Political variables do not improve the performance of trading rules

January 21 2009

A new study in *The Financial Review* provides empirical evidence on the Democratic premium and the presidential cycle effect by examining the implications of both factors on the predictability of U.S. excess stock returns.

Results show that even though political variables are often included in forecasting models, they will not help investors to systematically improve, in real-time, the performance of trading rules.

Using monthly U.S. data from 1953 to 2003, researchers analyzed the implications of political stock market anomalies for forecasting excess stock returns in real-time.

Based on widely used statistical model-selection criteria, political variables are often included in the forecasting model an investor should have used to forecast excess stock returns in real-time. The economic benefits an investor could have reaped upon using political variables to set up trading rules, however, would have been limited.

The limited success of political variables in forecasting excess stock returns also shows that political stock market anomalies, when analyzed in real time, are not necessarily an indication of market inefficiency.

The so called efficient market hypothesis is one of the cornerstones of modern finance theory. Broadly speaking, this hypthesis states that investors cannot use information on past and current financial market,

macroeconomic, and political developments to outperform the market.

"Our results raise doubts as to whether the Democratic premium anomaly and the presidential cycle anomaly constitute major challenges to the efficient markets hypothesis," the authors conclude.

Source: Wiley

Citation: Political variables do not improve the performance of trading rules (2009, January 21) retrieved 16 July 2024 from https://phys.org/news/2009-01-political-variables.html

This document is subject to copyright. Apart from any fair dealing for the purpose of private study or research, no part may be reproduced without the written permission. The content is provided for information purposes only.