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Review of the Impacts of Previous General Elections on Stock Market Performance: Insights for Investors

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Abstract*: This paper aims to examine how the announcement of election results affects the NSE (Nifty) and BSE (Sensex) indices. The analysis focuses on measuring the impact of daily average returns and volatility during different time periods before and after the election result announcement: thirty days, fifteen days, and seven days. The paper is based on secondary data as opinions and views of different authors who have conducted such kind of studies are referred for the purpose of writing this research paper and consolidated views are mugged up in the article form. The findings indicate that the impact of election results is predominantly observed in the short term, gradually diminishing over the medium and long term.*

The study concludes that there is no significant relationship between the announcement of election results and the performance of the stock market. It suggests that the stock market initially reacts unusually to this information, causing short-term anomalies that subsequently correct themselves in the following days.

This study aims to analyse the effect of election result announcements on the performance of India's major stock indexes, Sensex (BSE) and Nifty (NSE). By examining previous research and focusing specifically on the election result's impact on these indexes, this study aims to provide insights for investors to navigate the market with agility and caution during election periods, maximizing their investment outcomes..

Keywords: Anomaly, General Elections, Investment, Volatility, Sensex, Nifty

I. INTRODUCTION

India's general elections occur every five years, determining the country's leadership and significantly influencing various stakeholders, including investors, businesses, and financial institutions. The recurring nature of these elections introduces uncertainty, commonly referred to as political risk, which remains a primary concern for market participants, analysts, and policymakers. Political risk, observed globally, contributes to stock market inefficiency and volatility due to political and economic ambiguity.

Studies have highlighted the impact of general elections on market behaviour and index movement, emphasizing the role of investor sentiment and irrational reactions to specific information. Government decisions on economic policies, taxation, and business regulations further influence market performance, alongside factors like the availability of investment assets and changes in investor composition.

Emotions, such as optimism and pessimism, play a crucial role in shaping market dynamics, evident in past elections where market reactions were driven by expectations surrounding the formation of the government. The impact of election results on the stock market is observed worldwide, often leading to abnormal market behaviour upon announcement.

Looking forward to India's upcoming general election, it's evident that the stock market tends to exhibit positive trends following the conclusion of electoral processes. This has been observed consistently across various election cycles, irrespective of the political party or coalition emerging victorious. Sectors such as Banking, Consumer Durables, and Information Technology have consistently performed well post-election, contributing to the overall upward trajectory of benchmark indices like the Sensex and Nifty 50.

Prior to elections, market analysts and investors closely scrutinize the potential outcomes and their likely impact on market sentiment. Historical data reveals distinct market reactions to past election results. For instance, in 2004, when the BJP lost power, the market experienced a downturn, whereas in 2009, when the Congress retained power, the

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market saw an upward trend. Similarly, the anticipation of Narendra Modi's leadership in 2014 contributed to a pre-election rally in the market.

Leading up to the forthcoming general election, market sentiment initially appeared uncertain, particularly following the outcome of certain state assembly elections. However, subsequent victories for the BJP in these states significantly boosted investor confidence, leading to a notable surge in market indices, with the Nifty registering a substantial increase of nearly 10%.

Furthermore, Prime Minister Modi's affirmation of BJP's strong electoral prospects further bolstered market sentiment. Despite these positive indicators, there remains a cautious outlook regarding the potential market response post-election, especially considering the modest market performance following the BJP's significant electoral gains in 2019.

One plausible explanation for this subdued market reaction could be the phenomenon of 'priced-in' expectations, wherein market participants may have already factored in the anticipated election outcome, thereby limiting the scope for significant post-election market movements. Additionally, prevailing high valuations in the stock market, coupled with concerns about the sustainability of earnings growth, may dampen the extent of market euphoria typically associated with electoral victories.

Ultimately, while general elections undoubtedly serve as pivotal events influencing market sentiment, the broader economic landscape, including factors such as inflation trends, corporate earnings, and government policies, will continue to exert a more profound and enduring impact on post-election market dynamics. Thus, while elections are significant, investors are advised to adopt a balanced approach, considering both political developments and fundamental economic indicators when making investment decisions.

II. LITERATURE REVIEW

Researchers have previously explored how the stock market responds to the announcement of general election results, aiming to uncover anomalies and irregularities caused by this event. Within finance literature, two political effects have been extensively studied: the 'political business cycle' and the 'election effect'. The political business cycle examines stock market returns throughout a government's term, often referred to as the 'presidential cycle' in the US. Conversely, the 'election effect' scrutinizes stock returns surrounding the election date itself.

Aggarwal et al. (1999) examined events causing significant shifts in the volatility of emerging stock markets, finding that most events tended to be local, with the 1987 stock market crash being the only global event causing a significant jump in volatility across multiple emerging markets.

Balaji et al. (2018) focused on the impact of general elections on the Indian stock market, analyzing data from the BSE and NSE for the thirty days surrounding the previous five-year general elections. Their study, utilizing analytical tools like t-tests and f-tests, concluded that while there was no significant impact on the Nifty Index, the market exhibited short-term volatility rather than long-term effects.

Khalid et al. (2010) utilized the Markov Switching Process to study the impact of political events on financial market volatility in Pakistan from January 1999 to September 2006, concluding that different political events had varying degrees of impact on the economy.

Kabiru et al. (2015) studied the impact of general election results on share performances at the Nairobi Securities Exchange (NSE). Employing event study methodology, they analyzed data from the NSE for election years 1997, 2002, 2007, and 2013 in Kenya. Their findings indicated highly negative or positive market reactions to the elections, with significant cumulative abnormal returns observed in 1997 and 2007. They cautioned stakeholders not to overlook electioneering events and highlighted macroeconomic factors such as inflation and global financial crises as potential influences on the stock market.

SazaliAbidin et al. (2010) investigated the presence of a political cycle effect in stock returns, focusing on the performance of the National and Labour governments in New Zealand. Their findings revealed significantly higher stock returns associated with New Zealand's right-of-centre National party during their terms compared to their left-of-centre counterparts. They suggest that investors can make more informed investment decisions based on the governing political party.

Teddy Chandra (2015) investigated the impact of Indonesia's 2014 presidential election on the Indonesia stock exchange, observing abnormal returns for each event during the election period.

Objectives of the study:
To analyse the impact of the announcement of election results on the BSE and NSE Indexes (Sensex and Nifty).

III. FINDINGS

The stock market displays consistency in the medium and long term before the announcement of election results, with volatility emerging only after the results are made public. This volatility is transient, typically lasting for a short period (around 7 days) before and after the announcement, as indicated by daily average returns. Investors often align their strategies with the policies, ideologies, and political inclinations of contesting parties, resulting in bullish or bearish market trends. Analysis reveals a negative correlation in the short term for the years 1999, 2004, and 2009, implying a decline in market returns post-announcement. Conversely, positive correlations were observed in 2014 and 2019, indicating a favourable impact of the announcement on market returns. The findings of the various studies indicate that there is no notable correlation between the announcement of election results and the stock market's performance. It proposes that the stock market exhibits initial unusual reactions to this information, resulting in short-term anomalies that tend to normalize in the subsequent days.

IV. CONCLUSION

Elections and political events disrupt the natural equilibrium of the market, leading to anomalies and short-term abnormalities. In a liquid market, where security prices reflect all available information at any given time, stock prices react swiftly to election result information, causing temporary volatility. The study identifies the highest average return occurring post-announcement, stabilizing within a month. Notably, heightened variability is observed in the week following the election result announcement. Based on these observations, the study advises investors to exercise extra caution when making investment decisions during this period. Short-term investment strategies may offer benefits in the immediate aftermath of the election result announcement. Thus, investors are advised to remain vigilant during this period, leveraging short-term market strategies for potential benefits. Various events such as Budget announcements, elections, festivals, geopolitical tensions, corporate actions, etc., may induce slight anomalies in the market. Further research opportunities exist in exploring these events using machine learning and analytics, along with industry-specific and behavioural analyses, to deepen our understanding of stock market dynamics.

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