

Politically-themed Stocks: Characteristics and Investment Risks

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The phenomenon of politically-themed stocks refers to a stock rallying irrationally and repeatedly around every presidential election due to its connection with leading presidential candidates or amid expectations for benefits the campaign promises will bring about. Out of 60 stocks categorized by the media as politically-themed stocks during the 16th through 18th presidential elections, a total of 43 stocks surged abruptly to record the cumulative abnormal return being higher than 20% for five trading days.

Among the politically-themed stocks with short-term surges, those related to the president elect rallied on the day after the election, while those related to the runner-up relatively fell, creating a differentiation in returns. After five days, however, most politically-themed stocks, regardless of the association with the winner or the loser, recorded a negative cumulative abnormal return.

During the campaign period for the upcoming 19th presidential election, the number of politically-themed stocks related to top two candidates reached 39, among which 22 stocks saw their cumulative abnormal return for five trading days exceed 20%. Given that the abrupt hikes in politically-themed stock prices in the past were short-lived, investors must be wary of their investment decisions in recognition of politically-themed stocks' exposure to the risk of sudden price plunges.

* All opinions expressed in this paper represent the author's personal views and thus should not be interpreted as Korea Capital Market Institute's official position.

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The Korean media are constantly reporting about politically-themed stocks while conveying financial authorities' warning of any market manipulation risk associated with politically-themed stocks with the 19th presidential election just around the corner.¹⁾ Although it is hard to clearly define what a politically-themed stock is, it generally refers to any stock of a company that is allegedly linked to leading presidential candidates via kindship, school relations, and regional ties, or that is expected to benefit from the policies included in campaign pledges.

Although market manipulation issues were raised on stocks categorized as politically-themed stocks in every presidential election, those stocks are still a buzzword in the Korean stock market. This article tries to explore the characteristics of politically-themed stocks linked to top two candidates during Korea's 16th, 17th, and 18th presidential elections in 2002, 2007, and 2012, respectively, and discusses the implications.

Types and characteristics of politically-themed stocks

Many types of politically-themed stocks emerged during the past three presidential elections (from the 16th election in 2002 to the 18th in 2012). Among others, stocks that were related to presidential candidates and expected to benefit from campaign pledges were categorized into politically-themed stocks. During the past three presidential elections, the media labeled a total of 60 stocks as politically-themed and related to either the president elect or the runner-up.

However, not all stocks labeled as politically-themed by the media experienced irrational overheating. If a stock is categorized as politically-themed and the price surges irrationally, this could lead to abnormal returns. Hence, this article carries out a quantitative analysis on the prices of 60 politically-themed stocks. First, the abnormal returns on those stocks during the presidential campaign period were calculated to ultimately compute their cumulative abnormal return.

The analysis period to compute the abnormal return and the cumulative abnormal return on each stock was set from the date on which a political party to which a presidential candidate belonged began its primary election to December 18, the eve of the presidential election. Past data during the corresponding periods were used to estimate the model to compute the normal return.

Throughout the analysis, "stocks with anomalies" refer to those whose cumulative abnormal return for the first five trading days of the analysis period is 20% or higher. This means that stocks

1) The article is the English translation of the original article published in Korean before the 19th presidential election (KCMI Opinion, 2017-09).

whose abnormal returns for five trading days add up to 20% or higher are regarded as economically significant politically-themed stocks. As a result, a total of 43 stocks out of 60 stocks analyzed were found to have anomalies, more specifically, abrupt price surges as high as 20% or higher.

Table 1. No. of stocks with anomalies in politically-themed stocks during the 16th through 18th presidential elections

Election	Candidate	No. of politically-themed stocks	No. of stocks with anomalies
16 th	A	12	8
	B	7	6
17 th	A	6	6
	B	6	4
18 th	A	14	9
	B	15	10
Total		60	43

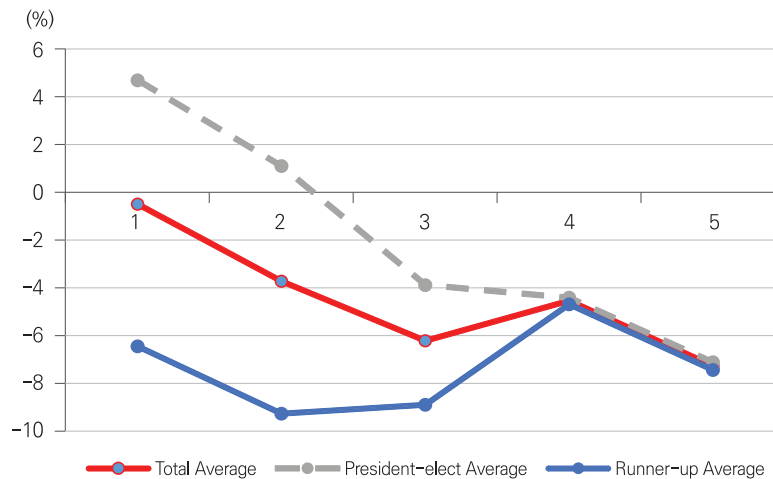
Returns right after the presidential election

If politically-themed stocks moved irrationally during the presidential election only, it is worth having a comparative look at how those stocks fared after each election. Post-election abnormal return data on 43 stocks that had abruptly surged during the campaign period revealed intriguing results.

Right after the election result was unveiled, the average cumulative return for one day (CAR[1]) slid to -0.49%, whereas a differentiation was observed between the abnormal return on the politically-themed stocks connected to the president elect (4.70%) and the runner-up (-6.46%). Simply put, politically-themed stocks linked to the president elect climbed abnormally on the day following the election, while the stocks linked to the runner-up suffered irrational declines.

However, the differences in cumulative returns on the president-elect and runner-up stocks narrowed as time went by. The average cumulative return for five trading days on both stocks (CAR[5]) converged to -7.12% and -7.45%, respectively. As a result, the rise in returns on the president-elect stocks on the day after the election seems to be a temporary phenomenon. Furthermore, the fact that the five-day cumulative return turned negative without any new event or market information implies an over-interpretation of what those stocks could deliver or a reflection of irrational investment sentiment.

Figure 1. Post-election CAR trends in the 16th through 18th elections



Note: Post-election trading days (X-axis) and returns (Y-axis)

Caution necessary for investments in politically-themed stocks

During the past three presidential elections, almost all politically-themed stocks climbed abnormally beating the industry benchmark. Five days after the elections, however, their average cumulative abnormal return turned negative, putting an end to the price rallies that went far beyond the normal range.

Similar to past elections, the 19th presidential election campaign currently underway has been also mired by mounting concerns about politically-themed stocks. According to a Korea Exchange press release unveiled on April 11, 2017,²⁾ politically-themed stocks accounted for the largest proportion (76.9%) in the bourse's watch list between February 2016 and February 2017. KRX reported that the stocks on the watch list had high volatility in both stock prices and trading volumes, incurring retail investors a loss of KRW 770,000 per account.

An analysis on the 19th presidential election using the same approach for the past three presidential elections resulted in a total of 39 politically-themed stocks related to the two leading candidates. Among those, the number of stocks whose cumulative abnormal return exceeding 20% for a short period reached 22.

The aforementioned analysis results call for investors looking to politically-themed stocks to clearly understand the price characteristics of politically-themed stocks and to use particular

2) Korea Exchange, April 11, 2017, Politically-themed stock trading: Review results and characteristics, Press Release.



caution in their investment decisions. Politically-themed stocks whose value abruptly rise without any change in fundamentals are in the end exposed to the risk of abrupt falls in investment returns. Korea's financial authorities must focus on establishing a more efficient monitoring system on market manipulation practices related to politically-themed stocks, which will help achieve systematic cooperation between ex-ante prevention and ex-post crackdown.