

Impact of Union Elections on the Stock Volatility

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Abstract

This paper examines the impact of union elections on volatility of stocks in India. The study is conducted on a sample of 6 company stocks picked from 3 different sectors i.e Banking, IT and Communications from NSE list. The data is considered for a total of 5 months 2 and half months pre elections and 2 and half month post election Analysis is done using Descriptive statistics and RSI tools and we have concluded that majority of the stocks under consideration are more volatile post elections, which show that investors are surprised from the election outcomes. Our findings have an important implication for optimal strategies of risk- adverse stock market investors and participants in the Equity market.

Keywords: Volatility, Descriptive statistics, RSI

Introduction

Country's political affairs can exert significant impact on its earnings distribution and prosperity. In democratic circumstances, voters elect parties which best characterize their personal opinions and welfares. The economy will be stimulated by weak expansionary policies before the elections, and harsh actions aimed at curbing the resultant inflation will have to follow at the commencement of the new period of office. It has to be noted, however, that any policy induced cycles in real activity will be concise if the economic agents and voters have balanced expectations.

Politicians are frequently concerned with the performance of the stock markets and economies of the countries and regions over which they preside. The ways to handle the economy during times of elections can be debated endlessly by candidates. With economic concerns heavily influencing politicians' agendas, it could be expected that investors take the actions of political officials into consideration when choosing where to invest.

Several recent papers look at whether security profits are impacted by politics. Booth and Booth (2003) report that the U.S. stock market tends to make better in the second half of the presidential phase. This phenomenon could be a indication of the political business cycle but can also be explained behaviorally.

The investigation into return volatility is acceptable on at least three grounds. First, the indecision about the election outcome has important implications for risk averse investors. Prior research has shown that investors are undiversified globally and display a significant home favoritism (French and Poterba, 1991; Baxter and Jermann, 1997). Since they hold predominantly domestic assets, the country specific political risk will not disperse in their portfolios. Consequently, the sole happening of elections in their home country could have severe implications for the risk level of their portfolios. Second, any market-wide fluctuations in reaction to election shocks will enlarge the systematic volatility of all stocks listed.

A political election is an occasion that could turn out to be significant to investors. With a strong link between politics and the performance of the economy, an election could be a turning point that changes investors' outlooks on stock indices. Having certain administrations in command may be favorable for investors compared to other political parties. If this is the case, an election could be a point where people begin drawing their money out of equity markets in these countries or increasing their investments in these countries. Given the major impact an election can have, the query arises as to how this event could impact the stock indices of the respective country.

Volatility is linked with randomness, uncertainty and has implications for variance risk. Generally, people tend to see volatility as a indication of market disturbance where by securities are not being priced moderately and the capital market is not functioning as fine as it should. The changes in the volatility of stock market income are capable of having major negative effects on risk averse investors and the economy. In this context, enlarged volatility in domestic stock market can impact consumption patterns, corporate capital investment decisions, leverage decisions, the business cycle and macroeconomic variables.

Economic growth is essential for enhanced quality of life of any country. Many theories highlight the role of investment in enhancing economic expansion. Financial steadiness is crucial for promoting investment. In a condition of financial stability, financial institutions and markets are able to competently mobilize savings, offer liquidity and apportion investment.

The study of financial assets volatility is important to academics, policy makers, and financial market participants for several reasons. First, forecast of financial market volatility is significant to economic agents because it represents a measure of risk exposure in their investments. Second, a volatile stock market is a serious concern for policy makers because instability of the stock market creates uncertainty and thus adversely affects growth prospects.

Hence stock return forecasting has created new job opportunities for the professionals those who are experts in volatility forecasting. Thus it can be seen that the study of stock market volatility is very vital and can be supportive for the formulation of economic policies and framing rules and regulations related to stock market volatility. From an investor's view point, it would be enormously useful if the prospect stock return volatility could be predicted from the past data.

Literature Review

Piyush Kumar Chowhan and Vasant Shukla (2000) in their research paper "Volatility in Indian stock markets" carried out an experiential study of BSE Sensex and a set of representative stocks are carried out to find the changes in their volatility in the last 2 years.

The evidence in the paper "Political Events and the Stock Market: Evidence from Israel" by **Tzachi Zach (2003)**, demonstrates that the income on the Israeli stock market's main index following political events are more extreme than the returns on the same index in other days.

Bernd Hayo and Ali M. Kutan (2004) in their research paper "The Impact of News, Oil Prices, and Global Market Developments on Financial Markets" argued that the international influence on financial markets depends upon the degree of financial liberalization.

In research paper "Relationships between stock markets and macroeconomic variables" by **Sezgin Acikalin, Rafet Aktas and Seyfettin Unal (2008)** it was concluded that there is a clear effect of stock market on the moves of interest rate but the net impact whether positive or negative is uncertain.

Anuradha Guru (2009), in her research paper "What moves stock prices and How" showed what all events affect stock prices, which helped to classify events into major five categories. Movements of stock prices are observed to depend on macroeconomic factors, like, domestic and international, economic, social or political events, market sentiments or hopes about future economic growth path or important budgetary, monetary and fiscal policy announcements etc.

Renuka Kinger (2009), in her article "Volatility of stock market and its causes" proposes that root cause of stock market volatility is surprising information breaking out in the market. So she concluded that portfolio should have margins to accommodate volatility caused due to various events.

Debashis Kundu (2009) in his research paper "Do unexpected events cause significant market volatility" concluded that major domestic and international events do not

cause significant volatility in Indian stock market. He also found that a macroeconomic event sometimes affects stock market indexes but not all the time. In article “Impact of Terror Attacks on Indian Stock Prices”.

Significance of the Study

The study of volatility in the Indian stock market in relation to the event like union elections is important for several reasons. Firstly, volatility is synonymous with risk and therefore increase in risk associated with a given economic activity should therefore see a reduced level of participation in that activity. In other words, when the Indian stock market exhibits high volatility a reduced level of participation can be expected and can lead to adverse consequences for investment in the local stock market. Secondly, changes in stock market volatility, basically can affect the consumption pattern, corporate investment decision, leverage decisions, the business cycle and macroeconomic variable of that country.

Statement of Problem

Most of the Investors are not able to pick right stocks at right time and they meet with a loss. Our analysis is taken up to guide investors to invest in stocks in the right time.

Objectives of the Study

1. To investigate how the Indian stock markets behave on the Election announcement in terms of its volatility.
 2. To measure and compare the daily stock returns pre and post elections.
- To analyse the volatility behaviour of selected companies listed in NSE.

Research Methodology

Samples of 6 company stocks are picked from NSE list using non probability convenience sampling technique. The study is done during pre and post election for a period of 2 and half month each. The secondary data collected is daily closing price of the stocks taken from NSE website. Descriptive statistics is used for the purpose of analysis.

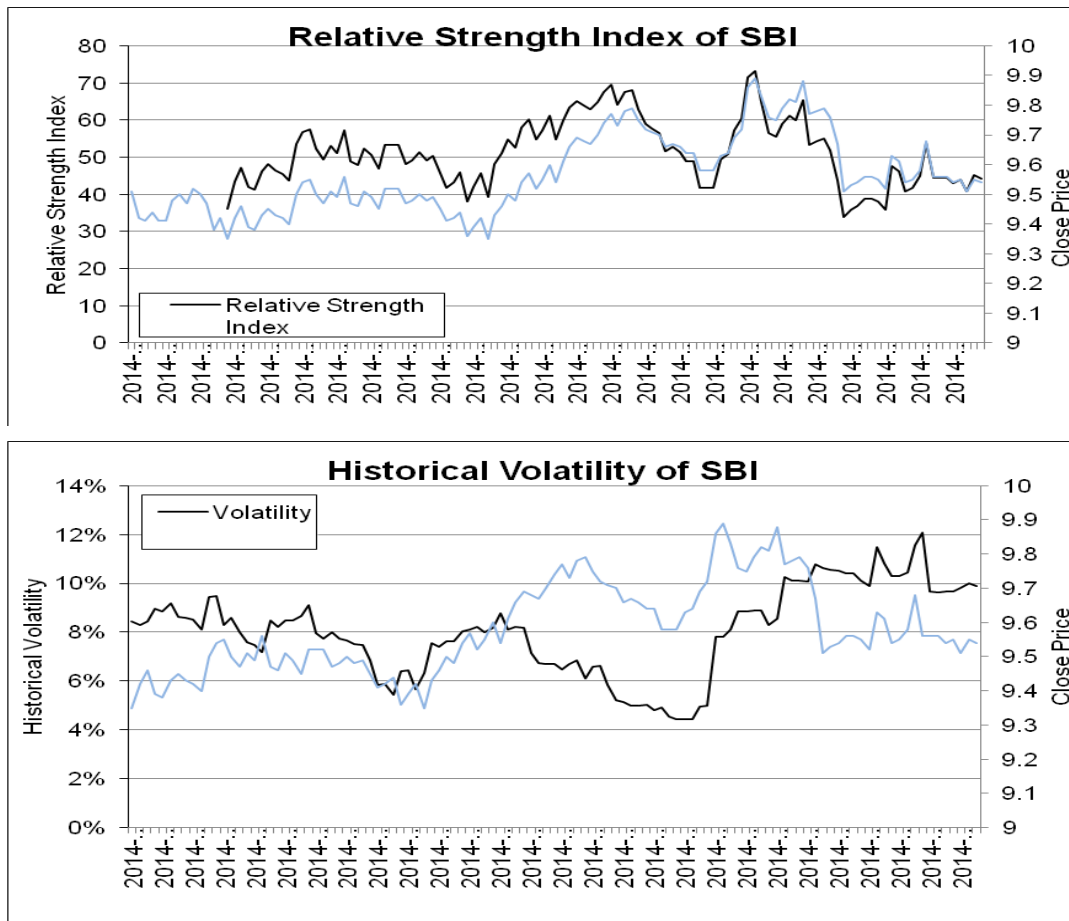
Analysis

Descriptive Statistics of State Bank of India pre and post elections

Table 1: Showing data for SBI

	Standard Deviation	Annualized SD	Skewness	Kurtosis
Pre Election	1.633	25.988	-0.167	-0.4792
Post Election	2.460	39.056	-1.0911	2.530

Graph1: Showing RSI and Historical volatility for SBI



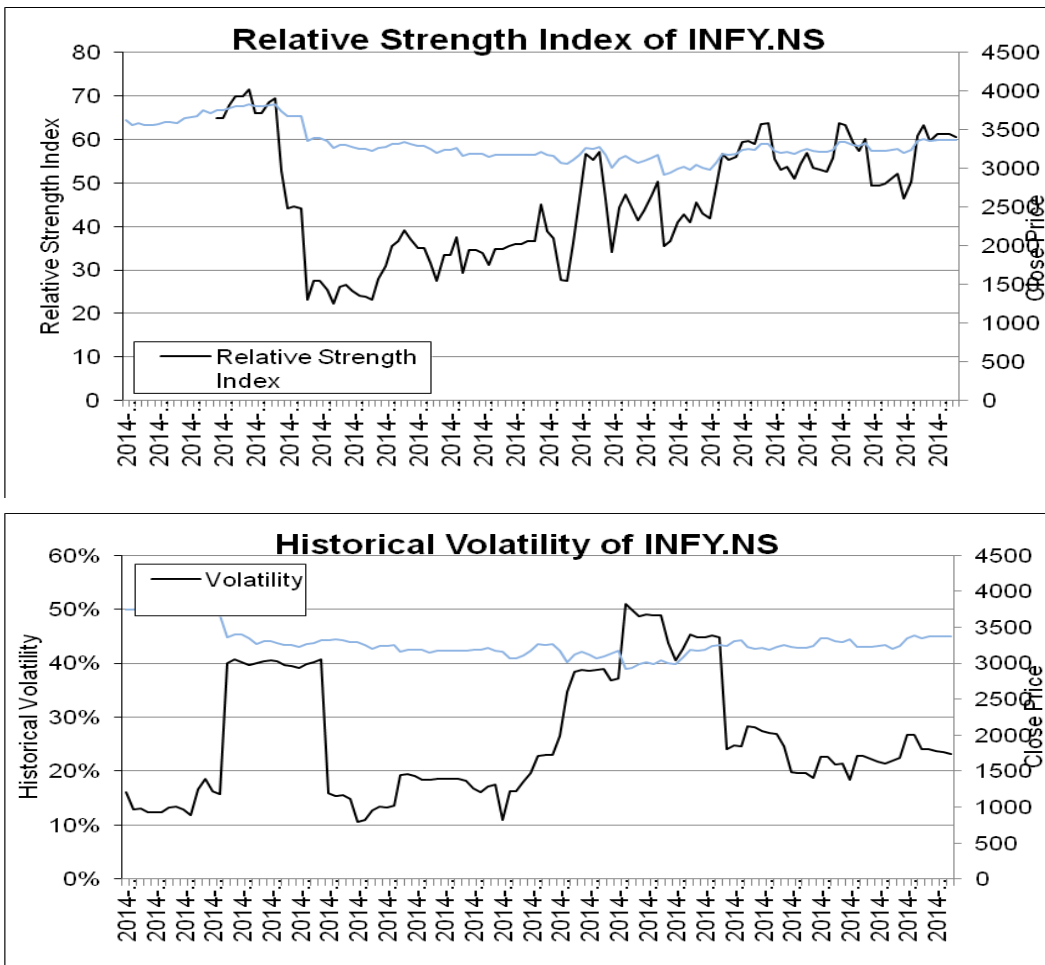
From above table it is evident that volatility of SBI stock is greater post-election i.e after the announcement of the results.

Descriptive Statistics of Infosys pre and post elections

Table 2: Showing data for Infosys

	Standard Deviation	Annualized SD	Skewness	Kurtosis
Pre Election	1.66	26.44	3.63	18.75
Post Election	2.057	32.657	1.492	5.197

Graph 2: Showing RSI and Historical volatility for INFOSYS



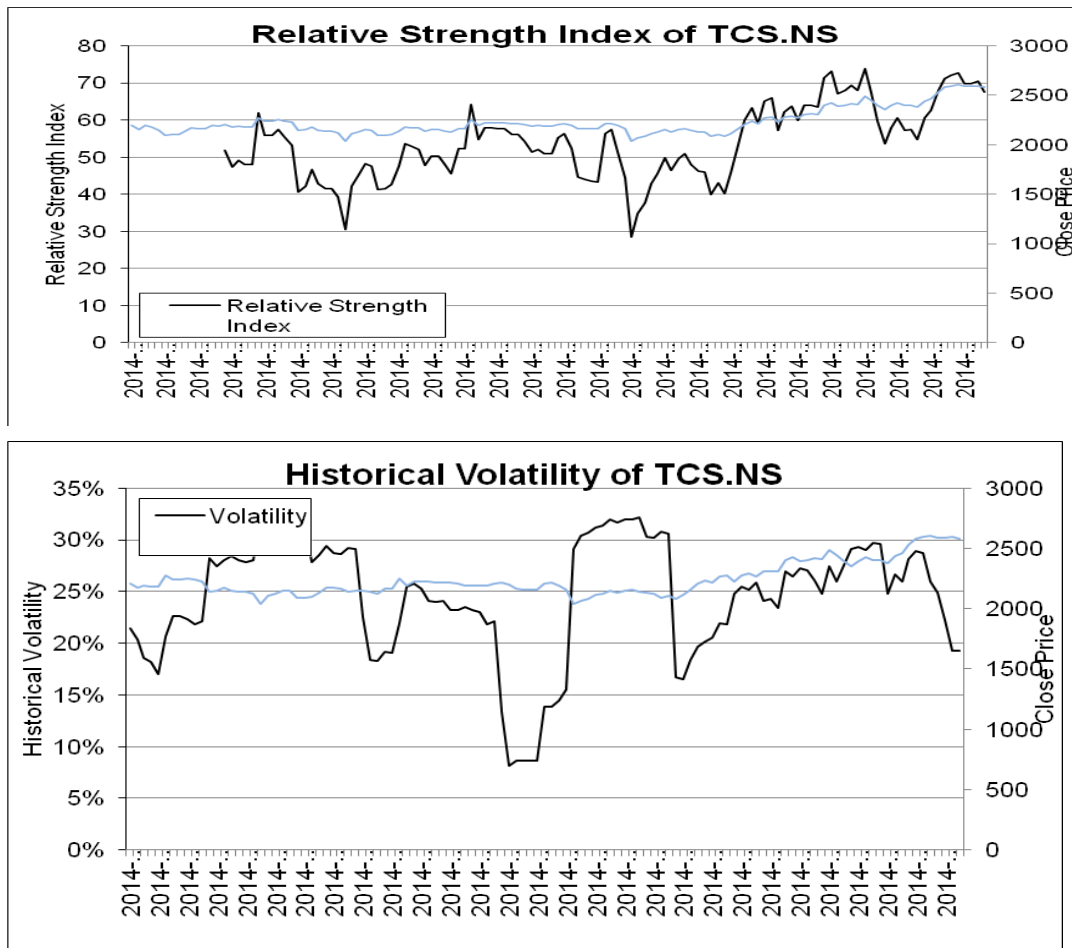
The above table showing data for Infosys Ltd. Indicates that the stock return is more volatile post-election.

Descriptive Statistics of TCS pre and post elections

Table 3: Showing data for TCS

	Standard Deviation	Annualized SD	Skewness	Kurtosis
Pre Election	1.664	26.429	-0.01057	1.0234
Post Election	1.687	26.784	0.8422	2.575

Graph 3: showing RSI and Historical volatility for TCS



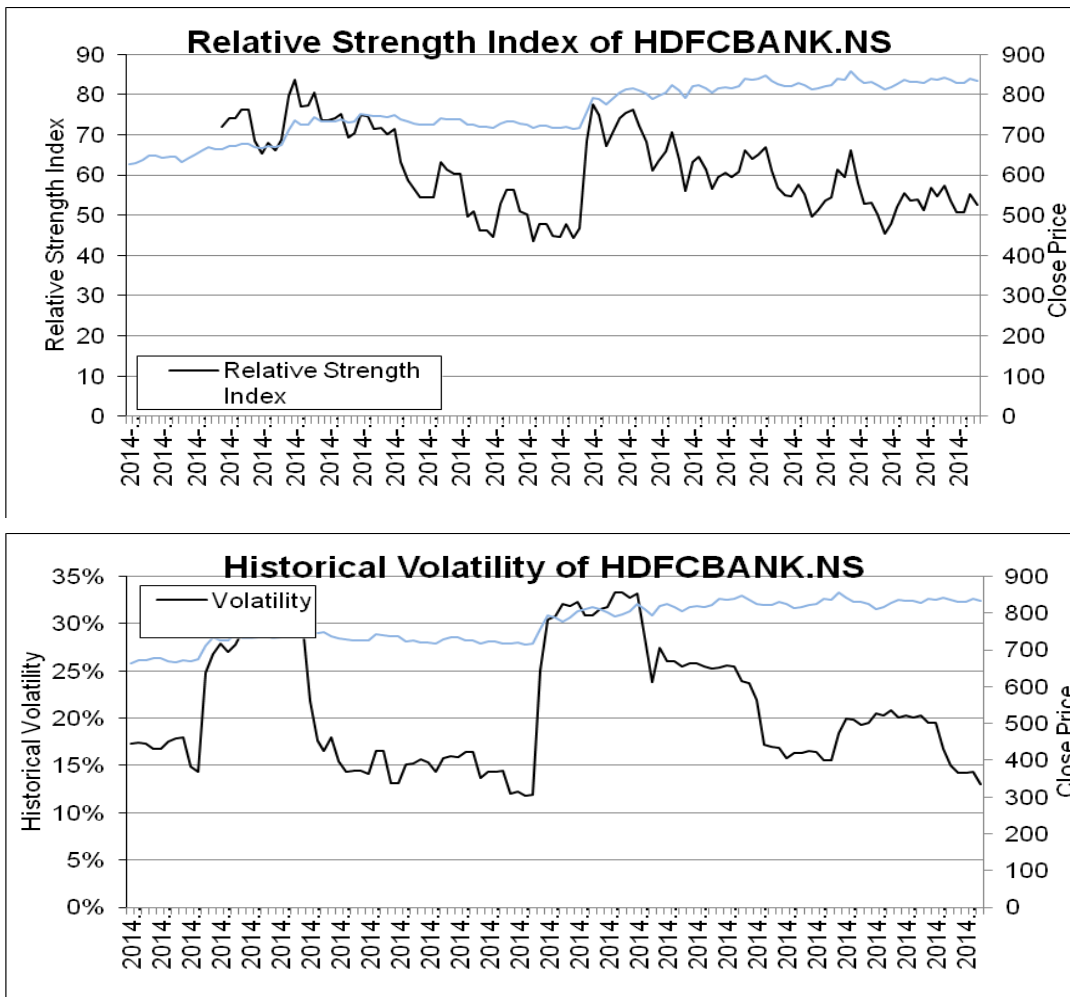
From the above table depicting data for TCS Ltd it is evident that there is no much change in volatility pre and post-election period.

Descriptive Statistics of HDFC pre and post elections

Table 4: Showing data for HDFC Bank

	Standard Deviation	Annualized SD	Skewness	Kurtosis
Pre Election	1.331	21.133	-1.0516	2.405
Post Election	1.226	19.462	-0.335	-0.349

Graph 4: showing RSI and Historical volatility for HDFC Bank



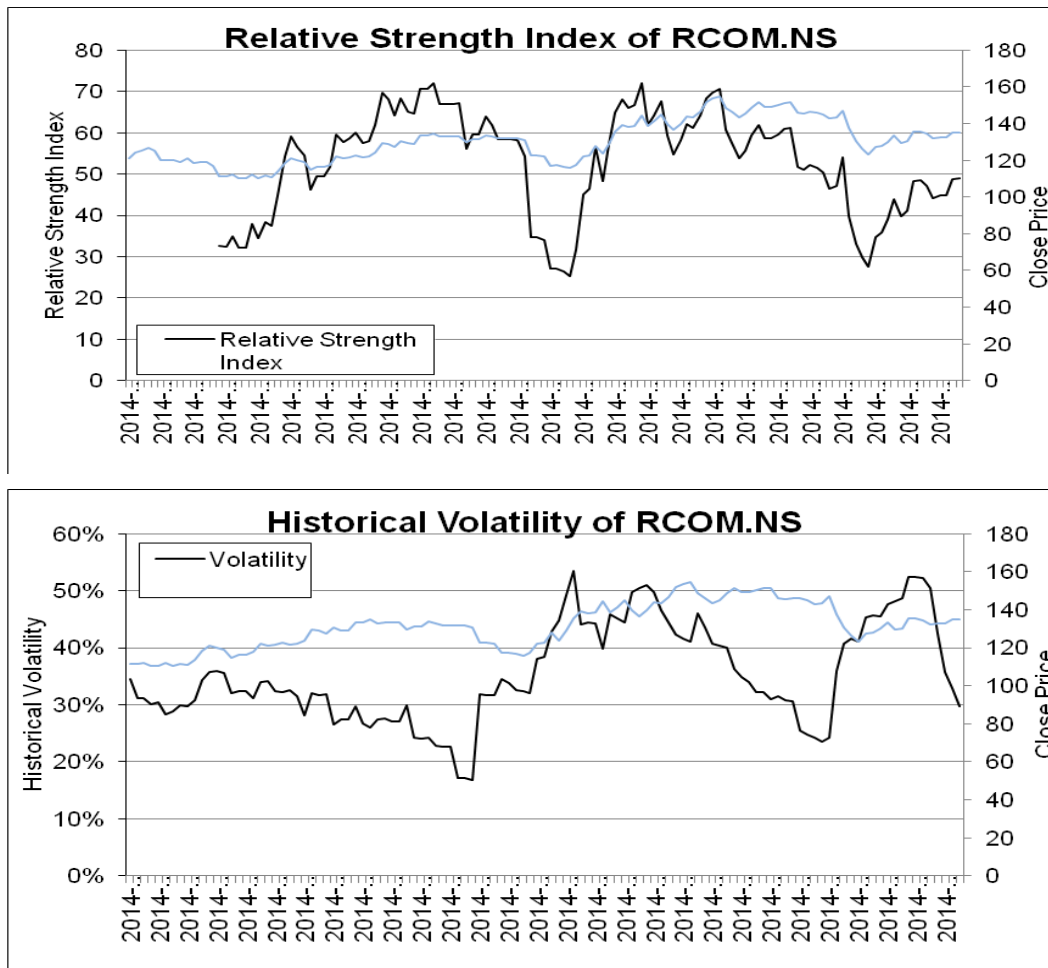
It can be understood from the above table that the volatility was higher before the elections when compared to post period. But there is not significant change in the volatility pattern for the 2 periods.

Descriptive Statistics of Reliance Communications pre and post elections

Table 5: showing data for Reliance communications

	Standard Deviation	Annualized SD	Skewness	Kurtosis
Pre-Election	1.959	31.11	0.2881	0.6814
Post-Election	2.5733	40.859	0.5428	0.0728

Graph 5: showing RSI and Historical volatility for Reliance Communications



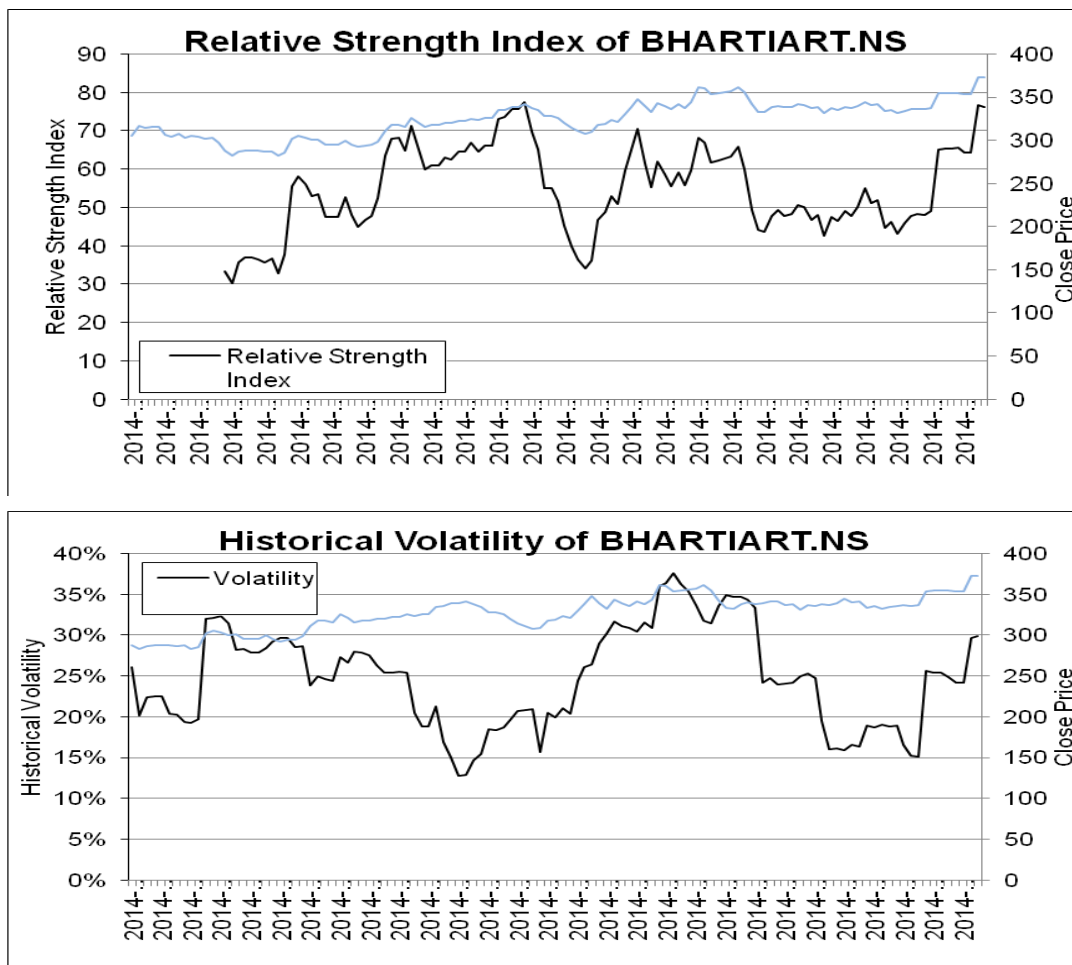
It can be clearly concluded from the above data regarding Reliance communications that volatility is higher during the post-election period compared to that before elections.

Descriptive Statistics of Bharti Airtel pre and post elections

Table 6: showing data for Bharti Airtel

	Standard Deviation	Annualized SD	Skewness	Kurtosis
Pre Election	1.6441	26.100	-0.828	1.531
Post Election	1.8183	28.866	-0.6423	1.061

Graph 6: showing RSI and Historical volatility for Bharti Airtel



From the above table it can be concluded that Bharati Airtel stocks were more volatile post-elections compared to pre-election period.

Findings

1. SBI shares were more volatile post-election and it is seen that the data is left skewed with the data peaked above the normal during pre-elections and is flatter post- elections.
2. HDFC shares were more volatile pre-elections but no major difference is observed during the 2 periods. Here the data is negatively skewed with the flatter peak prior elections and peaked above normal post- elections.
3. Infosys shares are observed to be volatile post elections, and data being positively skewed with flatter peaks during pre and post- election periods.
4. TCS Ltd. shares do not show any significant change in volatility during the 2 periods. The data is found to be marginally negatively skewed pre- elections but positively skewed post-elections with peak flatter than normal both the times.
5. Reliance Communications shares were more volatile post-elections with the data being positively skewed with peak flatter than normal.
6. Bharti Airtel Ltd. shares were more volatile post-elections with the data being negatively skewed with peak flatter than normal.
7. It can be seen from the RSI graph that HDFC stocks were more frequently over brought when compared to other stocks during the period of study.

Conclusion

India has witnessed years of up and down cycle in stock markets. Since 1992 Indian markets have peaked every fourth year and then drops 35-40% next 3 years. Some of the major conclusions drawn are that news related to any political and economic affair has direct effect on stock market. Any unusual news about the economy or about a particular company will affect the value of the stock. It is suggested that an accurate model to determine volatility should be employed by the investors.

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