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Relief Rally

Senators as Feckless as the Rest of Us at Stock Picking

By William Belmont, Dartmouth College; Bruce Sacerdote, Dartmouth College; and Ian Van Hoek, Dartmouth College

In April 2012, Congress passed the Stop Trading on Congressional Knowledge (STOCK) Act, which prohibits members of Congress and their staff from leveraging nonpublic information to make investment decisions. The act also requires the president, vice president, and all members of their staff to report any trades that exceed $1,000 within 45 days of the transaction.

The act made it clear for the first time that the laws against insider trading also apply to members of Congress and their staff. This prevents them from leveraging information gleaned from their official capacities as market regulators. The act also established additional public disclosure requirements for security trading activities of members of Congress to help monitor their compliance with the new insider trading laws. The act was celebrated with great fanfare during its signing ceremony and was seen as a pivotal step in addressing public skepticism about an unequal system. As former president Barack Obama put it, the STOCK Act was meant to address a "deficit of trust" between the American people and their lawmakers.

A year after the STOCK Act was passed, the bill was quietly amended, reversing major pieces of the law. Fast-tracked using a process known as unanimous consent, the amendment repealed the mandate for congressional aides and staffers to disclose their trading activities online. Senators and members of Congress now have the option to disclose their trades through an electronic system or paper filings. For members of Congress, these trades are now available on two websites (one for the House and one for the Senate). Disclosures by congressional staffers are not made available by websites.

Recently, the STOCK Act again made headlines when at least four senators avoided large losses by selling ahead of the COVID-19 stock market crash. The selling took place after a January 24 briefing of the Senate Health, Education, Labor, and Pensions Committee on the severity of the coming COVID-19-related health crisis. Some commentators have suggested that senators frequently use their private information to aid in both stock selection and market timing. We do not find evidence, however, that senators are successful stock pickers, nor do we find evidence of market timing.

Existing research has demonstrated that prior to the passage of the STOCK Act, portfolios that mimicked those of senators outperformed the market by approximately 1 percent per month and that investments by members of the House of Representatives outperformed the market by approximately 6 percent annually. The literature supports the hypothesis that prior to the passage of the STOCK Act, members of Congress were leveraging their privileged positions to achieve superior financial returns. Other research finds that senators achieved positive abnormal returns by avoiding annualized losses from sold stocks of 5.4 percent.

Additional research found that companies owned by members of Congress were more likely to be acquired or report earnings and revenue surprises and were more likely to receive government grants and contracts. In the three years leading up to the passage of the STOCK Act in 2012, senators'

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financial transactions spiked, with a maximum transaction value of $1,495,559,000 across 7,582 transactions in 2010. In 2015, three years after the passage of the STOCK Act, there was a maximum transaction value of $337,480,000 across 2,475 transactions, demonstrating a 77 percent reduction in the nominal value of senators' trades and a 67 percent reduction in the number of transactions made by senators. The evidence points to a twofold conclusion: First, the STOCK Act significantly reduced the amount of financial activity in the Senate. Second, prior to passing the act, senators were inclined to make many high-nominal value trades.

We examine the buy-and-hold abnormal returns of senators' picks from 2012 to March 2020. Senators' purchases underperform the industry-size benchmark at the one-month, three-month, and six-month horizons by 11, 28, and 17 basis points, respectively, but only the six-month horizon impact is statistically significant. Stocks sold by senators also show little evidence of stock-picking ability, underperforming the industry-size benchmark insignificantly at the six-month level and outperforming insignificantly (14 basis points) at the one-year level. We do not find evidence that Senate committee assignments lead to stock-picking or industry-picking skills within industries that are related to the committee assignment or under the committee's purview.

These findings contrast somewhat with recent news reports on senators selling stocks ahead of the COVID-19 stock market crash and studies of pre–STOCK Act data. While the literature found that Congress members' investments outperformed the market before the passage of the STOCK Act, our analysis of post–STOCK Act data finds only limited evidence that senators display stock-picking prowess.

NOTE:

This research brief is based on William Belmont, Bruce Sacerdote, and Ian Van Hoek, "Relief Rally: Senators as Feckless as the Rest of Us at Stock Picking," NBER Working Paper no. 26975, April 2020, http://www.nber.org/papers/w26975.