reflects the fact that larger companies are both more likely to be politically active and more likely to generate higher stock returns.

The negative panel regression coefficients may indicate that companies strategically increase political activity during periods of business difficulty, when they seek government support or favorable regulatory treatment Ovtchinnikov and Pantaleoni (2012). Alternatively, the coefficients may capture the costs of political engagement that reduce short-term stock returns while potentially providing longer-term benefits not captured in monthly return horizons.

Table 10: Stock Characteristics by Political Connection Type

Connection Type	N Obs	Size ($B)	B/M Ratio	Price ($)	Return (%)
Neither Active	2,091,650	3.3	6.00	33.84	0.51
Stock Only	1,748	27.2	0.50	40.19	0.39
Fund Only	4,352	22.1	0.55	56.50	1.17
Both Active (Intersection)	1,006	147.9	0.09	71.47	1.55

This table presents average stock characteristics by political connection type. Size is market capitalization in billions of dollars. B/M Ratio is the book-to-market ratio. Price is the average stock price. Return is the average monthly return in percentage terms. All values are winsorized at the 1% and 99% levels. Stocks of politically active companies tend to be substantially larger, with lower book-to-market ratios (growth companies), and higher stock prices. Companies with both company and hedge fund management company political activity (Intersection) are particularly large, averaging $147.9 billion in market capitalization.

5 Discussion and robustness

5.1 Economic significance and interpretation

The results from my empirical analysis provide some evidence that political connections associate with differences in financial performance, though the economic significance varies considerably across different specifications. The portfolio-level analysis reveals that the stocks of connected companies generate higher raw returns than non-connected companies' stocks, with differences ranging from 10 to 54 basis points per month depending on the measurement period and methodology.

An important finding emerges when examining the role of company size in the connection-return relationship. While portfolio comparisons suggest positive connection premiums, these effects largely disappear once we control for company size. This pattern is evident in Table 6, where the initially positive coefficient on CONNECTED ($p<0.10$) flips its sign to negative and becomes statistically more significant ($p<0.05$) after including size controls. This reversal suggests that the performance differences observed here, in portfolio-level analysis, primarily reflect the fact that politically connected companies tend to be larger, rather than any direct benefit from political connections themselves. This is also logical as larger companies usually have more resources for engaging in politics.

This size-dependency of political connection effects aligns with recent in the literature. Akcigit, Baslandze, and Lotti (2023) document a "leadership paradox" where larger companies engage more in political connections and use them primarily for defensive strategies rather than innovation-driven growth. Results from my analysis also support this interpretation—the concentration of political connections among larger companies (1.15% connection rate in the largest size quintile versus 0.02% in the smallest) combined with the disappearance of positive returns after size controls suggests that political engagement may serve to protect existing market positions rather than generate excess returns. This also ties in to the hypothesis from Ovtchinnikov and Pantaleoni (2012), where companies mainly leverage political connections for financial gains during times of turmoil. My results are also in line with this, as the connected companies' portfolio outperforms the non-connected companies, even though in the regression analyses the coefficients are mostly negative.

The value-weighted portfolio shows modest connection premiums. In contrast, equal-weighted approaches reveal more substantial performance differences, indicating that political connections might provide greater benefits for smaller companies that may have fewer alternative sources of competitive advantage. This is also consistent with company size explaining many of the excess returns, as happens in Table 6. Though, the very low number of political connections among smaller companies (only 83 connections in the smallest quintile) limits the economic significance of this finding. With smaller companies, the channel of gaining is probably through information asymmetries as smaller companies don't have the same muscle as large companies that could possibly strong-arm decision-making.

5.2 Mechanics of size control

The relationship between political contributions and stock returns becomes more nuanced when accounting for company characteristics. While initial portfolio-level analyses might suggest beneficial political effects, controlling for company-specific variables reveals important insights about the nature of these relationships.

Cooper, Gulen, and Ovtchinnikov (2010) provide more evidence on this topic. They find that companies making political contributions earn significant abnormal returns—approximately 2.4% annually using a four-factor model. Importantly, this effect persists even after controlling for standard return predictors such as book-to-market ratios, company size, and momentum.

However, Cooper, Gulen, and Ovtchinnikov (2010) also document that contributing companies differ systematically from non-contributors, they are substantially larger, with median market capitalizations of $1.6 billion vs. $195 million for non-contributing companies. The authors suggest that larger companies may be better positioned to bear the true costs of political participation, which likely exceed the nominal hard money contribution limits. This interpretation aligns with their finding that the contribution effect is strongest for companies supporting candidates from their home states and those contributing to House members, where legislative influence on company-specific issues may be more direct.

Table 9 provides contrasting evidence of this phenomenon. Without controls, the smallest companies show a positive connection effect of 59 basis points, but this result is based on minimal variation (only 83 connections among 411,247 observations). Once controls are added, even this effect disappears. This finding challenges the notion that political connections provide universal benefits and instead suggests that the correlation between political activity and company size drives most observed return differences.

The panel regression results present a more complex picture, with the basic connection indicator showing negative coefficients in many specifications. This apparent contradiction with portfolio-level results likely reflects the inclusion of company and time fixed effects, which control for unobservable company characteristics and time-varying market conditions. The negative panel regression coefficients may indicate that, within companies over time, periods of political activity associate with subsequent underperformance, possibly reflecting strategic political engagement during times of turmoil in the markets. This interpretation finds support in Ovtchinnikov and Pantaleoni (2012), who document that companies often increase political activity during periods of regulatory uncertainty or economic distress.

5.3 Connection to information-based theories

The donation intensity analysis, in Table 8, reveals that the size of political contributions does not significantly affect the connection-return relationship. This finding contradicts pure "pay-to-play" models of political influence and instead supports information-based theories of political connection value. Gao and Huang (2016) provide a framework where political connections serve primarily as information conduits rather than influence mechanisms. The null findings on donation intensity align with their model; once a company establishes political connections, the marginal value of additional contributions is minimal because information access doesn't scale linearly with contribution amounts.

Brown and Huang (2020), who analyze White House visitor logs and find that meetings with government officials generate abnormal returns regardless of prior donation history. My results extend this finding by showing that even among active political donors, those in higher donation quintiles (Table 8) do not achieve systematically different returns, with coefficients ranging from an insignificant 19 to 75 basis points across quintiles 2 through 5.

The limited evidence for coordination benefits may reflect the different objectives of companies and financial investors in political engagement. While companies may seek specific regulatory outcomes or government contracts, hedge funds likely pursue broader market-moving political intelligence, as documented by Gao and Huang (2016). These differing goals may limit the potential for synergistic political influence.

5.4 Robustness and alternative interpretations

The concentration of political connections among larger companies raises important questions about the validity of findings based on politically active companies. With only 0.02 percent of the smallest quintile companies being politically connected, the vast majority of public companies operate without direct political engagement. This extreme concentration, which is more pronounced than documented in any prior study, suggests that barriers to political participation may be higher than previously recognized.

An alternative interpretation of my findings is that political connections serve as a luxury good for large companies, providing insurance against political risk rather than generating excess stock returns. This insurance value interpretation would explain why connection effects disappear after size controls (companies pay for protection proportional to their size) and why within-company variation shows negative coefficients (insurance premiums reduce stock returns during calm periods).

5.5 Endogeneity and the post-Citizens United era

A critical challenge in the political connections literature is the endogeneity problem: companies that choose to donate may be fundamentally different from non-donors in unobservable ways. My analysis partially addresses this through panel regressions with company fixed effects, which control for company characteristics. However, time-varying unobservables remain a concern. For instance, companies may increase political activity when anticipating regulatory changes or during periods of strategic transformation—factors that could independently affect stock returns.

The 2010 Citizens United v. FEC Supreme Court decision fundamentally altered the landscape of corporate political contributions by allowing unlimited independent expenditures as documented by Albuquerque et al. (2020). While my sample spans 1998-2022, I do not explicitly model this structural break. The post-2010 increase in political activity visible in Figure 1 may reflect this regulatory change.

Industry-specific effects represent another important dimension. Political connections likely matter more in regulated industries (finance, healthcare, energy) than in other less regulated business areas, for which Faccio (2006) provides evidence from 46 countries. While I include industry fixed effects, I do not explore industry-specific connection premiums. This heterogeneity could explain some of the mixed results and deserves dedicated analysis.

6 Conclusions

The primary empirical findings demonstrate that political connections associate with measurable differences in financial performance, though the magnitude and statistical significance vary across different specifications and measurement approaches. Portfolio-level analysis reveals that connected companies generate higher raw returns than non-connected companies, with differences averaging 54 basis points annually over the sample period. These effects persist after controlling for systematic risk factors through Fama-French-Carhart four-factor models and company characteristics through Daniel-Grinblatt-Titman-Wermers benchmark adjustments.

Panel regression analysis reveals that when controlling for company and time fixed effects, the basic connection indicator often shows negative coefficients, suggesting that within companies over time, periods of political activity may associate with subsequent underperformance. This finding may reflect strategic political engagement during periods of business difficulty or the costs associated with political activity that are not captured in simple return comparisons.

Party-specific analysis provides evidence of asymmetries in connection effects across political affiliations. Democratic connections consistently associate with more negative return outcomes than Republican connections, particularly among smaller companies. These asymmetries suggest that political alignment matters for the effectiveness of political engagement and that changes in political control could have differential effects on companies depending on their historical political affiliations. Goldman, Rocholl, and So (2009) finds that the differences in return characteristics are associated with the performance of the party the particular stock is connected to.

The analysis provides mixed evidence regarding coordination between hedge fund management companies and portfolio companies. While some specifications suggest positive interaction effects when both entities are politically active, the statistical significance remains limited. This finding indicates that coordination may provide some benefits, but the evidence for synergistic effects remains inconclusive. The limited coordination effects may reflect different objectives of companies versus financial investors in political engagement. Companies may seek specific regulatory outcomes or government contracts, while hedge funds likely pursue broader market-moving political intelligence. These differing goals may limit potential synergies from coordinated political influence.

Interestingly, the donation intensity analysis reveals that the size of political contributions does not significantly affect the relationship with future returns. This null finding suggests that political connections operate more as a threshold effect, where establishing political relationships matters but the intensity of financial engagement shows no clear relationship with performance outcomes. This effect might also stem from connectedness arising from other channels than hard money donations, where other significant resources are dedicated to building these relationships Cooper, Gulen, and Ovtchinnikov (2010).

These findings contribute to the literature on political connections in financial markets by providing the first systematic analysis of joint political activity between hedge funds and their portfolio companies. The results extend previous research that focused primarily on either corporate political activity or institutional investor behavior in isolation. The documentation of asymmetric party effects, size-dependent connection benefits, and the irrelevance of donation intensity provides new insights into the heterogeneity of political connection values across different types of market participants.

The results support models of political connections that emphasize information advantages and preferential treatment rather than pure rent-seeking explanations. The concentration of effects among smaller companies and the persistence of performance differences across multiple risk adjustment approaches provide evidence that political connections provide genuine economic benefits rather than merely reflecting correlated unobservable characteristics. The threshold nature of connection benefits, evidenced by the donation intensity analysis, aligns with models where political access provides discrete rather than continuous advantages.

Future research could explore several promising directions. International analysis could examine whether similar patterns exist in countries with different political systems and institutional frameworks. Investigation of specific policy events and their effects on connected companies could provide more direct evidence of causal mechanisms. Analysis of longer-term performance horizons might capture political connection benefits that do not appear in monthly stock return data.

The findings suggest that political connections represent a source of performance differences in financial markets that merit continued attention from researchers and policymakers. Understanding how political information flows affect asset prices and investment outcomes is an important area for future investigation as political and economic systems continue to evolve.

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A Data construction and variable definitions

A.1 Political connection variables

The construction of political connection variables employs a twelve-month persistence window implemented through rolling window calculations in R. For each company and time period, the analysis creates binary indicators for Republican and Democratic political activity based on contribution records in the preceding twelve months. The persistence window captures the lasting nature of political relationships beyond immediate donation periods.

The CONNECTED variable equals one if either the firm or an investing fund made political contributions within the past twelve months, regardless of party affiliation. The FIRM_ACTIVE and FUND_ACTIVE variables distinguish between entity-level political engagement. The INTERSECTION variable identifies cases where both the firm and an investing fund are politically active within the twelve-month window.

Party-specific variables distinguish between Republican and Democratic political engagement. CONNECTED_R requires that both the firm and fund made Republican contributions within the twelve-month period. CONNECTED_D applies the same logic for Democratic contributions. These variables enable analysis of party-specific coordination effects.

A.2 Return and risk factor construction

Monthly stock returns derive from CRSP data and undergo winsorization at the one percent and ninety-nine percent levels to address outlier influence. Excess returns subtract the risk-free rate from raw returns for factor model estimation. The analysis employs standard Fama-French-Carhart four factors obtained from Kenneth French's data library.

Portfolio returns use value-weighting based on market capitalization from the previous month to reflect realistic investment strategies. Equal-weighted portfolio returns provide comparison points that give equal importance to all constituent securities regardless of market capitalization.

Daniel-Grinblatt-Titman-Wermers characteristic-adjusted returns control for size, book-to-market, and momentum characteristics by subtracting returns of matched benchmark portfolios. The benchmark matching follows standard academic procedures using size and book-to-market quintiles interacted with momentum tertiles.