

## Marcellus: Elections are irrelevant for equity investors



Exhaustive research by American political scientists, Chris Achen & Larry Bartels, shows that elections neither produce responsive governments nor do voters elect leaders who can tangibly impact economic outcomes and stockmarkets.

*“An understanding of the importance of the desire for recognition as the motor of history allows us to reinterpret many phenomena that are otherwise seemingly familiar to us, such as culture, religion, work, nationalism, and war...A religious believer, for example, seeks recognition for his particular gods or sacred practices, while a nationalist demands recognition for his particular linguistic, cultural, or ethnic group. ...liberal politics and liberal economics frequently rests on irrational forms of recognition that liberalism was supposed to overcome. For democracy to work, citizens need to develop an irrational pride in their own democratic institutions, and must also develop what Tocqueville called the “art of associating,” which rests on prideful attachment to small communities. These communities are frequently based on religion, ethnicity, or other forms of recognition that fall short of the universal recognition on which the liberal state is based.”*

**- Francis Fukuyama in ‘The End of History and the Last Man’ (1992) [the underlining is ours]**

## **Huntington & Fukuyama – the political scientists who riled the liberals**

In the 1990s, two books by iconoclastic political scientists – “The Clash of Civilisations and the Remaking of World Order” (1996) by Samuel Huntington and “The End of History and the Last Man” (1992) by his disciple, Francis Fukuyama – riled plenty of liberals. Both of these men cocked a snook at the then prevailing orthodoxy and said that we are all very tribal people who will ultimately identify with, look after and care for our own. So, if you are Indian Hindu you will live in a perpetual state of tension with Indian Muslims. If you are a White Anglo Saxon Protestant American, you will struggle to live peacefully with Americans of a different colour or creed. The idealist inside many of us recoiled at the ideas trumpeted by these men but events in the last 25 years have largely validated the thesis put forward by these two original thinkers.

In fact, a subsequent generation of political scientists, enriched by learnings from behavioural science and big data analysis, have shown just how right Huntington & Fukuyama are. In a remarkable book continuing exhaustive statistical analysis of American voting patterns and published five months before Donald Trump was elected President of the USA, Christopher Achen & Larry Bartels wrote:

*“The primary implications of our analysis of retrospective voting is that election outcomes are mostly just erratic reflections of the current balance of partisan loyalties in a given political system. In a two-party system with competitive elections, that means that the choice between the candidates is essentially a coin toss. Thus, the picture that emerges is not “a portrait of citizens moved to considered decision as they play their solemn role of making and unmaking governments...” Rather, elections are capricious collective decisions based on considerations that ought...to be largely irrelevant – and that will, in any case, soon be forgotten by the voters themselves.... Research in other countries have generally produced similar portraits of democratic citizens. Their ideological self-placements are often driven more by partisanship than by policy positions.... Can ordinary people, busy with their lives and with no firsthand experience of policy-*

*making or public administration, do what the theory expects them to? Can they formulate policy preferences, assess where candidates stand on the issues, set aside cognitive biases and group prejudices, and then choose a candidate who embodies an uplifting version of their own policy views?" [Source: '**Democracy for Realists: Why Elections do not Produce Responsive Government**' (2016)] [the underlining is ours]*

Achen & Bartels use clever number crunching to hammer home the point that we vote with our heart, not with our head. Here are a couple of examples:

- Across the world, incumbent governments were punished for the post-Lehman bust of 2008-10 with no consideration of whether their country did better or worse than the average country in navigating the crisis.
- Governors in oil rich American states tend to have a much higher probability of being re-elected when oil prices rise. "Similarly, voters in pro-cyclical states are consistently fooled into re-electing incumbents during national booms, only to dump them in national recessions." (Source: Justin Wolfers, 'Are Voters Rational? Evidence from Gubernatorial Elections')

[Our thanks to James Crabtree, author of the "The Billionaire Raj", for pointing us towards Achen & Bartels' book.]

Indian political scientists too have crunched numbers and produced sobering conclusions. In 'When Crime Pays: Money & Muscle in Indian Politics' (2017), Milan Vaishnav has highlighted that the probability of a candidate winning an election in India is materially higher if he has a criminal track record. Vaishnav explains that voters want to support politicians who are expert rent seekers so that these politicians can then share the spoils with his supporters. A criminal track record is perhaps the most effective way for a candidate to signal his rent seeking credentials. To quote Vaishnav:

*"Money helps grease the wheels, but voters too have a rational incentive to back*

*politicians with criminal reputations. In places where the rule of law is weak and social divisions are rife, politicians can use their criminality as a signal of their ability to do whatever it takes to protect the interests of their community – from dispensing justice and guaranteeing security to providing a social safety net. What the Indian state has been unable to provide, strongmen have promised to deliver in spades. What this means in practice is that voters are not necessarily blind to the predilections of the political class; many voters vote for politicians because, rather than in spite, of their criminal reputations.”*

### **Investment implications**

None of this is to deny the importance of the electoral process and the rituals associated with it. If not anything else, it gives people a voice even if they cannot use that voice to elect responsive governments. However, from the narrow perspective of investors in financial markets, elections are a sideshow for those who are willing to look beyond the keen jerk reactions of the market to election results. Time and again, we have seen in India and elsewhere that the reflex reaction of the market to election results is not a signal with any lasting value. In fact, just looking at Sensex returns under Congress versus non-Congress governments in India (20% CAGR vs 8% CAGR) is sufficient to dispel any notion that election outcomes have anything to do with stockmarket returns.

Economic factors do matter – we find that 58% of the Sensex’s returns over the past 15 years are driven by three macro factors (exchange rates, interest rates and GDP growth) – but since economic and political outcomes in India do not appear to be correlated to each other, investors should focus on the economy rather than obsessing about the forthcoming Assembly & General Elections in India.

Thankfully, directional forecasting of the economy is easier (albeit less interesting) than the far trickier exercise of forecasting election results.

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