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The Bradley Policy Research Center  
Financial Research and Policy  
Working Paper No.  
FR 09-06

February, 2009

**Red and Blue Investing: Values and Finance**

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# **Red and Blue Investing: *Values and Finance*<sup>1</sup>**

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**First Draft: April 2008  
This Draft: February 2009**

**Abstract:** Do political values influence investing? We answer this question using data on the political contributions and stock holdings of US investment managers. We find that mutual fund managers who make campaign donations to Democrats hold less of their portfolios (relative to non-donors or Republican donors) in industries that are deemed socially irresponsible (e.g. tobacco, guns and defense, natural resources). Although a higher fraction of Democrat-run mutual funds are socially responsible (SRI), this result holds for non-SRI funds and after controlling for other fund and manager characteristics. The effect is more than one-half of the under-weighting observed for SRI funds. Using the KLD score to measure firm responsibility, we find that Democrat managers also tilt towards firms with positive social features such as excellent employee relations and clean environmental records. We document similar results among a smaller sample of hedge fund managers, suggesting that lax corporate governance in the mutual fund industry is not the main driver of our results. We discuss how political values influence investing and the implications of our findings for the growing SRI movement and stock prices. A simple calibration shows that the pricing implications of Democrat managers' preference for social responsibility are similar in magnitude to the S&P 500 inclusion effect.

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<sup>1</sup> We thank seminar participants at UC Irvine, Stanford, Rochester, and the NBER Behavioral Finance Conference for a number of helpful comments and suggestions.

## 1. Introduction

Do political values influence investing? This is an interesting and important question for a number of reasons. First, we still have a limited understanding of how investors get their ideas and why their opinions appear to differ so greatly. Some exceptions are the growing literatures on the familiarity or local bias of investors (French and Poterba (1991), Tesar and Werner (1995), Huberman (2001)), information transmission through friends (Pound and Shiller (1989), Hong, Kubik and Stein (2005)) and differences of opinion among investors (Hong and Stein (2003)). The role of values, in general, and especially political values in shaping investments has not been explored.

Second, this question is natural in light of anecdotal evidence of major differences between Republicans and Democrats. Surveys show that Democrats, in contrast to Republicans, are more apt to support causes such as environmental and labor protection while opposing smoking, guns, and defense<sup>2</sup>. As a result, it is interesting to investigate whether Democrats under-weight “socially irresponsible” companies while over-weighting “socially responsible” ones. One possible reason for such portfolio decisions is that investors might derive utility from avoiding companies that are in conflict with their values. They may not want to see their savings invested in causes that they oppose, somewhat similarly to a boycott of consumer products. An alternative pecuniary-based explanation is that political values may shape investors’ risk-return models, i.e. investors may think that companies inconsistent with their values will also be less profitable or more risky in the future.

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<sup>2</sup> See Gallup survey from May 24, 2005, “Party Lines Shape Views of What’s Morally Acceptable” for survey evidence on the difference in values between Republicans and Democrats.

Third, the issue of political values and investing is particularly relevant in light of the growing importance of socially responsible investing (SRI) as an asset class. SRI has its roots in the screening of religious or moral vices (gaming, alcohol, and tobacco) from portfolios. But it has grown to encompass broader environmental and social issues such as the manufacture of military weapons as well as labor standards. The Social Investment Forum estimates that nearly one out of every nine dollars under professional management in the United States today is involved in SRI, or roughly 11 percent of the \$25.1 trillion in total assets under management tracked in Nelson's Directory of Investment Managers. Projections indicate that SRI is likely to grow significantly over the next decade.<sup>3</sup>

Yet, we know little about the trend toward SRI. For instance, we know that institutional ownership of sin stocks, particularly among endowments and universities but also among mutual funds and hedge funds, is lower relative to other stocks (Hong and Kacperczyk (2007)). Ownership of sin stocks tends to be dispersed among individual investors. But we don't know why that is the case. It might simply be that institutions want to avoid the hassle of owning socially irresponsible stocks to the extent that they face more litigation risk or bad press. But anecdotal evidence suggests that values are also likely to be at play as institutions like CalPERS seem to have an institutional activist (Democratic-leaning) agenda (Barber (2006)). Some SRI funds are simply marketed as investments that takes values into account. Others, such as Generation Partners, an SRI hedge fund started by Democrats Al Gore and David Blood, argue that investing in socially responsible companies is also good for profits because these companies will be better able to adapt to changes in long-term environmental and business conditions.

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<sup>3</sup> See the Social Investment Forum's 2007 Report on Socially Responsible Investing Trends at [www.socialinvest.org](http://www.socialinvest.org) for statistics on the growth of SRI.

In this paper, we look at how political values influence the investments of money managers, and in the process, provide new insights on a host of important issues. We investigate this question using data on the political contributions and stock holdings of US mutual fund and hedge fund managers. Our most basic hypothesis is that managers who donate to Democratic candidates are more likely to tilt their holdings away from (towards) socially irresponsible (responsible) stocks compared to non-donors or Republican donors. The null hypothesis is that political values have no explanatory value in predicting investments, perhaps because mutual funds uniformly under-weight socially irresponsible stocks to avoid litigation risk or scrutiny. We then analyze whether any changes in mutual fund holdings from differences in values affect how socially irresponsible companies are priced. A simple calibration shows that this pricing effect is similar in magnitude to the S&P 500 inclusion effect.

For the most part, we are agnostic about how values influence investments, though we provide some discussion and analysis on this question. As mentioned earlier, it could be for either pecuniary or non-pecuniary reasons (or both). On the pecuniary side, Democratic and Republican managers may differ in their opinions about socially responsible stocks because their different set of values shape their models of the world.

On the non-pecuniary side, managers may be using their portfolio choices as a form of perks as in classic principal-agent models (Jensen and Meckling (1976)). They may tilt toward stocks that conform with their political views if social responsibility of stock holdings enters their utility functions. However, if sociopolitical variables enter agents' utility functions, managers might also use their fund holdings to hedge against other non-stock-related adverse social or political outcomes. For example, Democratic managers might hold *more* tobacco or defense stocks prior to a close election to hedge against a perceived negative outcome in the

election (a Democrat defeat). Thus, the prediction of the non-pecuniary hypothesis is not so clear-cut.

We construct a unique database from 1992 to 2006 that links the political contributions and stock holdings of a large sample of US mutual fund managers. Our main independent variable is the political contributions of mutual fund managers, which we obtain from the Federal Election Committee (FEC) website. Democrats are defined as those managers with net positive contributions for federal Democratic candidates and vice versa for Republicans. Managers who have not donated to members of either party are defined as non-donors.

Our main dependent variables are derived from fund portfolio holdings. We consider two measures of social responsibility. The first, which we call *Political Sensitive Industries (PSI)* includes three standard industry screens: tobacco, guns and defense, and natural resources. We exclude vices such as alcohol and gaming from *PSI* since they are objectionable for religious or ethical reasons making predictions along political values lines less clear. The second measure is a commercially available score of corporate social responsibility provided by Kinder, Lydenberg, Domini, & Co. (KLD). The KLD ratings are built on a point-by-point assessment of companies along a number of dimensions. We focus on ratings in the categories of community activities, diversity, employee relations and environmental record, since they are most sensitive to political values. Our two measures of social responsibility are nearly orthogonal so results using one measure are unlikely to be driven by a mechanical correlation with the other measure.

We find strong evidence that political values influence the investment decisions of mutual fund managers. We first look at whether managers of different parties have different weights on politically sensitive industries. Because industry weights are correlated with fund style, we adjust each manager's holdings in politically sensitive industries by the fund's style

which is defined by the value-weighted mean size and value (book-to-market) characteristics across all the fund's holdings (Daniel, Grinblatt, Titman and Wermers (1997)), and we focus on the *residual* holdings in PSI. This ensures that our results are not an artifact of variations in fund style.

We find that a typical “Strong” Democrat holds -0.98% in *Residual PSI*, i.e. he under-weights politically sensitive industries by about 1% relative to a typical fund with the same size and value characteristics. In contrast, a “Strong” Republican holds 0.37% in *Residual PSI* or slightly over-weights politically sensitive industries. However, the Republican over-weighting is not statistically or economically significant. The difference in politically sensitive holdings between Strong Democrats and Strong Republicans is -1.34% with a t-statistic, clustered by manager, of 3.52. We also test whether there is a difference in the holdings of non-politically-sensitive vice stocks such as alcohol and gaming, and find no difference between Democrat and Republican donors.

While SRI funds are more likely to be managed by Democrats, it's important to emphasize that we drop all SRI funds from these tests so differences in the holdings of managers from different parties are not picking up the mechanical under-weighting of *PSI* by SRI funds. The typical SRI fund naturally under-weights the politically sensitive industries by 1.6% (adjusting for size and value characteristics), while a typical Strong Democrat under-weights *PSI* by about 1%. Thus, Strong Democrat managers of non-SRI mutual funds are nearly behaving like SRI funds in their holdings of stocks in politically sensitive industries. Moreover, a manager's political affiliation is largely uncorrelated with other fund and manager characteristics. As such, our results are robust to controlling more finely for a host of other fund and manager characteristics, in a multiple regression context.

We find similar results when we test whether managers of different parties hold stocks with different KLD Social Ratings. The typical stock in a portfolio managed by a Strong Democrat has a style-adjusted *KLD Rating* of 14.64 whereas that of a Strong Republican has a score of -2.54 (Higher ratings represent better grades on social responsibility measures). The spread in scores between Strong Democrats and Strong Republicans of 17.18 is significant with a t-statistic of 2.07. In contrast, a typical SRI fund has an adjusted score of 29.70 so the political ideology spread is again more than half of the spread between the holdings of SRI and non-SRI mutual funds, again emphasizing the economic significance of our results. These results are also robust to controlling for other manager and fund characteristics.

Beyond providing comfort in the robustness of our findings, the KLD measures are also useful in gauging whether Democratic managers not only avoid socially irresponsible stocks but also tilt towards stocks that are socially responsible. KLD not only ranks companies based on “concerns” criteria (e.g. whether or not a firm does environmental damage) but also on “strengths” criteria (e.g. whether a firm does a lot of charitable giving). As a result, we can see whether Democratic managers tilt towards firms that score higher on strengths criteria. We find that a significant fraction (more than a third) of the higher ratings of stocks in Democrat managers’ portfolios comes from seeking companies with strengths (as opposed to avoiding companies with concerns)

We are not sure about the exact reasons why political values influence mutual fund managers’ investment decisions. Our findings suggest that some form of “closet” SRI has been occurring in markets for some time with potentially important implications for stock prices. Importantly, our findings are not about retail investors who may or may not matter for price setting, but for mutual fund (and hedge fund) managers who are presumably the arbitrageurs or



marginal price setters in markets. The fact that Democratic managers are engaging in “closet” SRI and the Republicans are not doing much to counteract it implies a substantial effect of social responsibility for stock prices. We estimate that Democratic managers keep 1.3% of the market cap of politically-sensitive industries “off the market”. This is only slightly less than the 2% that S&P500 index funds hold “off the market” for stocks outside the S&P500 and the pricing implications of S&P500 have been well-documented.

In reality, distinguishing between pecuniary and non-pecuniary reasons is a difficult task since these rationales are intimately connected and lead to very similar behavior. Nonetheless, we attempt to parse out these different motives. The work of Geczy, Levin, and Stambaugh (2003) suggests that if the managers were simply indulging in non-pecuniary perks due to agency, then their performance might suffer as a result. We find that the overall performance of Democratic and Republican managers does not significantly differ in spite of their different loadings on socially responsible stocks. At least on the surface, it does not appear that the behavior of Democratic managers is hurting them. However the sample is quite short, so we are cautious in drawing definitive inferences regarding performance.

Our finding is also not driven by whether the mutual fund outsources its management. The theory work of Holmstrom (1999) on outsourcing and subsequent empirical work by Chen, Hong and Kubik (2007) on outsourcing of mutual funds argue that managers of outsourced funds may face weaker overall incentives. Hence, we might expect our effect to be more pronounced for outsourced funds to the extent that those managers face greater agency issues. However, we find that our results are not related to the outsourcing status of the fund.

We look to the hedge fund industry for a better understanding of how agency issues impact managerial investment decisions. Since hedge fund managers often have a significant

ownership stake in their funds and have incentive-based fees as a large part of their compensation, we believe they would be less likely to shift their investment holdings unless they believed it was also in the best interest of their fund. Even though our data set of hedge funds is smaller, we find similar patterns in the fund holdings of Democrat and Republican hedge fund managers.

We also test whether the difference in holdings of Democrat and Republican donors may be due to catering to local clients or stakeholders (who might have their own political values). We find that the political ideology of the state in which the mutual fund is based has no explanatory value in predicting the social responsibility of fund holdings.

Finally, we investigate whether managerial political contributions change over time and are affected by the contributions of other managers working at the same asset management firm. We show that campaign contributions are manifestations of a political affiliation that is usually stable over time, and that there is no effect of mutual fund “family” campaign contributions on either a manager’s individual contributions or investment decisions. This supports our fundamental assumption that political affiliation is largely a fixed effect, and thus that the timing of contributions is unrelated to portfolio holdings.

Our paper proceeds as follows. We describe the data in Section 2 and present the main results, robustness checks and additional analysis in Section 3. Section 4 discusses the possibility of sample selection bias and its effect on our results. The implications of these results, particularly in light of the fast growing SRI movement, are discussed in Section 5. We conclude in Section 6 with thoughts about future research.

## **2. Data**

We begin with Morningstar Principia Disks from 1992 to 2006 and focus on mutual funds run by a single manager, which encompasses more than half of the mutual fund universe.<sup>4</sup> We have approximately 2100 managers in our sample. The Morningstar disks provide names and tenures for each manager, along with advisory firms for each fund. We merge this single-manager Morningstar sample with the CRSP Mutual Fund Database and the CDA Spectrum Mutual Fund Holdings Database. The CRSP Mutual Fund Database provides information on a variety of mutual fund characteristics such as monthly fund returns and assets under management (or fund size). The CDA Spectrum Mutual Fund Holdings Database is used to obtain quarterly fund holdings. Funds that don't have the requisite information from all three databases in any given month are dropped from our sample. Our sample consists of actively-managed, diversified, domestic, equity mutual funds.

We obtain information on the political contributions of fund managers from the Federal Elections Committee (FEC) website ([www.fec.gov](http://www.fec.gov)), a site which makes files available for all federal contributions starting in 1979. Any individual who makes federal contributions is recorded in this database, which also provides the donor's home address, employer and amount of contributions to various candidates (along with each candidate's party). Using the names, addresses and employers of the managers from Morningstar, we look up each manager's potential contributions from this website. Of the 2100 managers, we are able to find approximately 600 of them in the FEC database. The rest are classified as non-donors.

Whenever available, we augment the managerial data with the database collected for Kostovetsky (2007), which contains managerial biographical information including year of birth, undergraduate institution, median SAT score of accepted freshmen at that institution in 2005,

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<sup>4</sup> For team-managed funds, it is not clear how to categorize a fund if it were managed both by Democrats and Republicans. Moreover, in some cases, fund management is simply reported as team-managed.

gender, graduate education dummy and graduate degree attained (if any). We have full biographical information on nearly 90% of the approximately 2100 managers in our sample, but we do not drop observations if there is missing biographical information.

For mutual fund stock holdings, we obtain shares outstanding, price, and SICCD (industry code) from the CRSP database. We obtain data for the calculation of book value (and thus book-to-market) from COMPUSTAT. The SRI status of a fund is obtained from the Social Investment Forum website. KLD social ratings<sup>5</sup> are obtained from the KLD database. We use a combination of SICCD code and KLD screens to define the *Tobacco*, *Guns and Defense*, *Natural Resources*, and *Other Vices* (alcohol and gaming). *Guns and Defense* consists of gun and weapons manufacturers as well as military contractors such as Boeing and Northrop Grumman. *Natural Resources* consists of forestry and mining companies.

We add up all contributions to federal candidates over the entire sample period from 1992 to 2006, and categorize them by the registered party of the recipient of the contribution. A manager is categorized as a Democrat donor if his *net* cumulative contribution to Democrats is positive and a Republican if it is negative. If the manager gave equally to both parties or if he does not appear in the FEC website, then we label him a non-donor. Of the roughly 600 managers we are able to find in the FEC database, about two-fifths are labeled Democratic and the remaining three-fifths are labeled Republican. Moreover, we further subdivide both Democrats and Republicans into a Strong group and a Weak group. The Strong group is defined as those managers who gave more than \$2000 in net contributions while the Weak group gave net donations less than or equal to \$2000. Under the McCain-Feingold Campaign Finance Reform of 2003, the cap on individual contributions to a political candidate in an election cycle

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<sup>5</sup> Only S&P500 stocks are covered by KLD in the first half of our sample so we focus on these stocks to avoid any time bias in our results.

was set to \$2000, so it's a convenient breakpoint between Strong and Weak supporters of either party.

It is important to note that using political contributions to proxy for personal attitudes toward firm social responsibility causes at least some measurement error. Some contributors may be making donations based on relationships with candidates rather than partisan affiliation. Some Republicans may have stronger negative attitudes toward tobacco or pollution than other Democrats. Finally, there might be selection bias if mutual fund managers (of either party) are different from the rest of the population so that their attitudes are also different and not reflected by opinion surveys of the general population. However, as long as these measurement errors are uncorrelated with true attitudes, they would tend to bias our study towards the null hypothesis.

Table 1 provides summary statistics for the explanatory variables of interest. All statistics are time-series averages of cross-sectional quarterly means and standard deviations. *Number of Funds* is simply the number of funds in our sample. The typical cross-section has about 488 funds in total. In a typical quarter, 61 funds are managed by Democrats and 106 funds by Republicans. Of the 61 Democratic funds, 35 are managed by Strong Democrats and 26 by Weak Democrats. Of the 106 Republican funds, 68 are managed by Strong Republicans and 38 by Weak Republicans. The remaining 321 funds are managed by non-donors.

*Manager Age* gives the age of the manager. There is little difference in age between Democrats and Republicans in our sample, but Democrats and Republicans are slightly older than non-donors. Part of this result may be due to wealth since older managers may be wealthier and hence can afford to make political donations. Alternatively, it might be that older managers have had more time to develop and express their political convictions. We next report the *Median Undergrad SAT* of the managers. Democrats have a somewhat higher SAT and again it

appears that managers who donated have higher SAT scores than non-donors. It might be that better-educated managers are wealthier and hence can afford to donate more to the party of their choice. We then report the gender (the dummy variable *Female*) of the manager. There are slightly more females among Democrats. The fraction of the managers with a graduate degree (dummy variable *Graduate Degree*) is also calculated. A somewhat higher fraction of Republican mutual fund managers have a graduate degree (usually MBA), 76.7% compared to 65.6%. In sum, these biographical details indicate some differences in terms of personal attributes between Democrats and Republicans, which we will control for in our analysis.

We next analyze whether there are differences in the portfolios managed by Democrats and Republicans. The first characteristic we consider is whether a fund is an SRI fund (a dummy variable *SRI Fund*). For the most part, our analysis will focus on non-SRI funds since the underweighting of socially irresponsible firms is “hard-wired” for most SRI funds. Only a small fraction of the funds in our sample are SRI funds (2.6%). Interestingly, we find that Democrats are more likely to manage an SRI fund: 8.4% of Democratic funds are SRI, while only 2.9% of Republican funds are SRI. Indeed, we find that among funds managed by Strong Democrats, 11.9% are SRI. This finding is important for two reasons. First, it means that we need to exclude or control for SRI fund status in our analysis to make sure SRI (rather than political affiliation) is not driving our results. The second reason is that this finding is consistent with our hypothesis that political values shape investing decisions. Democrats are more likely to run SRI funds and hence invest in socially responsible companies.

We go on to tabulate a number of measures of style and characteristics of the funds in our sample. The first two are fund size, i.e. assets under management (*Log Fund Size*) and family size or the assets under management of the family to which the fund belongs (*Log Family Size*).

There is little difference in terms of these two fund characteristics between Democratic and Republican managers. We also tabulate the mean log of the size (*Mean Component Log Size*) and the mean log of the book-to-market (*Mean Component Log B/M*) of the stocks held in a fund's portfolio. It appears that Republican funds hold slightly larger stocks (15.42 compared to 15.28) and slightly more in growth stocks (-1.09 to -1.13). Again, we will carefully control for these differences in our analysis.

Finally, in Table 1, we tabulate the dollar contributions of each donor group. *Dem Contributions* is simply defined as the net contributions to Democratic (versus Republican) candidates by managers. In our sample, the mean of *Dem Contribution* is -\$2,900, which indicates that the average manager is leaning Republican. We then break down contributions by affiliation, \$15,700 for Democratic donors and \$22,500 by Republicans. Clearly, Republicans tend to donate more money than Democrats. It is also informative to look at the contributions by Strong and Weak political leanings. Strong Democrats give \$26,700 compared to \$890 for Weak Democrats. And Strong Republicans give \$34,100 compared to \$950 for Weak Republicans. For completeness, we recalculate these donations by excluding SRI funds. Little is changed since SRI funds are only a small part of our sample.

In order to deal with outliers and skewness in the *Dem Contributions* variable, we work with the natural logarithm of contributions. *Dem Log Contributions* is the natural log of *Dem Contributions* if *Dem Contributions* is positive and minus the natural log of the absolute value of *Dem Contributions* if *Dem Contributions* is negative. It is set to zero if *Dem Contributions* is zero. This is a convenient way to rescale *Dem Contributions* while preserving the ranking in terms of political leanings.

Having completed a description of Table 1 and the explanatory variables of interest, we present in Table 2 the summary statistics for the dependent variables of interest. Namely, we focus on characterizing the holdings of mutual funds in terms of their investments in socially responsible stocks. We drop SRI funds for all tabulations in Table 2. In Panel A, we define *PSI*, our dependent variable of interest, as a dummy variable that equals one if a stock belongs in any of the following three industries: *Tobacco*, *Guns and Defense*, and *Natural Resources*. For all (non-SRI) funds, roughly 3.6% of a fund's holdings are in *PSI*. It is 2.82% for Democrats compared to 3.75% for Republicans. Indeed, if we look at Strong Democrats compared to Strong Republicans, the corresponding numbers are 2.55% compared to 3.91%. For comparison, a typical non-donor fund holds about 3.7% in *PSI*. These summary statistics tell us that Democratic funds are under-weighting stocks in politically sensitive industries. However, we can not draw conclusions from this table since these raw holdings do not adjust for the covariates that we discussed in Table 1. The next three rows break down these holdings into *Tobacco*, *Guns and Defense* and *Natural Resources*. Democrats, and particularly Strong Democrats, hold fewer stocks in each of these politically sensitive industries.

We also report fund holdings in *Other Vices* (alcohol and gaming). We leave alcohol and gaming out of *PSI* because the shunning of these industries by SRI funds may be driven more by religious screens than by political ideology. Since religious voters are more likely to be Republicans, we did not believe that these industries would be politically sensitive in the same way as the three industries in *PSI*. Indeed, we find that Democratic managers are slightly *over-weighting* gaming and alcohol compared to other managers. This finding is comforting because it shows that political ideology and SRI are not picking up identical effects, although there is obviously significant overlap between the two effects.



In Panel B, we report the KLD Ratings of the stocks held by the mutual funds in our sample. The *KLD Social Rating* is defined as the sum of the *Community Activities*, *Diversity*, *Employee Relations*, and *Environmental Record* scores. Ratings for a firm in each category are obtained by adding one point for each strength and subtracting one point for each concern, with higher ratings implying more strengths and/or fewer concerns. A mutual fund's rating in each category is just the value-weighted average of its portfolio stock components' ratings.

To make things clear, we will show how we calculate a firm's rating for the *Communities Activities* category. There are four *Community Activities* Strengths: "Charitable Giving", "Innovative Giving", "Support for Housing", and "Other Community Strengths"<sup>6</sup>. A firm gets a score of one if they perform well in a particular criterion and zero otherwise. There are also four *Community Activities* Concerns: "Investment Controversies", "Negative Economic Impact", "Tax Disputes", and "Other Community Concerns". A firm gets a score of -1 if they have a problem in one of these four subcategories and zero otherwise. For example, if a company has no strengths or concerns, it receives a *Community Activities* score of zero. If it performs "Charitable Giving" and "Innovative giving", it gets a score of 2. If it performs "Charitable Giving", "Innovative Giving", but also has "Tax Disputes", i.e. 2 strengths and 1 concern, it receives a score of 1. If it has "Tax Disputes" and "Other Concerns", it gets a community score of -2. Ratings for the other three categories are calculated in the same way.

We also only use scores for subcategories that were available throughout our sample period. For example, there is a community category called "Indigenous Peoples Relations" which was only introduced in 2000. We omit it to avoid any time biases. There are also three additional categories tracked by KLD beyond the four we consider: Human Rights, Corporate Governance,

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<sup>6</sup> KLD explains how each of these categories is defined.

and Product Quality. Human Rights only became available in the second half of our sample so we again omit it to avoid time biases. Corporate Governance and Product Quality are unrelated to political values, and are instead related to the profitability of a firm so it is not appropriate to include them when measuring the role of political values in investment decisions.

The first row of Panel B shows that the *KLD Rating* for a typical fund in our sample is 1.26. The *KLD Rating* for funds managed by Democrat donors is higher than those managed by Republican donors: 1.31 compared to 1.24. Indeed, when we compare Strong Democrats and Strong Republicans, the difference is 1.37 compared to 1.25. Similar results hold for each of the four categories, with higher ratings for funds managed by Strong Dems funds relative to other funds. Again, we don't want to draw any conclusions until we properly control for other managerial and fund characteristics that may explain these results.

### 3. Results

#### 3.1. Political Values and Holdings in Politically Sensitive Industries

We first look at mutual fund holdings in politically sensitive industries. The results are presented in Table 3. The dependent variable of interest is the residual holdings of stocks in politically sensitive industries. Industry loadings are adjusted for style effects by running cross-sectional (quarterly) regressions on *Mean Component Log Size* and *Mean Component Log B/M* and assigning each observation the residual from these regressions. For example, the *residual* holding in tobacco for fund  $i$  in quarter  $t$  is obtained by estimating the following cross-sectional regression within quarter  $t$ :

$$(1) \quad Tobacco_i = \mu + \varphi_1 * Mean Component Log Size_i + \varphi_2 * Mean Component Log B/M_i + \varepsilon_i$$

Then, fund  $i$  inherits the residual using the estimated coefficients from this regression. This also eliminates time-series variation in industry holdings since the residuals have means of zero within each quarter. *Residual PSI* is simply calculated by adding up the residual industry holdings in *Tobacco*, *Guns and Defense*, and *Natural Resources*.

The first row reports residual holdings in all politically sensitive industries for different managers sorted by political contributions. Throughout Table 3, SRI funds are dropped from the sample. We can see that Democrats under-weight *PSI* by 0.68%, whereas Republicans slightly over-weight *PSI* by 0.18%. The difference is -0.86% which has a t-statistic (clustered by fund manager) of 3.20. The effect is significantly stronger when we compare Strong Democrats to Strong Republicans. A Strong Democrat holds about -0.98% in *PSI* or under-weights (relative to size and value characteristics) by about 1%. A Strong Republican in contrast holds about 0.37% or slightly over-weights these politically sensitive industries. The difference between Strong Democrats and Strong Republicans is -1.34% with a t-statistic (clustered by manager) of 3.52. Notice that non-donors hold about 0.14% in *PSI*. Hence, Strong Republicans are slightly tilted toward socially irresponsible stocks, although this effect is not statistically significant.

In the next three rows, we break down the results by the constituent politically sensitive industries. Notice that all the signs go in the correct direction, in that each of the constituent industries is contributing to the strong *PSI* results. The spread between Democrats and Republicans for *Tobacco* is -0.29% with a t-statistic of 1.69. For *Guns and Defense*, it is -0.40% with a t-statistic of 2.36. It is slightly weaker for *Natural Resources*, with a spread of -0.17% and a t-statistic of 1.46. Comparing Strong Democrats to Strong Republicans across each of these constituent industries, one also finds consistent results. One interesting observation is that the

Strong Republican over-tilting toward PSI is largely driven by the tobacco industry. One thing to note in interpreting these constituent industry results is that *PSI* results can lead to a bigger point estimate difference and statistical significance because we are adding up the effects from each of the industries. Notice that the coefficients from the constituent industries (excluding *Other Vices*) add up to the *PSI* coefficients.

And as we suspected, there is no difference between Democrats and Republicans in the loadings on *Other Vices* such as alcohol and gaming. The spread is actually slightly positive at 0.02% with virtually no statistical significance. When we compare Strong Democrats to Strong Republicans, we actually see that Strong Democrats are tilted *towards* alcohol and gaming, 0.29% compared to 0.07% for Republicans and -0.02% for non-donors. However, these spreads are statistically insignificant. This is consistent with our hypothesis that attitudes toward *Other Vices* such as alcohol and gaming are based on religious rather than political values.

In Table 4, we conduct a similar analysis but use multivariate regression analysis. This allows us to control for other potential covariates. The dependent variable of interest is still *Residual PSI* while the independent variable of interest is *Dem Log Contributions*, a continuous measure of political values using the magnitude of political contributions. In column (1), the coefficient in front of Democratic Log Contributions is -0.049% with a t-statistic of 2.80. In order to see the economic significance of this coefficient, one can multiply the coefficient -0.049% by 16.54, which is the difference in the mean *Dem Log Contribution* variable for Democrats (8.13) and the mean *Dem Log Contribution* for Republicans (-8.41) (both of these numbers come from Table 1). This gives us a difference of -0.81%, which is roughly equivalent to the -0.86% figure for the Democratic and Republican spread from Table 3. Notice that SRI

funds are excluded in this analysis for columns (1)-(3) just as in Table 3. This assures us that our results, both here and in Table 3, are not driven by a fund's SRI status.

In column (2), we use raw *Dem Contributions* instead of the natural log and find similar results. In column (3), we replace the continuous measure of political ideology with a dummy variable for Democrats and a dummy variable for Republicans (*All Dems Dummy* and *All Reps Dummy*) and retrieve a coefficient of -0.816% on the *All Dems Dummy* and a coefficient of 0.044% on the *All Reps Dummy*. The difference in these coefficients is the value of -0.86% from Table 3.

In column (4), we return to *Dem Log Contributions* as the variable of interest and add SRI funds into our sample, as well as introducing a host of covariates including an *SRI Fund* dummy, other managerial characteristics, and fund characteristics. The coefficient in front of *Dem Log Contributions* is -0.050% with a t-statistic of 3.02, which is virtually unchanged from before. The *SRI Fund* dummy variable gets a coefficient of -1.723% with a t-statistic of 5.51. We can see that the typical SRI fund naturally under-weights politically sensitive industries by about 1.7 percentage points.

The SRI effect is a useful benchmark with which to judge the economic significance of our results. The spread between Democrats and Republicans is about 0.9% or roughly half of the SRI under-weighting. Thus, about half of Democratic managers of active non-SRI US mutual funds are mimicking SRI funds in their loadings on politically sensitive industries. Moreover, a manager's political affiliation is largely uncorrelated with other fund and manager characteristics. As such, our results hold when we control more finely in a multiple regression context for a host of other fund or manager characteristics. Notice that few of the other coefficients are significant. One exception is *Median Undergrad SAT*, which comes in with a

negative coefficient. One explanation why better-educated managers may hold less of their portfolio in politically sensitive industries is the focus at top colleges on growing industries which gives these managers (relatively) less knowledge about “old economy” sectors like tobacco, guns, or mining. In columns (6) and (7), we check that our results are robust to different ways of clustering standard errors, and find that our results are largely unchanged when we cluster by fund or by fund family.

In columns (5) – (7), we also introduce region dummy variables for each of the nine US census regions. This is meant to ensure that the effect of political values is not being driven by the location of the fund, i.e. local bias. For example, it is possible that Republicans from the South hold more southern stocks (which happen to be socially irresponsible stocks like tobacco) while Democrats from the West Coast hold “coast” stocks (which happen to be socially responsible stocks like technology). Instead, by comparing columns (4) and (5), it’s easy to see that adding region dummies makes little difference for our analysis.

In Table 5, we break down the regression analysis in Table 4 into constituent industries. The first two columns just replicate the *PSI* results from Table 4 for comparison purposes. The next three pairs of columns show the results by constituent industries. Notice that in each case, the coefficients on *Dem Log Contributions* all go in the correct direction, i.e. more Democratic contributions lead to lower loadings on each politically sensitive industry. When one performs the calibration in Table 4 for each of the constituent industries, one finds similar results to the breakdown in Table 3, i.e. under-weights by Democrats are about half as large as those of SRI funds. In contrast, SRI funds significantly under-weight *Other Vices*. Yet Democrats do not under-weight this sector at all. This tells us that *Dem Log Contributions* is a more refined measure of political values than simple SRI loadings.

### 3.2. Political Values and KLD Scores of Fund Portfolios

We next use KLD ratings as alternative measures of firm corporate responsibility. We find very similar results when we use the KLD score measure. Table 6 is the KLD score analogue to Table 3. Again, KLD scores are adjusted for size and value characteristics in the same way as the *PSI* measure was adjusted in Table 3. The *KLD Rating* of a typical stock in a Democratic manager's portfolio is 7.75 in contrast to a -3.26 for that in a Republican-managed fund. The spread of 11.01 has a t-statistic of 2.00. Comparing Strong Democrats to Strong Republicans, we find that a Strong Democrat fund has an adjusted score of 14.64 whereas a Strong Republican has an adjusted score of -2.54. The spread in scores of 17.18 is significant with a t-statistic of 2.07. The typical non-donor's portfolio of stocks has a score of -1.79.

We then break down the *KLD Rating* into its constituent components: *Community Activities*, *Diversity*, *Employee Relations*, and *Environmental Record*. Across the board, we find that Democrat-managed funds have significantly higher scores and these differences expand when we compare Strong Democrats to Strong Republicans. Again, the point estimates of the scores by the components add up to the KLD rating. In totality, we find that stocks holdings of Democrats are more socially responsible than those of non-donors or Republicans. Republicans are again slightly tilted toward irresponsible stocks compared to non-donors (-2.54 compared to -1.79).

In Table 7, we run a multiple regression analysis using Residual KLD rating (the analogue to Table 4 for *PSI*). In column (1), the coefficient in front of *Dem Log Contributions* is 0.65 with a t-statistic of 1.91. Similar results hold if we use raw Democratic contributions in

column (2) and dummy variables for political affiliations in column (3). Again, the results in columns (1) – (3) exclude SRI funds.

In column (4), we consider a more elaborate regression specification with controls for a host of covariates. The coefficient in front of *Dem Log Contributions* is 0.76 with a t-statistic of 2.35. So multiplying this by 16.5 gives 12.5, which is the spread in the score between Democrats and Republicans. The coefficient in front of *SRI Dummy* is 29.7 so a typical SRI fund has an adjusted KLD score of 29.70 (relative to non-SRI funds). The spread between Democrats and Republicans is 42% (12.5 divided by 29.70) of the SRI spread, which emphasizes the economic significance of our results. These results are also robust to controlling for other manager and fund characteristics, using different ways of clustering standard errors, as well as controlling for local bias with regional dummy variables.

In Table 8, we break down the multiple regression analysis of Table 7 by the constituent category scores that go into the overall *KLD Rating*. This table is the analogue to Table 5 for *PSI*. The results are very similar to that of Table 7. Across the board, Democrats tend to hold stocks with higher KLD scores than non-donors and Republicans. And the economic magnitudes using the coefficients on *SRI Dummy* as a benchmark are fairly strong across the board as well.

Beyond providing comfort in the robustness of our findings, the KLD scores are also useful to gauge whether Democratic managers not only avoid socially irresponsible stocks but also tilt towards stocks that are socially responsible. KLD not only ranks companies based on concern criteria (for which a firm gets 0 if there is no concern and -1 if there is a concern) but also on strength criteria (for which a firm gets a 1 if there is a strength and 0 if there is no strength). As a result, we can see whether Democratic managers tilt towards firms that score higher on strengths criteria or whether they solely steer away from firms with concerns.



In Table 9, we conduct just such an analysis. We take the format and specifications of Table 8 where our dependent variables were the overall KLD scores of a manager's portfolio and the scores by the different categories of community activities, diversity, employee relations and environmental record. Rather than considering these scores, we consider separately a portfolio's strength criteria score as compared to its concerns criteria score within of these categories. In Panel A, the overall strength and concerns scores are considered in the first two columns respectively. The coefficient in front of *Dem Log Contributions* is 0.267 for the strengths score and 0.467 for the concerns score. Notice that these two coefficients add up to the coefficient in the third column for the total effect. This total coefficient is the same as the one on *Dem Log Contributions* in column (2) of Table 8. We suppress the coefficients for all the other control variables for brevity. Concerns clearly play a stronger role than strengths in the investment decisions of Democratic managers. Still, it seems that Democratic managers do not simply tilt away from concerns but also tilt towards companies with positive social contributions.

It is instructive to do the same analysis within each of the four separate categories. For community activities, the strengths and concerns effect are of similar magnitude. For diversity, the strengths effect is stronger than the concerns effect. In this category, Democratic managers tilt toward companies with strong diversity records. The effects for employee relations are similar. For environmental record, Democratic managers steer away from companies with lots of concerns, but also move away from companies with lots of strengths.

We should avoid drawing too strong a conclusion from these results since the strengths and concerns features may be correlated so firms with lots of strengths are probably also firms with fewer concerns. Furthermore, none of these decompositions is statistically significant. Nonetheless, this analysis does suggest that the effects are not simply coming from Democratic

managers avoiding firms with social concerns, but also from seeking stocks that actively try to behave in a socially responsible manner.

### *3.3. Robustness Checks*

We also conducted a number of robustness checks, which we briefly summarize here. Details can be obtained from the authors. First, we categorize managers as Democrats and Republicans only if they donated to either one party or the other and not both. Currently, we take the net contributions to define political affiliation, but we could also consider only “pure donors”. We find that the results are similar when we use this metric of political affiliation. Second, we consider the robustness of our findings to different sub-periods. Unfortunately, our sample period is fairly short, so results should be taken with a grain of salt. We split our sample period into two equal sub-periods and find similar magnitudes in both halves of the sample. Third, we drop non-donors from the sample for all regressions and find similar results. Finally, we use the nine Morningstar style boxes (Large, Midcap, Small X Growth, Blend, Value) as style controls instead of the continuous variables (mean component log size and mean component log book-to-market) and find similar results.

### *3.4. Additional Analysis*

For the most part, we are agnostic about how values influence investments, though we provide some discussion and analysis below. As we will argue in the conclusion, regardless of the exact motivation, the fact that values influences investments may have important implications for financial markets. Nonetheless, we briefly take a stab at parsing out these different motives. The work of Geczy, Levin, and Stambaugh (2003) suggests that if managers

were simply indulging in non-pecuniary motives due to agency, then their performance might suffer as a result. Similarly the work of Hong and Kacperczyk (2007) on the abnormal risk-adjusted out-performance of sin stocks suggests that Democratic managers might be hurt by their tilt toward social responsibility.

In Table 10, we regress the performance of the mutual fund managers in our sample on the measures of political affiliation. The first three columns report the results for monthly fund returns net of expenses. Interestingly, we find some evidence that Republican managers do better than Democratic managers. In column (1), the coefficient in front of the All Dems Dummy is 0.061% compared to the coefficient of 0.092% for All Reps Dummy. Similar results obtain in column (3). This suggests that both Democrats and Republicans do better than non-donors but that the out-performance difference between Democrats and Republicans is small (only around 3 basis points a month or 36 basis points a year). In column (2), we run a parametric version of these regressions using the linear variable *Dem Log Contributions* and we can see that the coefficient is not statistically significant. The out-performance by both sets of donors is potentially hard-wired in this sample since donors probably donated or could donate because their funds might have done better than average. Remember that this is not a feasible trading strategy since we identify political contributions ex-post over the entire sample period.

We get very similar results when we use other measures of fund performance including the standard Carhart (1997) four-factor adjusted alphas and Daniel, Grinblatt, Titman, and Wermers (1997) adjusted alphas. These results are reported in columns (4) through (7). Indeed, using these metrics, we find almost negligible differences in the performance of Democratic versus Republican managers. We can conclude that the overall performance of Democratic and Republican managers does not differ much as a result of their different tilts to socially

responsible stocks. At least on the surface, it does not appear that the investment choices of Democratic managers is hurting the bottom line. However, the sample period is fairly short, so it is difficult to draw definitive inferences regarding performance.

Given that we do not find a substantial difference in performance of Democratic managers, we are still not sure whether the motive is pecuniary or non-pecuniary in nature. Had we found a substantial deterioration, we might have concluded in favor of the non-pecuniary side. Instead, we rely on the theories of agency and organization to generate some predictions that might cut in favor of one side or the other. The basic idea is that, to the extent that the influence of political values on holdings is similar to perks, we should find it prevalent in situations where the manager faces greater agency issues. We rely on previous theory work of Holmstrom (1999) on outsourcing and subsequent empirical work by Chen, Hong and Kubik (2007) on outsourcing of mutual funds that argue that managers of outsourced funds may face worse incentives. Hence, we would expect our effect to be more pronounced for outsourced funds to the extent those managers face greater agency issues.

In Table 11, we take the regression specifications from earlier tables and introduce two new independent variables. The first is *Fund Outsourced*, which is a dummy variable which equals one if a fund's management is outsourced and zero otherwise. The second is *Fund Outsourced x DLC*, which is the interaction of the outsourcing dummy variable with our variable of interest which is *Dem Log Contributions* (or DLC for short). We consider our two measures of social responsibility as dependent variables.

In the first two columns, we look at the effect of outsourcing on the *residual PSI*. For *residual PSI*, the coefficient in front of *Fund Outsourced x DLC* is positive and statistically insignificant. We would expect a negative coefficient in front of the interaction term if the effect

of political ideology on the holding of politically sensitive industries is stronger for outsourced funds. In the second two columns, we present the results for the *Residual KLD Rating*. Again, we expect to see that our effect is bigger for outsourced funds, which, in this case, means a positive coefficient in front of the interaction term. Instead, the coefficient is actually negative with borderline statistical significance. Thus, there is actually a *smaller* effect among outsourced funds.

One can draw a couple of conclusions from these findings. It does not appear that our results are due to perk behavior in which managers with fewer incentives engage in more of this behavior. However, it does not rule out that the results are still of a non-pecuniary nature. It might be that such non-pecuniary behavior is tied up with a rationalization that such stocks do well. As a result, outsourced managers who are performing their management at “arm’s length” do not really care to engage in such behavior. In contrast, a manager with substantive stake in the fund might actually engage in more of this behavior to the extent that he views it as active management that is also good for society but whose costs are minimal to him and his fund.

Finally, we also test whether this behavior is due to managerial catering to regional clients. Democratic managers might simply be representing Democratic investors who want their fund to be more socially responsible even if it’s not officially an SRI fund. In order to see whether this is the case, we can control for the political leanings of the state in which the fund is headquartered. The idea is that if most of a fund’s clients are local then the state political affiliation captures the political values of their clientele.

We conduct just such an analysis in Table 12. Using the standard regression specifications from before, we introduce a new variable called State Dem Share, which is simply the Democratic share of the two-party vote in each state in the prior four presidential elections

(1992, 1996, 2000, and 2004). We find the political affiliation of the state in which the fund is headquartered are not driving our results. The coefficient in front of State Dem Share is insignificant and the coefficient in front of our variable is unchanged. We also repeat the analysis and exclude funds from New York and Massachusetts from our sample. The rationale for this exclusion is that many of the fund families in these mutual fund hubs (like Fidelity and Oppenheimer) have national clienteles so their decisions may not be driven by their (Democratic) leanings of their states. We find that this makes little difference for our results.

### *3.5. Hedge Funds*

We next turn to the hedge fund industry to get a better understanding of *how* political values affect investment decisions. One possibility is that our results are a product of weak corporate governance standards at certain mutual funds allowing their managers to indulge their own political sensibilities even at the expense of shareholders. In that case, we would expect hedge fund managers, who have stronger performance incentives in their compensation packages and often have a large ownership stake in their funds, would be less likely to alter their holdings to correspond with their own political affiliation. Alternatively, if our results in the mutual fund arena are a product of different beliefs about investment opportunities among managers with different political values, we would expect to see similar results in the hedge fund industry.

We gather data on hedge fund holdings from quarterly 13f filings, and use the TASS database for a list of current and defunct hedge fund firms. Holdings are aggregated at the management company level so we are unable to determine which hedge fund is holding which stocks for firms that manage multiple hedge funds. Furthermore, only firms that control over \$100 million in equities are required to report their holdings. As a result of these two

requirements, our sample consists of only 185 U.S. hedge funds, a much smaller sample size than we have for mutual funds. Another limitation is that 13f filings only show long positions in US equities while hedge funds often go short or invest in other asset classes such as bonds, commodities, and derivatives. These limitations add noise causing the significance of our results to be downward biased.

We gather a list of hedge fund managers from TASS and match it with campaign contributions using the FEC filings. Since most hedge fund firms manage multiple funds and have multiple named managers, we aggregate contributions across managers for each firm. Thus a “Democrat” hedge fund firm would be one where its managers gave more in combined contributions to Democrats than Republicans. Industry classification and KLD Ratings are obtained in the same way as described in the data section for mutual funds.

We perform two simple tests that are identical to those performed for mutual fund managers. Unfortunately, we lack data on hedge fund manager characteristics so we replicate the multivariate regression analysis. We first sort hedge fund management firms by the net contributions of their managers to investigate the effect of political affiliation on industry holdings. Table 13 shows hedge fund holdings, adjusted for differences in style, in different politically sensitive industries for firms with managers of differing political affiliations. Democrat-run hedge funds underweight *PSI* by 0.76 percentage points relative to hedge funds managed by Republicans (t-statistic of 2.02). The results are significantly weaker when we divide managers into Strong and Weak Democrats (and Republicans) and look into the constituent industries. This is not surprising given our small sample and the data limitations which add noise to our data.

We also look at the KLD Social Ratings of firms owned by hedge funds with managers of different affiliations. Table 14 shows the style-adjusted mean social ratings of firms owned by Democrat-run hedge funds versus hedge funds run by Republicans. As with mutual funds, Democrat-owned hedge funds own firms with higher social ratings and this is especially true for funds owned by so-called Strong Democrats (who contributed greater than \$2000 per/manager to Democratic candidates). The average Strong-Democrat-managed hedge fund firm has a KLD rating of 21.56 while a Strong-Republican-managed firm has a KLD rating of -14.51 for a difference of 36.07 (t-statistic of 2.43). Furthermore, these results are robust across different categories such as community activities, diversity, employee relations, and environmental record. In total, these results suggest that political values even affect the decision-making of hedge fund managers whose payoffs are more strongly-linked to their performance than the payoffs of mutual fund managers.

### *3.6. Time and Family Effects*

One of the fundamental assumptions of our study is that a manager's political affiliation stays largely fixed over time. This assumption allows us to aggregate a manager's political contributions over a 15-year span from 1992 to 2006 with the idea that contributions in one year can predict fund holdings many years later. However, a person's political philosophy often evolves over time. In this section, we examine whether using political contributions that are more contemporaneous with holdings can do a better job predicting fund holdings than using total contributions over the horizon of our study.

We also use the evolution of managerial contributions over time to get to the root of our causality argument. An alternative hypothesis that might explain our results is that mutual fund



managers first decide which stocks to hold and then make political contributions in an attempt to improve the performance of these holdings. Therefore, we test whether a manager's campaign contributions predict their holdings or simply follow them. Finally, we investigate whether there is a "house effect" for political contributions. Are managers whose coworkers contribute to one party more likely to contribute to that party as well? We also check whether the contributions of co-workers affect a manager's investment decisions.

We first need to define several new variables for this section.  $DLC [a,b]$  is defined as the log-transformed net contributions to Democrats of a manager from month  $a$  to month  $b$  relative to the holdings date. For example  $DLC [-3,0]$  is simply the log-transformed net contributions of a manager in the three months prior to the holdings date.  $DLC EX[a,b]$  is defined as  $DLC - DLC [a,b]$ , in other words the log-transformation of all net contributions except those from month  $a$  to month  $b$ . For example  $DLC EX[-3,3]$  is simply the log-transformation of all of a manager's net contributions except for those made in the three months prior and subsequent to the holdings date.  $FAMDLC [a,b]$  is defined as the log-transformed total donations of all other mutual fund managers working in the same fund family at the holdings date (divided by the number of other managers) from month  $a$  to month  $b$  relative to the holdings date.  $FAMDLC_{total}$  is the same as  $FAMDLC$  but also includes the donations of the observed manager in addition to those of the observed manager's co-workers.

Table 15 reports the results from regressions of holdings in politically sensitive industries on political contributions. These regressions are identical to those in specification (4) of Table 4 except for the use of differing representations of political contributions. The same set of controls is used for all specifications. In column (1), we see a negative effect of prior-quarter campaign contributions on holdings in PSI with nearly identical statistical significance to the coefficient on

*DLC* in specification (4) of Table 4 ( $t=2.95$  on *DLC* [-3,0] vs.  $t = 3.02$  for *DLC*). Column (2) shows that there is a similar negative effect on holdings in PSI from the political contributions in the three months *after* the holdings date.

We then examine whether the manager's political contributions from outside the six-month window around the holdings have any leftover explanatory value. Column (3) shows that even after controlling for the *DLC* in the prior three months and the *DLC* in the subsequent three months, the rest of the manager's contributions still help predict a manager's holdings in PSI. The coefficient of -0.045% ( $t$ -stat of 2.50) is only slightly smaller than the coefficient of -0.050% ( $t$ -stat of 3.02) on total *Dem Log Contributions*. In columns (4) – (6), we repeat this analysis using 12-month instead of 3-month windows, and obtain very similar results. Once again, the manager's contributions outside the two-year window around the holdings date still have significant explanatory value even after controlling for the donations with the 2-year window.

Next, we add manager fixed effects to our regressions. We want to test whether, for each manager, there is a negative time-series correlation between net contributions (to Democrats) and holdings in PSI. In columns (7) and (8), we use 3-month windows and do find negative coefficients although they are not statistically significant. In columns (9) and (10), we use 12-month windows and actually find positive coefficients (so managers are actually more likely to hold PSI in years when they give more money to Democrats) which are again statistically insignificant. In Table 16, we repeat the analysis with KLD Rating as our dependent variable and obtain qualitatively similar results to those in Table 15. Once again, contributions prior to and after the holdings date have explanatory value but do not affect the explanatory value of donations from outside the window. Furthermore, holding the manager fixed, time-series

evolution in contributions does not have value in explaining time-series evolution of KLD Ratings of stock holdings.

We next analyze whether “house effects”, i.e. the political contributions of other managers in the mutual fund advisor firm, affect a manager’s contributions and holdings. In Table 17, we examine what factors explain a manager’s political contributions in the following quarter. We find that the average quarterly net contributions of other managers in the same fund family do not predict a manager’s contributions in that same quarter. In fact, the coefficient on *FAMDLC [0,3]* in Column (1) is actually negative, -0.08, although not significant, which means that managers actually contribute to the opposite party of their peers. In column (2), we regress a manager’s quarterly contributions on the average lifetime (over our time-horizon from 1992 to 2006) contributions of the other managers in the firm at the time. Here, the coefficient is positive, 0.08, but still insignificant (t-statistic of 1.00). In columns (3) – (5), we add controls and find that age is the only variable that affects managerial contributions. Younger managers are more likely to give to Democrats than older managers. In column (4), we also add time dummies to ensure that time trends in political contributions are not influencing our results and find no change from the coefficients in column (3). Finally, in columns (6) and (7) we add manager fixed effects to see whether managerial contributions change when they move from one family to another. We find no evidence of such a phenomenon with no explanatory value from either the size of the family’s assets or the contributions of the other managers in the family.

Lastly, we look at whether the campaign contributions of other managers at a mutual fund firm affect a fund’s holdings in the same way that the fund manager’s contributions affect holdings in politically sensitive industries and companies with different social responsibility rankings. Panel A of Table 18 shows the effect of family contributions on holdings in PSI while

Panel B shows the effect of family contributions on KLD ratings of stock holdings. In columns (1) and (2), we can see insignificant coefficients on *FAMDLC* (the other managers' contributions) and strong effects from the manager's contributions.

In the prior section on hedge funds, we hypothesized that the data limitation which forces us to work at the family level (rather than the manager level) weakens our inference ability. We now test this hypothesis by aggregating to the family level for mutual funds. In columns (3) and (4), of Table 18, we regress holdings data on family contributions without including individual contributions and allow for clustering by family. With the exception of column (4) of Panel A, we find that our results are weaker than working at the fund level since the individual manager contributions are muddled by contributions of other managers who do not affect the fund holdings. If there was significant intra-family correlation in contributions, this would obviously not be a big problem.

These results broadly support our main assumption: Managerial contributions are manifestations of a political affiliation that is usually stable over time. Their distribution over time comes from random effects such as a manager's particular regard for a certain candidate or candidates rather than shifts in political affiliation or attempts to influence elections to improve fund performance. Furthermore, a manager's political contributions and holdings decisions in any quarter are largely unaffected by the political affiliation of other mutual fund managers working at the same mutual fund advisory firm at the same time.

#### **4. Selection Bias**

One potential problem for our methodology is the implicit assumption that partisans who work in the mutual fund industry have attitudes toward socially-responsible firm behavior similar

to those of the broader US population. It is easy to see this problem by focusing on gender differences in holdings decisions. For example, we might expect that women would place more importance on firm diversity policies than men and would thus hold companies with higher diversity rankings. However, in column (6) of Table 8, we see that female mutual fund managers actually hold firms with *lower* diversity ratings than male managers, although the difference is not statistically significant (t-stat of 1.34). Similar anomalies can be found in Table 5 where we see that female mutual fund managers underweigh tobacco and natural resources but overweigh guns and defense. Are women in the US more health and environmentally conscious than men but also more security-conscious? It is not clear why this is the case.

One way to evaluate the importance of this problem is to check whether the distribution of our sample of mutual fund managers is similar to the distribution of the broader population. For example, the 90-10 male-to-female ratio in our sample suggests that it's not a typical woman who becomes a mutual fund manager. It also warns us to be careful in using general female attitudes to make predictions for our sample. On the other hand, the 60-40 ratio of Republicans-to-Democrats is very close to that of the general population (especially since our sample consists mostly of white men who are more likely to be Republicans). Thus, we believe that our sample suffers relatively little from selection bias issues. However, if mutual fund managers are somehow different from the rest of the population, their career choice suggests that they are likely to place *less* emphasis on "social responsibility" than a typical person of the same party in the general population. Therefore, any selection bias problem would bias our observed results toward the null hypothesis.

## **5. Implications of Our Findings**

In this section, we discuss the broader implications of our findings. First, our findings may explain the puzzle of why so many institutions seem to have avoided sin stocks for some time as documented in Hong and Kacperczyk (2007). Our findings suggest that a form of “closet” SRI has been occurring in markets for some time and has been practiced by large money managers. The fact that Democratic managers are engaging in closet SRI and the Republicans are not doing much to counteract it implies a substantial effect for stock prices. Looking at our sample, we have many Democratic managers but fewer in number than Republicans (roughly 60% of the managers are Republicans). Furthermore, they manage roughly the same size funds on average. Since the Republicans do not significantly tilt to counteract the Democrats, it means that Democratic opinions will influence stock prices.

Looking forward, our findings imply that the growing movement of SRI may have a substantial effect on asset prices (increasing the prices of socially responsible companies and decreasing the prices of irresponsible ones). Existing research by Hong and Kacperczyk (2007) suggests that such demand shifts can have big influences on prices in the context of sin stocks. One way to measure the importance of demand shifts in this context is to compare them to the demand shifts from index funds which contribute to the so-called S&P500 inclusion effect (Shleifer (1986)). A simple, back-of-the-envelope formula for measuring the proportional demand for stocks in politically-sensitive industries if Democrat mutual fund managers were replaced by non-donors equals:  $(\text{Fraction of US Market-Cap Held by Mutual Funds}) \times (\text{Fraction of Mutual Funds Managed by Democrats}) \times (\text{Underweighting by Democrats relative to Non-Donors})$ . Domestic stock mutual funds hold approximately 40% of the total US market capitalization. In our sample, about 13% of managers are Democratic donors. Finally, Democratic holdings underweight PSI by about 25% compared to non-donors. Multiplying these

figures together, we get a demand shift of 1.3% of total market-cap. This means that, for example, tobacco which has a typical market-cap of around \$150 billion, this would correspond to \$2 billion that are being “kept off the market” by Democratic managers of mutual funds.

Now we can do a similar calculation for S&P500 index funds. Again, 40% of the total market is held by domestic stock funds. Nearly 5% of mutual fund assets are held in S&P500 index funds. Finally, these index funds underweight stocks outside the index by 100%. Multiplying these together gives us a demand shift of 2% which is of the same order of magnitude as the 1.3% market cap demand shift from Democratic underweighting of PSI. An obvious criticism is that a lot of institutional (non-mutual fund) money is also indexed to the S&P500 so this back-of-the-envelope estimate is too low. Of course, the same story holds for Democratic managers of institutional assets which are also not included in our 1.3% estimate. This calculation really compares apples-to-apples in the sense that it focuses on the demand shift effects from the mutual fund arena. It’s also important to note that there are many Democratic mutual fund managers who don’t make campaign contributions (and are classified as non-donors) but who may under-weight PSI similar to their donor peers. Thus, 1.3% is really a lower bound for the demand shift effect from the mutual fund industry.

## **6. Conclusion**

In this paper, we ask whether political values influence investment decisions. We use data on the political contributions and stock holdings of US mutual fund managers and find a surprising answer. We show that managers who donate to Democrats under-weight (relative to non-donors or Republican donors) stocks that are deemed socially irresponsible (e.g. tobacco, guns and defense, natural resources, low KLD scores). This effect is one-half of the under-

weighting observed for SRI funds. This finding is very robust, and our findings are similar when we focus on the holdings of hedge fund managers. It is surprising because our sample is composed of large professional money managers who are important marginal price setters in markets. Hence, our findings suggest that as the SRI movement grows, its impact on asset prices may be substantial. Considering that many professional managers are already practicing “closet SRI”, it is unlikely that they will provide the contrarian positions needed to stabilize prices in markets.

There is much promising work still to be done on the role of values in investing. A better and more comprehensive data can be collected on not only single-managed funds but also data on team-managed funds. Along similar dimensions, there is much we do not know about how values influences investing for pension funds. Furthermore, our analysis of the performance associated with political values is only cursory. A deeper analysis into the influence of values on performance should also be conducted. Finally, there are natural implications for asset prices, which can be explored in future research.



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**Table 1**  
**Summary Statistics**

Table 1 reports time-series averages of quarterly cross-sectional means and standard deviations (shown in brackets) for fund and manager predictor variables. Results are shown for the entire sample, and then for subgroups by political contributions. *All Dems* includes all mutual funds whose managers made more federal campaign contributions to Democrat politicians than Republican politicians in the period from 1998 to 2007. *Strong Dems* made more than \$2000 in contributions to Democrats (net of contributions to Republicans), while *Weak Dems* contributed \$2000 or less to Democrats (net of contributions to Republicans). *Non Donors* either made no contributions or made equal contributions to members of both parties. *All Reps*, *Strong Reps*, and *Weak Reps* are defined similarly. *Number of Funds* is the number of observations each quarter that meet our selection criteria. *Manager Age* is the age of the mutual fund manager. *Median Undergrad SAT* is the median SAT score of incoming freshmen in 2005 at the undergraduate institution attended by the mutual fund manager. *Female* is a dummy variable which equals one if the mutual fund manager is female, and zero otherwise. *Graduate Degree* is a dummy variable which equals one if the mutual fund manager has a graduate (master's or doctoral) degree, and zero otherwise. *SRI Fund* is a dummy variable which equals one if the mutual fund is classified as a socially-responsible fund, and zero otherwise. *Log Fund Size* is the natural logarithm of the total net assets of the mutual fund (in \$millions). *Log Family Size* is the natural logarithm of one plus the assets under management of all the other funds in the fund family (in \$millions). *Mean Component Log Size* is a weighted average of the log market cap of stocks in the mutual fund's portfolio (weighted by their share in the portfolio). *Mean Component Log B/M* is a weighted average of the log book-to-market of stocks in the mutual fund's portfolio (weighted by their share in the portfolio). *Dem Contributions* is the total of campaign contributions made by the mutual fund manager to Democrats (net of contributions to Republicans). *Dem Log Contributions* is the natural log of the absolute value of net contributions, multiplied by negative one for *All Reps* and set to zero for *Non Donors*. The sample consists of single-managed mutual funds from the first quarter of 1992 to the fourth quarter of 2006.

Variable	All Funds	All Dems	All Reps	Strong Dems	Weak Dems	Non Donors	Weak Reps	Strong Reps
<i>Number of Funds</i>	488	61	106	35	26	321	38	68
<i>Manager Age</i>	46.8 [9.7]	48.1 [10.7]	49.8 [9.2]	49.5 [10.9]	46.4 [9.9]	45.4 [9.3]	47.4 [8.2]	51.2 [9.4]
<i>Median Undergrad SAT</i>	1209 [187]	1288 [166]	1238 [163]	1291 [178]	1284 [171]	1185 [190]	1257 [158]	1228 [165]
<i>Female</i>	10.2%	11.4%	9.7%	12.3%	10.0%	10.1%	3.5%	13.0%
<i>Graduate Degree</i>	72.0%	65.6%	76.7%	68.4%	61.8%	71.6%	72.6%	79.4%
<i>SRI Fund</i>	2.6%	8.4%	2.9%	11.9%	3.8%	1.4%	4.6%	1.9%
<i>Log Fund Size (\$MIL)</i>	4.80 [2.01]	5.04 [2.10]	4.91 [2.12]	4.98 [2.15]	5.13 [2.04]	4.72 [1.95]	4.79 [2.09]	4.99 [2.12]
<i>Log Family Size (\$MIL)</i>	6.39 [3.48]	6.56 [3.70]	6.45 [3.53]	5.97 [3.73]	7.30 [3.55]	6.33 [3.40]	6.49 [3.47]	6.41 [3.57]
<i>Mean Component Log Size</i>	15.49 [1.51]	15.28 [1.40]	15.42 [1.54]	15.21 [1.30]	15.37 [1.52]	15.55 [1.51]	15.40 [1.53]	15.45 [1.55]
<i>Mean Component Log B/M</i>	-1.14 [0.39]	-1.09 [0.37]	-1.13 [0.43]	-1.05 [0.37]	-1.15 [0.37]	-1.16 [0.38]	-1.12 [0.38]	-1.13 [0.45]
<i>Dem Contributions (\$)</i>	-2,900 [30,900]	15,700 [36,500]	-22,500 [54,500]	26,700 [45,400]	890 [530]	0 [0]	-950 [670]	-34,100 [64,900]
<i>Dem Contributions (\$)</i> (SRI Funds Excluded)	-3,200 [30,400]	14,100 [35,300]	-22,700 [54,500]	24,700 [45,000]	900 [530]	0 [0]	-930 [670]	-34,000 [64,500]
<i>Dem Log Contributions (\$)</i>	-0.82 [4.88]	8.13 [1.68]	-8.41 [1.76]	9.27 [1.25]	6.60 [0.65]	0 [0]	-6.59 [0.75]	-9.39 [1.32]
<i>Dem Log Contributions (\$)</i> (SRI Funds Excluded)	-0.89 [4.79]	8.02 [1.63]	-8.42 [1.77]	9.17 [1.21]	6.60 [0.66]	0 [0]	-6.57 [0.76]	-9.39 [1.32]

**Table 2****Summary Statistics: Industry Holdings and KLD Social Ratings**

Panel A reports time-series averages of quarterly cross-sectional means and standard deviations (in brackets) for industry holdings for the entire sample and for subgroups sorted by political contributions. Panel B reports time-series averages of quarterly cross-sectional means and standard deviations (in brackets) for KLD Social Ratings for the entire sample and for subgroups sorted by political contributions. Subgroups are defined in Table 1. *PSI* is defined as the holdings (as a percentage of total assets) in the three politically sensitive industries of *Tobacco*, *Guns and Defense*, and *Natural Resources*. *Other Vices* is defined as the holdings (as a percentage of total assets) in alcohol and gaming, two industries which are often avoided by socially responsible mutual funds. The *KLD Rating* is defined as the sum of the *Community Activities*, *Diversity*, *Employee Relations*, and *Environmental Record* scores. Ratings for a stock in each category are obtained by adding one point for each strength and subtracting one point for each concern, with higher ratings implying more strengths and/or fewer concerns. A mutual fund's rating in each category is the value-weighted average of its portfolio stock components' ratings. The sample consists of single-managed mutual funds from the first quarter of 1992 to the fourth quarter of 2006. Socially responsible mutual funds are excluded.

<b>Panel A:</b> <b>Industry Holdings</b>	<b>All Funds</b>	<b>All Dems</b>	<b>All Reps</b>	<b>Strong Dems</b>	<b>Weak Dems</b>	<b>Non Donors</b>	<b>Weak Reps</b>	<b>Strong Reps</b>
<i>PSI</i>	3.60% [3.93%]	2.82% [3.12%]	3.75% [4.17%]	2.55% [3.07%]	3.17% [3.06%]	3.70% [3.92%]	3.45% [3.69%]	3.91% [4.27%]
<i>Tobacco</i>	0.87% [1.81%]	0.69% [1.37%]	1.03% [2.24%]	0.56% [1.28%]	0.85% [1.40%]	0.84% [1.65%]	0.79% [1.31%]	1.17% [2.57%]
<i>Guns and Defense</i>	2.18% [2.62%]	1.67% [2.06%]	2.10% [2.61%]	1.54% [2.09%]	1.84% [1.95%]	2.30% [2.68%]	1.98% [2.43%]	2.16% [2.64%]
<i>Natural Resources</i>	0.57% [2.01%]	0.46% [1.15%]	0.62% [1.91%]	0.45% [1.09%]	0.49% [1.05%]	0.57% [2.00%]	0.67% [1.80%]	0.58% [1.67%]
<i>Other Vices</i>	1.02% [1.82%]	1.14% [1.96%]	1.12% [1.80%]	1.26% [2.23%]	0.97% [1.34%]	0.96% [1.76%]	1.15% [1.82%]	1.11% [1.74%]
<b>Panel B: KLD Social Ratings</b>								
<i>KLD Rating</i>	1.263 [0.788]	1.314 [0.780]	1.238 [0.832]	1.367 [0.874]	1.240 [0.666]	1.260 [0.770]	1.214 [0.755]	1.252 [0.864]
<i>Community Activities</i>	0.250 [0.238]	0.262 [0.243]	0.251 [0.235]	0.284 [0.254]	0.233 [0.214]	0.247 [0.235]	0.249 [0.219]	0.254 [0.241]
<i>Diversity</i>	0.921 [0.480]	0.910 [0.474]	0.909 [0.481]	0.905 [0.477]	0.916 [0.469]	0.926 [0.478]	0.909 [0.469]	0.910 [0.487]
<i>Employee Relations</i>	0.358 [0.321]	0.352 [0.320]	0.337 [0.327]	0.356 [0.333]	0.345 [0.291]	0.366 [0.357]	0.337 [0.321]	0.337 [0.324]
<i>Environmental Record</i>	-0.266 [0.310]	-0.210 [.286]	-0.259 [.308]	-0.178 [0.285]	-0.254 [0.277]	-0.279 [0.313]	-0.282 [0.308]	-0.249 [0.299]

**Table 3****Residual Industry Holdings Sorted by Political Contributions**

Table 3 reports industry holdings for subgroups sorted by political contributions. Subgroups are defined in Table 1.  $D - R$  is the difference between *All Dems* and *All Reps*, i.e. Column (1) minus Column (2).  $SD - SR$  is the difference between *Strong Dems* and *Strong Reps*, i.e. Column (4) minus Column (8). *PSI* is defined as the holdings (as a percentage of total assets) in the three politically sensitive industries of *Tobacco*, *Guns and Defense*, and *Natural Resources*. *Other Vices* is defined as the holdings (as a percentage of total assets) in alcohol and gaming, two industries which are often avoided by socially responsible mutual funds. Industry weights are adjusted for size and value effects by running cross-sectional regressions on *Mean Component Log Size* and *Mean Component Log B/M* and assigning each observation the residual from these regressions. Heteroskedasticity-robust t-statistics, allowing for clustering by fund manager, are reported in brackets. The sample consists of single-managed mutual funds from the first quarter of 1992 to the fourth quarter of 2006. Socially responsible mutual funds are excluded.

<b>Residual Industry Holdings</b>	<b>All Dems (1)</b>	<b>All Reps (2)</b>	<b>D - R (3)</b>	<b>Strong Dems (4)</b>	<b>Weak Dems (5)</b>	<b>Non Donors (6)</b>	<b>Weak Reps (7)</b>	<b>Strong Reps (8)</b>	<b>SD - SR (9)</b>
<i>PSI</i>	-0.68% [3.63]	0.18% [0.94]	-0.86% [3.20]	-0.98% [3.47]	-0.32% [1.50]	0.14% [1.54]	-0.16% [0.60]	0.37% [1.42]	-1.34% [3.52]
<i>Tobacco</i>	-0.12% [1.72]	0.17% [1.06]	-0.29% [1.69]	-0.25% [2.78]	0.03% [0.27]	-0.01% [0.15]	-0.10% [0.95]	0.31% [1.32]	-0.56% [2.23]
<i>Guns and Defense</i>	-0.43% [3.42]	-0.03% [0.22]	-0.40% [2.36]	-0.55% [2.85]	-0.28% [1.99]	0.13% [2.27]	-0.16% [1.03]	0.05% [0.29]	-0.60% [2.40]
<i>Natural Resources</i>	-0.13% [2.13]	0.04% [0.41]	-0.17% [1.46]	-0.17% [1.98]	-0.07% [0.92]	0.01% [0.19]	0.10% [0.55]	0.01% [0.07]	-0.18% [1.25]
<i>Other Vices</i>	0.11% [0.70]	0.09% [0.82]	0.02% [0.11]	0.29% [1.12]	-0.12% [1.06]	-0.02% [0.53]	0.12% [1.10]	0.07% [0.45]	0.22% [0.73]

**Table 4****Regression of Holdings in Politically Sensitive Industries on Political Contributions**

Table 4 reports estimated coefficients from pooled OLS regressions of total fund holdings in politically sensitive industries (*Tobacco, Guns and Defense, and Natural Resources*) on measures of political affiliation. Industry weights are adjusted for size and value effects by running cross-sectional regressions on *Mean Component Log Size* and *Mean Component Log B/M* and assigning each observation the residual from these regressions. *Dem Contributions* is the total campaign contributions made by the mutual fund manager to Democrats (net of contributions to Republicans), and is winsorized at the 1% and 99% level. *Dem Log Contributions* is the natural log of the absolute value of net contributions, multiplied by negative one for *All Reps* and set to zero for *Non Donors*. *All Dems Dummy* is a dummy variable which equals one for managers who contributed more to Democrats than to Republicans, and zero otherwise. *All Reps Dummy* is a dummy variable which equals one for managers who contributed more to Republicans than to Democrats, and zero otherwise. All other predictor variables are defined in Table 1. Region dummy variables for each of the nine U.S. census regions are added in specifications (5) through (7). Heteroskedasticity-robust t-statistics, allowing for clustering by fund manager (by fund in specification (6), or by fund family in specification (7)) are reported in brackets. The sample consists of single-managed mutual funds from the first quarter of 1992 to the fourth quarter of 2006.

Predictor Variable	Dependent Variable = Residual PSI						
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
<i>Dem Log Contributions</i> (\$)	-0.049%			-0.050%	-0.045%	-0.045%	-0.045%
	[2.80]			[3.02]	[2.89]	[3.45]	[2.53]
<i>Dem Contributions</i> (\$1000)		-0.024%					
		[2.95]					
<i>All Dems Dummy</i>			-0.816%				
			[3.95]				
<i>All Reps Dummy</i>			0.044%				
			[0.21]				
<i>SRI Fund</i>				-1.723%	-1.623%	-1.623%	-1.623%
				[5.51]	[4.92]	[4.86]	[4.42]
<i>Manager Age</i>				0.003%	-0.003%	-0.003%	-0.003%
				[0.36]	[0.35]	[0.39]	[0.37]
<i>Median Undergrad SAT</i>				-0.001%	-0.001%	-0.001%	-0.001%
				[1.94]	[2.10]	[2.50]	[2.07]
<i>Female</i>				0.025%	-0.040%	-0.040%	-0.040%
				[0.13]	[0.21]	[0.24]	[0.20]
<i>Graduate Degree</i>				0.005%	0.015%	0.015%	0.015%
				[0.03]	[0.09]	[0.10]	[0.10]
<i>Log Fund Size</i> (\$MIL)				-0.058%	-0.041%	-0.041%	-0.041%
				[1.48]	[1.03]	[0.99]	[1.07]
<i>Log Family Size</i> (\$MIL)				0.027%	0.025%	0.025%	0.025%
				[1.02]	[0.95]	[0.96]	[0.89]
<i>Constant</i>	0.007%	0.025%	0.136%	1.227%	1.500%	1.500%	1.500%
	[0.10]	[0.33]	[1.54]	[1.67]	[1.99]	[2.30]	[2.07]
SRI Funds Included?	NO	NO	NO	YES	YES	YES	YES
Clustering	Mgr	Mgr	Mgr	Mgr	Mgr	Fund	Family
Region Dummies	NO	NO	NO	NO	YES	YES	YES
Observations	28480	28102	28480	26703	26703	26703	26703
Clusters	1944	1933	1944	1680	1680	1689	710

**Table 5**  
**Regressions of Residual Industry Holdings on Political Contributions**

Table 5 reports estimated coefficients from pooled OLS regressions of fund holdings in various industries on political affiliation measures. *PSI* is defined as the holdings (as a percentage of total assets) in the three politically sensitive industries of *Tobacco*, *Guns and Defense*, and *Natural Resources*. *Other Vices* is defined as the holdings in alcohol and gaming, two industries which are often avoided by socially responsible mutual funds. Industry weights are adjusted for size and value effects by running cross-sectional regressions on *Mean Component Log Size* and *Mean Component Log B/M* and assigning each observation the residual from these regressions. *Dem Log Contributions* is the natural log of the absolute value of net contributions, multiplied by negative one for *All Reps* and set to zero for *Non Donors*. All other predictor variables are defined in Table 1. Region dummy variables for each of the nine U.S. census regions are added in specifications (2), (4), (6), (8), and (10). Heteroskedasticity-robust t-statistics, allowing for clustering by fund manager are reported in brackets. The sample consists of single-managed mutual funds from the first quarter of 1992 to the fourth quarter of 2006.

Predictor Variable	PSI		Tobacco		Guns and Defense		Natural Resources		Other Vices	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
<i>Dem Log Contributions</i> (\$)	-0.051%	-0.045%	-0.020%	-0.017%	-0.022%	-0.020%	-0.009%	-0.009%	0.001%	0.000%
	[3.06]	[2.89]	[1.58]	[1.58]	[2.05]	[1.87]	[1.31]	[1.20]	[0.06]	[0.03]
<i>SRI Fund</i>	-1.734%	-1.623%	-0.598%	-0.457%	-1.147%	-1.143%	0.010%	-0.022%	-0.642%	-0.605%
	[6.01]	[4.92]	[7.19]	[5.64]	[4.94]	[4.91]	[0.05]	[0.10]	[5.41]	[4.52]
<i>Manager Age</i>		-0.003%		-0.002%		-0.005%		0.004%		-0.009%
		[0.35]		[0.29]		[0.85]		[1.04]		[2.00]
<i>Median Undergrad SAT</i>		-0.001%		-0.001%		-0.000%		-0.000%		-0.000%
		[2.10]		[1.81]		[1.31]		[0.09]		[0.95]
<i>Female</i>		-0.040%		-0.218%		0.326%		-0.148%		0.041%
		[0.21]		[2.70]		[2.15]		[2.73]		[0.21]
<i>Graduate Degree</i>		0.015%		0.008%		-0.047%		0.054%		-0.028%
		[0.09]		[0.08]		[0.38]		[0.58]		[0.28]
<i>Log Fund Size</i> (\$MIL)		-0.041%		0.016%		-0.033%		-0.024%		0.026%
		[1.03]		[0.88]		[1.29]		[1.09]		[1.50]
<i>Log Family Size</i> (\$MIL)		0.025%		0.006%		0.019%		0.000%		-0.016%
		[0.95]		[0.40]		[1.13]		[0.01]		[1.26]
<i>Constant</i>	0.005%	1.500%	-0.000%	0.828%	0.013%	0.840%	-0.008%	-0.169%	0.018%	0.432%
	[0.07]	[1.99]	[0.00]	[1.62]	[0.27]	[1.71]	[0.19]	[0.60]	[0.43]	[0.77]
<i>SRI Funds Included?</i>	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
<i>Clustering</i>	Mgr	Mgr	Mgr	Mgr	Mgr	Mgr	Mgr	Mgr	Mgr	Mgr
<i>Region Dummies</i>	NO	YES	NO	YES	NO	YES	NO	YES	NO	YES
<i>Observations</i>	29271	26703	29271	26703	29271	26703	29271	26703	29271	26703
<i>Clusters</i>	1977	1680	1977	1680	1977	1680	1977	1680	1977	1680

**Table 6****Residual KLD Social Ratings Sorted by Political Contributions**

Table 6 reports KLD Social Ratings for subgroups sorted by political contributions. Subgroups are defined in Table 1.  $D - R$  is the difference between *All Dems* and *All Reps*, i.e. Column (1) minus Column (2).  $SD - SR$  is the difference between *Strong Dems* and *Strong Reps*, i.e. Column (4) minus Column (8). The *KLD Rating* is defined as the sum of the *Community Activities*, *Diversity*, *Employee Relations*, and *Environmental Record* scores. Ratings for a stock in each category are obtained by adding one point for each strength and subtracting one point for each concern, with higher ratings implying more strengths and/or fewer concerns. A mutual fund's rating in each category is the value-weighted average of its stock components' ratings. KLD Ratings for each category are adjusted for size and value effects by running cross-sectional regressions on *Mean Component Log Size* and *Mean Component Log B/M* and assigning each observation the residual from these regressions. Heteroskedasticity-robust t-statistics, allowing for clustering by fund manager, are reported in brackets. The sample consists of single-managed mutual funds from the first quarter of 1992 to the fourth quarter of 2006. Socially responsible mutual funds are excluded. Ratings are rescaled by 100 to simplify the display.

<b>Residual KLD Social Ratings</b>	<b>All Dems (1)</b>	<b>All Reps (2)</b>	<b>D - R (3)</b>	<b>Strong Dems (4)</b>	<b>Weak Dems (5)</b>	<b>Non Donors (6)</b>	<b>Weak Reps (7)</b>	<b>Strong Reps (8)</b>	<b>SD - SR (9)</b>
<i>KLD Rating</i>	7.75 [1.69]	-3.26 [1.07]	11.01 [2.00]	14.64 [2.05]	-1.20 [0.30]	-1.79 [1.42]	-4.59 [1.24]	-2.54 [0.59]	17.18 [2.07]
<i>Community Activities</i>	1.06 [0.72]	-0.30 [0.29]	1.37 [0.75]	2.68 [1.10]	-1.04 [0.93]	-0.38 [0.93]	-1.32 [1.47]	0.24 [0.16]	2.43 [0.85]
<i>Diversity</i>	3.41 [1.71]	-0.53 [0.38]	3.94 [1.62]	4.64 [1.51]	1.82 [0.86]	-0.69 [0.94]	0.51 [0.19]	-1.09 [0.68]	5.73 [1.66]
<i>Employee Relations</i>	0.66 [0.48]	-2.00 [2.16]	2.67 [1.60]	1.91 [1.00]	-0.96 [0.50]	0.20 [0.38]	-1.78 [1.34]	-2.13 [1.72]	4.04 [1.77]
<i>Environmental Record</i>	2.61 [1.62]	-0.42 [0.34]	3.03 [1.49]	5.41 [2.25]	-1.02 [0.61]	-0.92 [1.89]	-2.00 [1.33]	0.43 [0.25]	4.97 [1.68]



**Table 7****Regression of KLD Social Rating on Political Contributions**

Table 7 reports estimated coefficients from pooled OLS regressions of the *KLD Rating* on measures of political affiliation. The *KLD Rating* is defined as the sum of the *Community Activities*, *Diversity*, *Employee Relations*, and *Environmental Record* scores. KLD Ratings are adjusted for size and value effects by running cross-sectional regressions on *Mean Component Log Size* and *Mean Component Log B/M* and assigning each observation the residual from these regressions. *Dem Contributions* is the total campaign contributions made by the mutual fund manager to Democrats (net of contributions to Republicans), and is winsorized at the 1% and 99% level. *Dem Log Contributions* is the natural log of the absolute value of net contributions, multiplied by negative one for *All Reps* and set to zero for *Non Donors*. *All Dems Dummy* is a dummy variable which equals one for managers who contributed more to Democrats than to Republicans, and zero otherwise. *All Reps Dummy* is defined similarly. All other predictor variables are defined in Table 1. Region dummy variables for each of the nine U.S. census regions are added in specifications (5) through (7). Heteroskedasticity-robust t-statistics, allowing for clustering by fund manager (by fund in specification (6), or by fund family in specification (7)) are reported in brackets. The sample consists of single-managed mutual funds from the first quarter of 1992 to the fourth quarter of 2006. In all regressions, the dependent variable is rescaled by 100 to simplify the display.

Predictor Variable	Dependent Variable = Residual KLD Rating						
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
<i>Dem Log Contributions</i> (\$)	0.65 [1.94]			0.76 [2.35]	0.73 [2.30]	0.73 [2.71]	0.73 [2.32]
<i>Dem Contributions</i> (\$1000)		0.39 [1.70]					
<i>All Dems Dummy</i>			9.54 [2.01]				
<i>All Reps Dummy</i>			-1.46 [0.44]				
<i>SRI Fund</i>				29.70 [2.58]	29.16 [2.63]	29.16 [2.60]	29.16 [2.36]
<i>Manager Age</i>				0.30 [1.93]	0.33 [2.12]	0.33 [2.28]	0.33 [2.21]
<i>Median Undergrad SAT</i>				0.01 [1.17]	0.01 [0.84]	0.01 [0.96]	0.01 [0.87]
<i>Female</i>				-7.67 [1.97]	-7.75 [2.00]	-7.75 [2.16]	-7.75 [2.43]
<i>Graduate Degree</i>				-2.47 [0.84]	-2.65 [0.91]	-2.65 [1.04]	-2.65 [0.98]
<i>Log Fund Size</i> (\$MIL)				-0.54 [0.92]	-0.57 [0.98]	-0.57 [0.98]	-0.57 [0.83]
<i>Log Family Size</i> (\$MIL)				-1.49 [4.44]	-1.62 [4.72]	-1.62 [4.73]	-1.62 [4.85]
<i>Constant</i>	-0.42 [0.34]	-0.44 [0.36]	-1.79 [1.42]	-9.76 [0.81]	-12.27 [0.96]	-12.27 [1.05]	-12.27 [0.97]
SRI Funds Included?	NO	NO	NO	YES	YES	YES	YES
Clustering	Mgr	Mgr	Mgr	Mgr	Mgr	Fund	Family
Region Dummies	NO	NO	NO	NO	YES	YES	YES
Observations	26516	26141	26516	24900	24900	24900	24900
Clusters	1926	1915	1926	1667	1667	1675	703

**Table 8**  
**Regressions of KLD Category Ratings on Political Contributions**

Table 8 reports estimated coefficients from pooled OLS regressions of various KLD Category Ratings on political affiliation measures. The *KLD Rating* is defined as the sum of the *Community Activities*, *Diversity*, *Employee Relations*, and *Environmental Record* scores. A mutual fund's rating in each category is the value-weighted average of its stock components' ratings. Category ratings are adjusted for size and value effects by running cross-sectional regressions on *Mean Component Log Size* and *Mean Component Log B/M* and assigning each observation the residual from these regressions. *Dem Log Contributions* is the natural log of the absolute value of net contributions, multiplied by negative one for *All Repts* and set to zero for *Non Donors*. All other predictor variables are defined in Table 1. Region dummy variables for each of the nine U.S. census regions are added in specifications (2), (4), (6), (8), and (10). Heteroskedasticity-robust t-statistics, allowing for clustering by fund manager are reported in brackets. The sample consists of single-managed mutual funds from the first quarter of 1992 to the fourth quarter of 2006. In all regressions, the dependent variables are rescaled to simplify display.

Predictor Variable	KLD Rating		Community Activities		Diversity		Employee Relations		Environmental Record	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
<i>Dem Log Contributions</i> (\$)	0.715 [2.15]	0.735 [2.30]	0.136 [1.17]	0.128 [1.20]	0.217 [1.51]	0.251 [1.77]	0.201 [2.10]	0.232 [2.53]	0.161 [1.27]	0.124 [1.02]
<i>SRI Fund</i>	32.615 [2.91]	29.155 [2.63]	6.489 [1.54]	6.632 [1.64]	5.383 [1.06]	3.660 [0.77]	7.168 [2.00]	4.987 [1.57]	13.574 [4.07]	13.876 [4.02]
<i>Manager Age</i>		0.329 [2.12]		0.002 [0.03]		0.183 [2.57]		0.201 [3.74]		-0.056 [0.96]
<i>Median Undergrad SAT</i>		0.007 [0.84]		0.005 [1.69]		0.000 [0.03]		0.000 [0.03]		0.002 [0.64]
<i>Female</i>		-7.750 [2.00]		-3.478 [2.85]		-2.563 [1.34]		-1.249 [0.94]		-0.461 [0.26]
<i>Graduate Degree</i>		-2.648 [0.91]		-0.906 [0.87]		-0.565 [0.39]		-0.227 [0.23]		-0.949 [0.89]
<i>Log Fund Size</i> (\$MIL)		-0.571 [0.98]		0.792 [4.71]		-1.172 [3.51]		-0.397 [1.88]		0.206 [0.90]
<i>Log Family Size</i> (\$MIL)		-1.616 [4.72]		-0.545 [4.84]		-0.409 [2.32]		-0.315 [2.37]		-0.348 [2.33]
<i>Constant</i>	-0.366 [0.30]	-12.27 [0.96]	-0.078 [0.19]	-4.269 [0.97]	0.017 [0.03]	-4.749 [0.66]	-0.046 [0.10]	-4.189 [1.01]	-0.259 [0.56]	0.935 [0.21]
SRI Funds	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Clustering	Mgr	Mgr	Mgr	Mgr	Mgr	Mgr	Mgr	Mgr	Mgr	Mgr
Region Dummies	NO	YES	NO	YES	NO	YES	NO	YES	NO	YES
Observations	27289	24900	27289	24900	27289	24900	27289	24900	27289	24900
Clusters	1959	1667	1959	1667	1959	1667	1959	1667	1959	1667

**Table 9****Regressions of KLD Category Ratings on Political Contributions – Decomposition**

Table 9 reports estimated coefficients from pooled OLS regressions of decompositions of KLD Category Ratings on political affiliation measures and control variables. Specifications (2), (4), (6), (8), and (10) from Table 8 are used with decompositions of total and category ratings into strengths and weaknesses as the dependent variables. A firm receives one point if it exhibits a particular strength and zero otherwise. A firm receives negative one point if it exhibits a particular concern and zero otherwise. Strengths (and concerns) are then added up over each category to get a category strength score and a category concern score, and are added together to get a total score in that category. Higher ratings are “good” for both strengths (more strengths) and for concerns (fewer concerns). A mutual fund’s rating in each category is the value-weighted average of its stock components’ ratings. Heteroskedasticity-robust t-statistics, allowing for clustering by fund manager are reported in brackets. The sample consists of single-managed mutual funds from the first quarter of 1992 to the fourth quarter of 2006. In all regressions, the dependent variables are rescaled by 100 to simplify display.

<b>Predictor Variable</b>	<b>Strengths (1)</b>	<b>Concerns (2)</b>	<b>Total (3)</b>
<b>Panel A: Y = KLD Rating</b>			
<i>Dem Log Contributions</i>	0.267 [0.57]	0.467 [1.11]	0.735 [2.30]
<b>Panel B: Y = Community Activities</b>			
<i>Dem Log Contributions</i>	0.067 [0.54]	0.061 [0.83]	0.128 [1.20]
<b>Panel C: Y = Diversity</b>			
<i>Dem Log Contributions</i>	0.182 [0.80]	0.069 [0.38]	0.251 [1.77]
<b>Panel D: Y = Employee Relations</b>			
<i>Dem Log Contributions</i>	0.109 [0.89]	0.123 [1.47]	0.232 [2.53]
<b>Panel E: Y = Environmental Record</b>			
<i>Dem Log Contributions</i>	-0.091 [0.81]	0.215 [1.21]	0.124 [1.02]
Fund/Manager Controls	YES	YES	YES
SRI Funds	YES	YES	YES
Clustering	Mgr	Mgr	Mgr
Region Dummies	YES	YES	YES
Observations	24900	24900	24900
Clusters	1667	1667	1667

**Table 10**  
**Regressions of Mutual Fund Returns on Political Contributions**

Table 10 reports Fama-MacBeth (1973) estimates of monthly mutual fund returns regressed on lagged fund and managerial characteristics. *Net Returns* are monthly returns, net of expenses. *Carhart 4F-Adj.* are net returns adjusted using the Carhart (1997) four-factor model, and *DGTW-Adjusted* are net returns adjusted using the Daniel, Grinblatt, Titman, and Wermers (1997) characteristics-based approach. *Fund Turnover* is the fund's turnover of assets. *Fund Age* is the number of years since the fund's inception. *Expense Ratio* is total annual expenses as a fraction of assets under management. *Total Load* is the sum of front-end, deferred, and rear-end charges as a percentage of new assets. *Lag 12Mth Fund Flows* is net flows over the previous twelve months as a fraction of previous assets under management. *Lag 12Mth Returns* are net returns over the last twelve months. All other predictor variables are defined in Table 1. Fama-MacBeth (1973) t-statistics are in brackets. The sample consists of single-managed mutual funds from January 1993 to December 2006.

Predictor Variable	Net Returns			Carhart 4F-Adj.		DGTW-Adjusted	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
<i>All Dems Dummy</i>	0.061%		0.033%		0.032%		0.045%
	[2.42]		[1.23]		[1.17]		[1.34]
<i>All Reps Dummy</i>	0.092%		0.069%		0.015%		0.042%
	[3.56]		[2.55]		[0.58]		[1.73]
<i>Dem Log Contributions (\$)</i>		-0.001%		0.002%		0.000%	
		[0.27]		[0.79]		[0.15]	
<i>SRI Fund</i>	-0.089%	-0.140%	-0.110%	-0.160%	-0.110%	0.032%	0.082%
	[1.65]	[1.97]	[2.02]	[2.22]	[2.02]	[0.35]	[1.08]
<i>Log Fund Size</i>	-0.011%	-0.019%	-0.027%	-0.023%	-0.027%	-0.017%	-0.004%
	[1.14]	[1.54]	[2.74]	[1.90]	[2.74]	[1.48]	[0.54]
<i>Log Family Size</i>	0.010%	0.010%	0.012%	0.006%	0.012%	-0.003%	-0.002%
	[1.86]	[1.72]	[2.93]	[1.07]	[2.93]	[0.75]	[0.73]
<i>Fund Turnover</i>	0.013%	0.051%	0.037%	0.052%	0.037%	0.050%	0.034%
	[0.36]	[0.99]	[1.03]	[0.94]	[1.03]	[1.14]	[1.24]
<i>Fund Age</i>	-0.003%	-0.002%	-0.002%	-0.002%	-0.002%	0.001%	0.000%
	[3.28]	[1.81]	[2.43]	[1.39]	[2.43]	[0.65]	[0.74]
<i>Expense Ratio</i>	-8.375%	-0.03%	-5.39%	1.55%	-5.393%	1.39%	3.90%
	[1.59]	[0.00]	[1.01]	[0.21]	[1.01]	[0.27]	[1.10]
<i>Total Load</i>	-0.522%	-2.065%	-0.747%	-2.196%	-0.747%	0.195%	-0.074%
	[0.99]	[1.89]	[1.50]	[2.00]	[1.50]	[0.20]	[0.15]
<i>Lag 12Mth Fund Flows</i>	-0.118%	-0.078%	-0.084%	-0.088%	-0.084%	-0.014%	-0.014%
	[2.17]	[1.77]	[2.14]	[1.92]	[2.14]	[0.37]	[0.56]
<i>Lag 12Mth Returns</i>	2.989%	2.508%	2.506%	2.561%	2.506%	1.180%	1.275%
	[3.83]	[3.69]	[3.65]	[3.80]	[3.65]	[3.03]	[3.64]
<i>Manager Age</i>			-0.002%	-0.003%	-0.002%	0.002%	0.002%
			[1.26]	[1.01]	[1.26]	[0.92]	[1.51]
<i>Median Undergrad SAT</i>			0.000%	0.000%	0.000%	0.000%	0.000%
			[3.76]	[3.47]	[3.76]	[2.48]	[1.17]
<i>Female</i>			0.011%	-0.046%	0.011%	-0.090%	-0.004%
			[0.44]	[1.02]	[0.44]	[2.05]	[0.15]
<i>Graduate Degree</i>			0.002%	0.032%	0.002%	-0.009%	0.005%
			[0.07]	[0.79]	[0.07]	[0.22]	[0.23]
<i>Constant</i>	0.64%	0.688%	0.527%	-0.679%	0.527%	-0.435%	-0.379%
	[2.44]	[2.57]	[1.78]	[2.85]	[1.78]	[2.27]	[2.71]
Number of Months	168	168	168	168	168	168	168

**Table 11**  
**Effect of Incentives on the Role of Political Values**

Table 11 reports estimated coefficients from pooled OLS regressions of holdings in politically sensitive industries ((1) – (2)) and KLD Rating ((3) – (4)) on the interaction between fund outsourcing and measures of political affiliation. *Fund Outsourced* is a dummy variable which equals one if a mutual fund contracts out the investment management to a subadviser and zero otherwise. *Fund Outsourced X DLC* is the interaction between *Fund Outsourced* and *Dem Log Contributions*. All other predictor variables are defined in Table 1. Heteroskedasticity-robust t-statistics, allowing for clustering by fund manager are reported in brackets. The sample consists of single-managed mutual funds from the first quarter of 1992 to the fourth quarter of 2006. Residual KLD Ratings are rescaled by 100 to simplify display.

Predictor Variable	Residual PSI		Residual KLD Rating	
	(1)	(2)	(3)	(4)
<i>Dem Log Contributions</i> (\$)	-0.052%	-0.044%	0.82726	0.862
	[2.78]	[2.55]	[2.34]	[2.51]
<i>SRI Fund</i>	-1.794%	-1.621%	35.702	29.216
	[6.21]	[4.91]	[3.29]	[2.67]
<i>Manager Age</i>		-0.003%		0.331
		[0.33]		[2.16]
<i>Median Undergrad SAT</i>		-0.001%		0.007
		[2.09]		[0.85]
<i>Female</i>		-0.039%		-7.859
		[0.20]		[2.04]
<i>Graduate Degree</i>		0.014%		-2.659
		[0.08]		[0.91]
<i>Log Fund Size</i> (\$MIL)		-0.043%		-0.663
		[1.08]		[1.13]
<i>Log Family Size</i> (\$MIL)		0.026%		-1.567
		[0.99]		[4.58]
<i>Fund Outsourced</i>	-0.074%	-0.173%	-7.51987	-7.644
	[0.40]	[0.85]	[2.81]	[2.60]
<i>Fund Outsourced X DLC</i>	0.006%	-0.011%	-0.989	-0.918
	[0.20]	[0.34]	[1.68]	[1.55]
<i>Constant</i>	0.019%	1.505%	0.56021	-11.525
	[0.24]	[2.00]	[0.42]	[0.91]
SRI Funds Included?	YES	YES	YES	YES
Clustering	Mgr	Mgr	Mgr	Mgr
Region Dummies	NO	YES	NO	YES
Observations	28863	26703	26937	24900
Clusters	1958	1680	1941	1667

**Table 12****Effect of Regional Political Leanings on Industry Holdings and KLD Social Ratings**

Table 12 reports estimated coefficients from pooled OLS regressions of holdings in politically sensitive industries ((1) – (5)) and KLD Rating ((6) – (10)) on regional political leanings. *State Dem Share* is defined as the Democratic share of the two-party vote over the last four presidential elections (1992 – 2004) for the state in which the mutual fund is located. In several specifications, funds based in the states of Massachusetts and New York are dropped from the sample. All other predictor variables are defined in Table 1. Heteroskedasticity-robust t-statistics, allowing for clustering by fund manager are reported in brackets. The sample consists of single-managed mutual funds from the first quarter of 1992 to the fourth quarter of 2006. Residual KLD Ratings are rescaled by 100 to simplify display

Predictor Variable	Dependent Variable = Residual PSI					Dependent Variable = Residual KLD Rating				
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
<i>State Dem Share</i>	0.662%	-0.204%	-0.054%	1.691%	1.013%	-2.135	-15.318	-17.870	12.300	-12.357
	[0.58]	[0.11]	[0.01]	[1.48]	[0.59]	[0.11]	[0.46]	[0.53]	[0.58]	[0.35]
<i>Dem Log Contributions</i> (\$)			-0.054%	-0.051%	-0.057%			0.506	0.757	0.740
			[2.08]	[3.11]	[2.47]			[1.04]	[2.27]	[1.47]
<i>SRI Fund</i>				-1.704%	-1.626%				29.755	31.208
				[5.42]	[4.55]				[2.59]	[2.34]
<i>Manager Age</i>				0.002%	0.009%				0.294	0.073
				[0.23]	[0.75]				[1.89]	[0.35]
<i>Median Undergrad SAT</i>				-0.001%	-0.001%				0.008	0.010
				[2.13]	[1.82]				[1.04]	[0.93]
<i>Female</i>				-0.005%	0.416%				-7.899	-2.329
				[0.02]	[1.50]				[2.02]	[0.41]
<i>Graduate Degree</i>				-0.012%	-0.061%				-2.539	-3.680
				[0.07]	[0.27]				[0.88]	[0.91]
<i>Log Fund Size</i> (\$MIL)				-0.056%	-0.018%				-0.546	-1.387
				[1.44]	[0.33]				[0.94]	[2.07]
<i>Log Family Size</i> (\$MIL)				0.019%	-0.019%				-1.558	-1.875
				[0.73]	[0.54]				[4.54]	[3.97]
<i>Constant</i>	0.024%	-0.025%	-0.079%	1.387%	1.158%	-0.802	-1.257	-0.774	-8.733	5.338
	[0.24]	[0.24]	[0.77]	[1.84]	[1.31]	[0.48]	[0.78]	[0.44]	[0.70]	[0.33]
Excluding NY and MA	NO	YES	YES	NO	YES	NO	YES	YES	NO	YES
SRI Funds	NO	NO	NO	YES	YES	NO	NO	NO	YES	YES
Clustering	Mgr	Mgr	Mgr	Mgr	Mgr	Mgr	Mgr	Mgr	Mgr	Mgr
Region Dummies	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO
Observations	28045	17267	17267	26670	16541	26139	15940	15940	24871	15279
Clusters	1919	1264	1264	1676	1117	1902	1251	1251	1663	1105

**Table 13****Hedge Funds - Residual Industry Holdings Sorted by Political Contributions**

Table 13 reports industry holdings for hedge fund subgroups sorted by political contributions. Subgroups are defined in Table 1. *D – R* is the difference between *All Dems* and *All Reps*, i.e. Column (1) minus Column (2). *SD – SR* is the difference between *Strong Dems* and *Strong Reps*, i.e. Column (4) minus Column (8). *PSI* is defined as the holdings (as a percentage of total assets) in the three politically sensitive industries of *Tobacco*, *Guns and Defense*, and *Natural Resources*. *Other Vices* is defined as the holdings (as a percentage of total assets) in alcohol and gaming. Industry weights are adjusted for size and value effects by running cross-sectional regressions on *Mean Component Log Size* and *Mean Component Log B/M* and assigning each observation the residual from these regressions. Heteroskedasticity-robust t-statistics, allowing for clustering by fund manager, are reported in brackets. The sample consists of hedge funds from the first quarter of 1992 to the fourth quarter of 2006.

<b>Residual Industry Weights</b>	<b>All Dems (1)</b>	<b>All Reps (2)</b>	<b>D - R (3)</b>	<b>Strong Dems (4)</b>	<b>Weak Dems (5)</b>	<b>Non Donors (6)</b>	<b>Weak Reps (7)</b>	<b>Strong Reps (8)</b>	<b>SD - SR (9)</b>
<i>PSI</i>	-1.09% [4.63]	-0.33% [1.12]	-0.76% [2.02]	-0.46% [0.98]	-1.40% [5.52]	0.99% [3.20]	-0.25% [0.89]	-0.44% [0.72]	-0.02% [0.02]
<i>Tobacco</i>	-0.15% [1.61]	0.02% [0.20]	-0.17% [1.11]	0.04% [0.16]	-0.24% [4.31]	0.06% [0.51]	0.08% [0.58]	-0.05% [0.23]	0.09% [0.28]
<i>Guns and Defense</i>	-0.69% [4.08]	-0.03% [0.11]	-0.66% [1.95]	-0.27% [0.71]	-0.90% [5.58]	0.56% [0.90]	0.06% [0.25]	-0.17% [0.26]	-0.11% [0.14]
<i>Natural Resources</i>	-0.25% [2.15]	-0.32% [3.41]	0.07% [0.49]	-0.22% [2.57]	-0.26% [1.54]	0.37% [4.44]	-0.39% [3.49]	-0.22% [1.35]	-0.01% [0.03]
<i>Other Vices</i>	-0.06% [0.22]	0.24% [0.87]	-0.30% [0.78]	-0.08% [0.38]	-0.05% [0.12]	-0.34% [1.12]	0.12% [0.30]	0.42% [1.12]	-0.51% [1.17]

**Table 14****Hedge Funds - Residual KLD Social Ratings Sorted by Political Contributions**

Table 14 reports KLD Social Ratings for hedge fund subgroups sorted by political contributions. Subgroups are defined in Table 1.  $D - R$  is the difference between *All Dems* and *All Reps*, i.e. Column (1) minus Column (2).  $SD - SR$  is the difference between *Strong Dems* and *Strong Reps*, i.e. Column (4) minus Column (8). The *KLD Rating* is defined as the sum of the *Community Activities*, *Diversity*, *Employee Relations*, and *Environmental Record* scores. Ratings for a stock in each category are obtained by adding one point for each strength and subtracting one point for each concern, with higher ratings implying more strengths and/or fewer concerns. A hedge fund's rating in each category is the value-weighted average of its stock components' ratings. KLD Ratings for each category are adjusted for size and value effects by running cross-sectional regressions on *Mean Component Log Size* and *Mean Component Log B/M* and assigning each observation the residual from these regressions. Heteroskedasticity-robust t-statistics, allowing for clustering by fund manager, are reported in brackets. The sample consists of hedge funds from the first quarter of 1992 to the fourth quarter of 2006. Ratings are rescaled by 100 to simplify the display.

<b>Residual KLD Social Ratings</b>	<b>All Dems (1)</b>	<b>All Reps (2)</b>	<b>D - R (3)</b>	<b>Strong Dems (4)</b>	<b>Weak Dems (5)</b>	<b>Non Donors (6)</b>	<b>Weak Reps (7)</b>	<b>Strong Reps (8)</b>	<b>SD - SR (9)</b>
<i>KLD Rating</i>	8.87 [1.14]	-2.67 [0.39]	11.54 [1.12]	21.56 [2.41]	2.43 [0.23]	19.47 [1.15]	5.33 [0.71]	-14.51 [1.20]	36.07 [2.43]
<i>Community Activities</i>	1.61 [0.45]	1.39 [0.60]	0.22 [0.05]	5.74 [1.03]	-0.49 [0.11]	4.37 [0.62]	4.68 [1.88]	-3.48 [0.83]	9.22 [1.33]
<i>Diversity</i>	0.44 [0.14]	-3.90 [1.21]	4.34 [0.96]	3.36 [0.99]	-1.04 [0.23]	0.37 [0.06]	0.22 [0.05]	-10.00 [2.25]	13.36 [2.42]
<i>Employee Relations</i>	3.88 [1.85]	-2.09 [0.94]	5.97 [1.96]	3.32 [0.96]	4.17 [1.57]	11.31 [2.63]	-3.02 [0.97]	-0.71 [0.23]	4.02 [0.87]
<i>Environmental Record</i>	2.94 [0.99]	1.93 [0.71]	1.01 [0.25]	9.15 [3.52]	-0.22 [0.05]	3.42 [0.72]	3.45 [1.01]	-0.31 [0.07]	9.46 [1.84]



**Table 15****Regression of Holdings in Politically Sensitive Industries on Political Contributions – Time-Series Effects**

Table 15 reports estimated coefficients from pooled OLS regressions of total fund holdings in politically sensitive industries on measures of political affiliation. Industry weights are adjusted for size and value effects by running cross-sectional regressions on *Mean Component Log Size* and *Mean Component Log B/M* and assigning each observation the residual from these regressions. The predictor variables are *Dem Log Contributions* (as defined earlier) using net donations over various periods of time. For example, *DLC* (\$) [-3,0] uses the net contributions of a manager in the three months prior to the date in which stock holdings are reported. *DLC* (\$) [0,3] uses the net contributions of a manager in the three months after the date in which stock holdings are reported. Finally, *DLC* (\$) EX[-3,3] uses the total net contributions of a manager from January 1992 to December 2006 but excludes those in the six-month window around the holdings date. All specifications include controls from Table 4 (*SRI*, *Manager Age*, *Median Undergrad SAT*, *Female*, *Graduate Degree*, *Log Fund Size*, *Log Family Size*) and are defined in the same way. Heteroskedasticity-robust t-statistics, allowing for clustering by fund manager are reported in brackets. Specifications (7) through (10) include manager fixed effects.

Predictor Variable	Dependent Variable = Residual PSI									
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
<i>DLC</i> (\$) [-3,0]	-0.078%	-0.062%	-0.072%				-0.022%	-0.021%		
	[2.95]	[2.94]	[3.27]				[1.19]	[1.19]		
<i>DLC</i> (\$) [0,3]		-0.053%	-0.065%					-0.019%		
		[2.61]	[3.05]					[1.12]		
<i>DLC</i> (\$) EX[-3,3]			-0.045%							
			[2.51]							
<i>DLC</i> (\$) [-12,0]				-0.050%	-0.028%	-0.046%			0.001%	0.001%
				[2.50]	[1.91]	[2.54]			[0.06]	[0.07]
<i>DLC</i> (\$) [0,12]					-0.046%	-0.062%				-0.008%
					[2.59]	[3.00]				[0.48]
<i>DLC</i> (\$) EX[-12,12]						-0.045%				
						[2.30]				
Manager Fixed Effect?	NO	NO	NO	NO	NO	NO	YES	YES	YES	YES
Controls?	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Observations	26703	26703	26703	26703	26703	26703	26703	26703	26703	26703
Clusters	1680	1680	1680	1680	1680	1680	1680	1680	1680	1680

**Table 16****Regression of KLD Social Rating on Political Contributions – Time-Series Effects**

Table 16 reports estimated coefficients from pooled OLS regressions of the *KLD Rating* on measures of political affiliation. The *KLD Rating* is defined as the sum of the *Community Activities*, *Diversity*, *Employee Relations*, and *Environmental Record* scores. KLD Ratings are adjusted for size and value effects by running cross-sectional regressions on *Mean Component Log Size* and *Mean Component Log B/M* and assigning each observation the residual from these regressions. The predictor variables are *Dem Log Contributions* (as defined earlier) using net donations over various periods of time. For example, *DLC* (\$) [-3,0] uses the net contributions of a manager in the three months prior to the date in which stock holdings are reported. *DLC* (\$) [0,3] uses the net contributions of a manager in the three months after the date in which stock holdings are reported. Finally, *DLC* (\$) EX[-3,3] uses the total net contributions of a manager from January 1992 to December 2006 but excludes those in the six-month window around the holdings date. All specifications include controls from Table 4 (*SRI*, *Manager Age*, *Median Undergrad SAT*, *Female*, *Graduate Degree*, *Log Fund Size*, *Log Family Size*) and are defined in the same way. Heteroskedasticity-robust t-statistics, allowing for clustering by fund manager are reported in brackets. Specifications (7) through (10) include manager fixed effects.

Predictor Variable	Dependent Variable = Residual KLD Rating									
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
<i>DLC</i> (\$) [-3,0]	0.986%	0.803%	0.962%				-0.390%	-0.364%		
	[1.91]	[1.89]	[2.11]				[1.37]	[1.32]		
<i>DLC</i> (\$) [0,3]		0.595%	0.800%					-0.530%		
		[1.60]	[1.92]					[1.52]		
<i>DLC</i> (\$) EX[-3,3]			0.729%							
			[2.21]							
<i>DLC</i> (\$) [-12,0]				0.861%	0.437%	0.672%			-0.241%	-0.245%
				[1.89]	[1.19]	[1.58]			[0.85]	[0.87]
<i>DLC</i> (\$) [0,12]					0.863%	1.084%				0.181%
					[2.30]	[2.45]				[0.48]
<i>DLC</i> (\$) EX[-12,12]						0.607%				
						[1.89]				
Manager Fixed Effect?	NO	NO	NO	NO	NO	NO	YES	YES	YES	YES
Controls?	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Observations	24900	24900	24900	24900	24900	24900	24900	24900	24900	24900
Clusters	1667	1667	1667	1667	1667	1667	1667	1667	1667	1667

**Table 17****Regression of Quarterly Managerial Contributions on Fund Family and Manager Characteristics**

Table 17 reports estimated coefficients from pooled OLS regressions of quarterly managerial contributions on family contributions and various fund and managerial characteristics. *DLC* (\$) [0,3] is defined as the log-transformed net contributions by a manager in the three months subsequent to the holdings date. The predictor variables include *FAMDLC* (\$) [0,3] which is the log-transformed net contributions over the three months subsequent to the holdings date averaged over all other managers in the family. *FAMDLC* (\$) is the log-transformed net contributions from 1992 to 2006 averaged all other managers in the family. For each observation, “Other family managers” is defined as all who manage a fund in the family at the holdings date except for the manager of the fund in the observation. Several specifications include controls from Table 4 (*SRI*, *Manager Age*, *Median Undergrad SAT*, *Female*, *Graduate Degree*, *Log Fund Size*, *Log Family Size*) and are defined in the same way. Heteroskedasticity-robust t-statistics, allowing for clustering by fund manager are reported in brackets. Specification (4) includes time dummies. Specifications (6) through (7) include manager fixed effects.

Predictor Variable	Dependent Variable = DLC (\$) [0,3]						
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
<i>FAMDLC</i> (\$) [0,3]	-0.008 [0.32]		-0.013 [0.51]	-0.021 [0.76]		-0.024 [0.80]	
<i>FAMDLC</i> (\$)		0.008 [1.00]			0.005 [0.75]		0.001 [0.25]
<i>SRI Fund</i>			1.003 [1.46]	1.011 [1.47]	0.992 [1.45]		
<i>Manager Age</i>			-0.012 [2.45]	-0.012 [2.47]	-0.012 [2.46]	-0.021 [1.36]	-0.020 [1.36]
<i>Median Undergrad SAT</i>			0.000 [1.11]	0.000 [1.11]	0.000 [1.10]		
<i>Female</i>			-0.138 [0.73]	-0.137 [0.72]	-0.135 [0.72]		
<i>Graduate Degree</i>			-0.187 [1.69]	-0.187 [1.69]	-0.186 [1.69]		
<i>Log Fund Size</i> (\$MIL)			0.013 [0.53]	0.013 [0.53]	0.013 [0.51]	-0.014 [0.60]	-0.014 [0.60]
<i>Log Family Size</i> (\$MIL)			-0.010 [0.60]	-0.010 [0.58]	-0.008 [0.47]	0.037 [1.13]	0.037 [1.11]
<i>Constant</i>			0.213 [0.49]	0.207 [0.49]	0.217 [0.50]	0.692 [1.04]	0.665 [1.03]
Manager Fixed Effect?	NO	NO	NO	NO	NO	YES	YES
Time Dummies	NO	NO	NO	YES	NO	NO	NO
Observations	20086	20086	18702	18702	18702	18702	18702
Clusters	1571	1571	1375	1375	1375	1375	1375

**Table 18****Regressions of KLD Social Rating and Holdings in PSI on Fund and Family Political Contributions**

Panel A reports estimated coefficients from pooled OLS regressions of total fund holdings in politically sensitive industries on measures of fund and family political affiliation. Panel B reports estimated coefficients from pooled OLS regressions of KLD Ratings on measures of fund and family political affiliation. DLC and FAM DLC are defined as in tables 15 through 17. FAM DLCtotal is identical to FAM DLC except that it also includes the campaign contributions of the observed manager as well as other managers in the family. Specifications (1) and (2) allow for clustering by manager while (3) and (4) allow for clustering by family. Specifications (1) and (2) also include manager and fund controls as in Table 17.

<b>Panel A:</b>	<b>Dependent Variable = Residual PSI</b>			
<b>Predictor Variable</b>	<b>(1)</b>	<b>(2)</b>	<b>(3)</b>	<b>(4)</b>
<i>DLC</i> (\$) [-3,0]	-0.085%			
	[2.80]			
<i>FAM DLC</i> (\$) [-3,0]	-0.004%			
	[0.19]			
<i>FAM DLCtotal</i> (\$) [-3,0]			-0.063%	
			[2.07]	
<i>DLC</i> (\$)		-0.059%		
		[3.42]		
<i>FAM DLC</i> (\$)		-0.022%		
		[1.51]		
<i>FAM DLCtotal</i> (\$)				-0.050%
				[3.56]
Controls?	YES	YES	NO	NO
Clustering	Mgr	Mgr	Family	Family
Observations	18697	18697	20023	20023
Clusters	1375	1375	609	609
<b>Panel B:</b>	<b>Dependent Variable = Residual KLD Rating</b>			
<b>Predictor Variable</b>	<b>(1)</b>	<b>(2)</b>	<b>(3)</b>	<b>(4)</b>
<i>DLC</i> (\$) [-3,0]	1.361%			
	[2.31]			
<i>FAM DLC</i> (\$) [-3,0]	-0.280%			
	[0.49]			
<i>FAM DLCtotal</i> (\$) [-3,0]			0.720%	
			[1.25]	
<i>DLC</i> (\$)		1.193%		
		[3.26]		
<i>FAM DLC</i> (\$)		0.453%		
		[1.78]		
<i>FAM DLCtotal</i> (\$)				0.546%
				[1.67]
Controls?	YES	YES	NO	NO
Clustering	Mgr	Mgr	Family	Family
Observations	17367	17367	18606	18606
Clusters	1343	1343	597	597