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Do Political Factors Affect Stock Returns during Presidential Elections?

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Abstract

This study investigates whether or not political factors such as government policy and political connections affected stock returns during the 2008 Taiwanese presidential election. We find that firms that benefitted from (were threatened by) the proposed Three-Links policy of the winning party experienced positive (negative) stock returns during the election. We use the sensitivities of firms' returns to bilateral trade flows between Taiwan and China to measure the government-policy effect. Our results show that the effects of political connections weakly exist, but they become more significant when the support ratio of the winning party increased in polling data. We also find that only the government-policy effect holds for different crash-risk and corporate-governance levels. Finally, investment strategies based on both political factors can generate positive abnormal returns with respect to the Fama-French-Three-factor-Model.

JEL: G11; G14; G18; G32

Keywords: Government policy, political connections, stock returns, polling data, and zero-cost portfolio.

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