

How Does The Impact of Political Uncertainty, Such As Elections and Geopolitical Tensions, Affect The Stock Market Volatility?

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I. Introduction

The stock market — along with financial markets around the world — shares a defining characteristic: they are all highly sensitive to external factors, particularly political uncertainty. Although markets naturally fluctuate due to a range of influences, periods of political instability often introduce an added layer of volatility that investors cannot ignore. Around the globe, political uncertainty regularly causes sharp market movements, affecting asset prices, investor confidence, and broader economic forecasts.

Among the types of political uncertainty that have the most pronounced effects are elections, geopolitical tensions, and government policy actions. Elections, which may bring leadership changes and shifts in economic policy, play a critical role in shaping market expectations. Although often overlooked compared to more immediate events, elections establish the foundation for future government actions that directly impact financial markets. Similarly, geopolitical tensions — including military conflicts and diplomatic crises — can disrupt global trade, alter commodity prices, and destabilize investor sentiment, causing widespread volatility. Finally, policy changes such as adjustments to fiscal policy, new regulations, or central bank interventions further contribute to uncertainty, challenging the market's ability to price risk accurately.

This paper will explore the different forms of political uncertainty and their impacts on stock market volatility. By examining elections, geopolitical tensions, and government actions, we aim to provide a clearer understanding of how political developments fuel market instability and why political uncertainty remains a persistent and powerful force in global financial systems.

II. Types of Political Uncertainty

Political uncertainty can arise from a range of sources, but three major categories consistently have the most direct impact on financial markets: elections, geopolitical tensions, and policy changes initiated by governments. Each of these areas introduces unique risks and challenges for investors. Elections often create uncertainty about future leadership and economic policy direction. Geopolitical tensions, such as military conflicts or diplomatic disputes, can disrupt trade and global economic stability. Policy changes — including shifts in fiscal policy, regulation, and monetary policy — directly affect business operations and investor strategies. Understanding how each of these factors contributes to market volatility is essential for grasping the broader relationship between politics and financial market behavior.

a. Elections

The process of elections creates significant political uncertainty because they enable new leaders to take power while allowing policy directions to change. Financial markets show reactions to both election results and election-related market speculations. The CBOE Volatility Index (VIX) increased by 27% in October 2020 before the U.S. presidential election according to Bloomberg (2020). Market reactions to election outcomes depend on which political party or candidate appears likely to win. The Vanguard (2020) report shows that U.S. election months typically result in lower stock returns but these returns usually bounce back after election results become known when investors view the outcome as favorable to markets. Investors base their expectations on taxation changes and regulatory and spending decisions which directly affect energy and healthcare and financial sectors.

b. Geopolitical Tensions

The uncertainty caused by geopolitical tensions between trade wars and military conflicts leads to decreased investor confidence which disrupts global market operations. The S&P 500 experienced multiple days of more than 2% decline in 2018-2019 because of U.S.-China trade war tariff announcements (CNBC, 2019). The Russian invasion of Ukraine in 2022 caused Brent crude prices to exceed \$130 per barrel which triggered worldwide stock market declines and inflation concerns (Reuters, 2022). The events disrupt worldwide supply networks particularly those that depend on raw materials or manufacturing while creating enduring changes in trade relationships and investment patterns.

c. Policy Changes and Government Actions

Market movements become substantial when governments implement fiscal decisions together with regulatory reforms and central bank actions. Interest rate changes receive close attention from market participants. The S&P 500 declined by about 20% during 2022 after the Federal

Reserve implemented aggressive rate hikes to fight inflation (Federal Reserve, 2022). Major tax reforms either boost or reduce economic performance. The 2017 Tax Cuts and Jobs Act in the U.S. led to increased corporate earnings which resulted in a 19.4% S&P 500 growth during that year (Forbes, 2018). The stock prices of technology companies tend to decrease when antitrust investigations intensify as demonstrated by the 2020 hearings about major technology firms (Wall Street Journal, 2020). Government decisions create direct effects on economic conditions while simultaneously affecting how investors feel about the market.

III. Mechanisms Through Which Political Uncertainty Affects Market Volatility

Market volatility responds to political uncertainty through multiple related factors which include investor sentiment and behavior together with uncertainty premiums and economic expectation changes. Political instability during elections and trade disputes and international conflicts leads investors to experience decreased confidence levels. The heightened anxiety among investors leads them to choose safe-haven assets including gold and Treasury bonds and the U.S. dollar while they sell riskier assets such as equities. Jiang et al. (2024) discovered through their research that political instability leads to higher market volatility and reduced investor confidence in worldwide markets. The CBOE Volatility Index (VIX) increased by 27% in October 2020 according to Bloomberg (2020) as investors prepared for election uncertainties during the 2020 U.S. presidential election.

Markets respond to such uncertainty by adding risk premiums which economists call an "uncertainty premium" because investors need higher expected returns to offset political risk perceptions. The research by Pastor and Veronesi (2013) demonstrates that markets tend to overreact to political risk which leads to mispriced assets and elevated volatility. The economic system experiences direct macroeconomic effects when interest rates increase because bond investors seek higher returns which drives up borrowing expenses for both businesses and governments. The resulting pressures act as a deterrent to corporate investment and hiring and expansion which creates a cycle of economic slowdown and intensified market anxiety.

The political environment leads to major changes in how people view economic conditions. The S&P 500 stock index experienced multiple declines exceeding 2% per day in 2018-2019 because investors reacted to unexpected tariff announcements that affected global supply chain stability (CNBC, 2019). The European Commission reduced its 2025 eurozone growth projection from 1.3% to 0.9% because of rising trade tensions and unpredictable U.S. economic policies (Reuters, 2025). Market participants need to adjust their inflation and GDP growth and interest rate expectations because of political developments. Political uncertainty creates market instability through fear-based actions that alter asset prices and make it difficult to accurately predict macroeconomic outcomes.

IV. Long Term VS Short Term

Stock market performance responds strongly to political uncertainty through immediate market volatility and lasting market adjustments. Market participants experience rapid price movements because they remain uncertain about upcoming leadership choices and policy changes. The CBOE Volatility Index (VIX) increases by 20% on average during the three months preceding U.S. presidential elections according to Forbes (2024). The market experienced daily price movements exceeding 2% during the 2020 election season because investors were uncertain about pandemic policy decisions according to CNBC (2024). The market reacts instantaneously to geopolitical tensions which create immediate market effects. The S&P 500 index dropped by about 12% from January to early March 2022 because investors adapted to the prolonged Russia-Ukraine conflict according to Bloomberg (2022). Investors tend to move their assets into bonds and gold and stable foreign currencies when they experience short-term market declines because of fear and a "flight to safety." The market's long-term reaction depends on the speed at which political clarity emerges. The market stabilizes after election results become official or diplomatic solutions are established. The 12-month period following U.S. midterm elections showed an average equity market gain of 7.5% according to JP Morgan (2023) because investors regained confidence. The market remains volatile when elections become contested or conflicts drag on for extended periods. Political uncertainty demonstrates to investors that market behaviors result from the combination of fear and speculation and optimism. The resolution of uncertainty together with subsequent economic policies determines long-term market trends although quick market reactions become common during periods of tension.

V. Investment Strategies Amid Political Uncertainty

Investors should adopt a complex political uncertainty management plan which combines portfolio diversification with risk control and enduring long-term investment strategies.

a. Diversification

The fundamental approach to reduce risk during political instability is through diversification. Investors who spread their investments across different asset classes and sectors and geographic locations can minimize the negative effects of market segment disruptions. The addition of international stocks and bonds and alternative assets helps protect investments from domestic political disturbances. According to Investopedia the S&P 500 provides wide market exposure yet its focus on large-cap U.S. equities makes it insufficient for complete diversification. A portfolio that includes various assets is necessary to handle the unpredictable nature of political events.

b. Risk Management

Risk management techniques need to be implemented strongly because of political uncertainty. The protection of portfolios from major losses can be achieved through hedging strategies which include options and futures. The stability of investments can be achieved through the purchase of safe-haven assets including gold and government bonds. The low correlation of gold with other asset classes makes it an effective hedge during times of market turbulence. U.S. Treasuries are considered safe investments by traditional standards but recent market changes have led some investors to reevaluate their positions. Investors who use these instruments will be able to handle better the risks that come from political volatility.

c. Long-Term Perspective

Investors need to maintain their long-term investment perspective when political uncertainty exists. Market fluctuations in the short term stem from immediate political event responses yet historical data demonstrates markets recover in due time. The historical data indicates that diversified portfolios have produced positive returns even during multiple political crises. Farther stresses that investors should maintain their focus on long-term objectives instead of making decisions based on short-term market fluctuations. Investors who stick to their long-term strategy will prevent themselves from making hasty choices that could damage their financial targets.

Investors who want to handle political uncertainty effectively should combine diversification with proactive risk management and long-term investment principles. Investors who use these strategies will improve their resistance to political volatility while reaching their financial objectives.

VI. Conclusion

Stock market volatility remains significantly influenced by political uncertainty which arises from elections and policy changes and geopolitical tensions. The research demonstrates how short-term market reactions produce significant investor sentiment changes because of fear and speculation and risk aversion. The U.S. presidential elections together with international conflicts such as the Russia-Ukraine war have proven to be consistent triggers of market volatility which results in measurable effects on the S&P 500 and VIX indices. The market's long-term direction mainly depends on how quickly and clearly political matters are resolved and their resulting economic effects.

Looking ahead, financial markets will experience growing influence from global politics because economic disturbances in one region now spread across the world. The combination of technological progress and rising populism and changing alliances will introduce additional

political risk factors. Investors need to stay alert through data-based strategies and flexible portfolio management to handle uncertain market conditions.

The knowledge of political risk mechanisms enables investors to make better investment choices. Investors who use diversification and safe-haven hedging and maintain a long-term perspective can reduce volatility's negative impact and achieve stable returns in uncertain political environments.

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