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Stocks vs Mutual Funds in An Election Year: Which is More Profitable?

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ABSTRACT
This study analyzes the reaction of stock markets and mutual funds to political events using a sample of 15 countries that held elections. In general, we document the returns before and after the elections and use t-test to determine the effect and f-test to measure the volatility of both. The results show that the short-term effect is significant for all mutual funds and only a few stocks are significant. In addition, with the same conditions, it does not necessarily have the same impact on the two instruments. However, we only found the short-term impact. While the explanation is not too clear, investors may want to observe the economic impact on stocks and mutual funds arising from longer time horizons.

Keywords:
Volatility, Political Event, Market Reaction

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INTRODUCTION

We recently observed the reaction of financial markets to political events. These events generate uncertainty that triggers concern among investors due to erratic market price movements(Kedia & Satpathy, 2023). Our observations found that politics triggers yield instability during such events (Changwatchai & Aumpon, 2024; Upadhyaya et al., 2024). However, whether investment instruments in financial markets have the same impact under the same conditions requires further research.

The emergence of price volatility due to political events is of particular concern among investors. The decision to withdraw and add funds from or into such investment instruments is often influenced by the perception of risk and potential expected returns. This will be considered by investors in determining the right strategy to minimize risk and take advantage of certain connectivity to become an opportunity amid unstable conditions (Hartwell & Zadorozhna, 2024). Not only that, but as a place where investors can choose a balanced and high-quality portfolio (Fan et al., 2024).

This concern raises the question of how the stock market and mutual funds react amid political uncertainty. An in-depth analysis is required to determine the impact of politics on both instruments. With a clear understanding of the differences in their volatility and resilience, investors can develop more effective investment strategies to overcome the political challenges and achieve their investment goals more optimally.

A look at the market reaction with political events will explain how investors react in case of external shocks. To measure this, we use the event futures methodology by dividing it into short-term, medium-term and long-term. After that, we use t-test to determine the I mpact after the event. We then use the f-test to compare the variance between pre- and post-election returns. We take a total of 15 countries that held elections to determine the difference in impact and volatility between stocks and mutual funds.

There is an interesting pattern to the cumulative abnormal returns. We observe volatility prior to the election, which indicates that investors have already felt the effects of the event. We find different impacts of political events on returns. Therefore, this study aims to look at the reaction of the stock market and mutual funds to political events. This study uses the daily stock return formula combined with a t-test to measure the prices of stocks and mutual funds in 15 countries that hold elections. The results of this study can provide insights into the volatility of stocks and mutual funds during political uncertainty, allowing them to develop more effective investment strategies and better manage risks.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Prospect Theory

Prospect Theory, developed by Daniel Kahneman and Amos Tversky, explains how investors make decisions under conditions of risk and uncertainty (Kumari et al., 2024; Srinivasan & Karthikeyan, 2023). The theory suggests that investors are not always rational and are often affected by cognitive biases. In the context of market volatility, Prospect Theory is used to investigate the asymmetry in volatility used for decision-making under risk (Skoglund, 2021). During periods of political or economic uncertainty, such as election years, investors may be more reactive to bad news than good news, causing greater price fluctuations and increased volatility.

Impact Political Election

Politics has an impact on financial market uncertainty. Kedia & Satpathy (2023) found that political uncertainty, such as elections, creates economic uncertainty that generates financial market volatility. Volatility tends to overreact in the pre-election period and post-election shows a reversal (Benson & Kong, 2021). The post-election reversal reaction is a significant decrease in implied volatility (Shaikh, 2019). Therefore, some investors believe that elections are Bearish (Shaikh, 2017), although some believe elections are Bullish. The emergence of these price dynamics is referred to as the direct impact of political events (Volodin et al., 2017). Baig et al. (2024) also revealed in their research that political uncertainty is a factor in the high degree of price clustering.

Based on previous research, it shows a different impact on the influence of political events. Studies conducted by Lehrer (2018) show that the impact of politics is very small on cumulative returns. Balaji et

al. (2018) also revealed that political events have no significant effect on daily stock returns. However, research conducted by Afnan et al. (2023) found that political connections have a significant effect on inflation volatility and government instability reduces its volatility. Therefore, further research is needed to better understand how the stock market and mutual funds react to political events.

Several studies have been conducted to determine the impact of politics on stock prices. However, it is still rare to conduct research on mutual funds. The purpose of this study focuses on the reaction of stocks and mutual funds in the political year by using daily returns, t test and F test. By asking the question, how do stocks and mutual funds react in the face of political uncertainty during pre and post elections. The hypothesis of this study is formulated as follows:

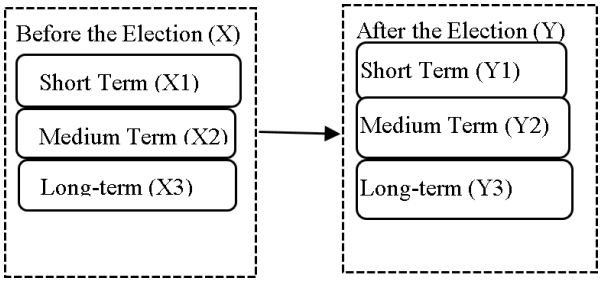
H01 : There is no significant impact of elections on stock and mutual fund returns.

H02 : All stocks and mutual funds have the same impact on pre- and post-election volatility whether significant or insignificant.

H1 : All or some stocks and mutual funds have a significant impact in either the short term or medium term or long term.

H2 : Stocks and mutual funds have different impacts on pre- and post-election volatility whether significant or insignificant.

Research Frame Work



RESEARCH METHODS

Our research uses the composite stock price index and mutual fund index obtained from Yahoo Finance. Our main objective is to examine the reaction of stock and mutual fund markets to political events. We found that 36 countries held elections in the 2019-2024 period. We limit the sample with the criteria of having their own stock market and mutual funds listed on Yahoo Finance with random sampling of each instrument. As a result, we found 15 countries that fit the criteria with one sample per instrument.

Table 1. List of Stock and Mutual Fund Samples

	Stock	Mutual Funds
BEL	BEL 20	Value Square Fd Equity Belgium C Cap
UK(GBR)	FTSE 250	PIMCO GIS UK Corporate Bd Instl GBP Inc
IND	NIFTY 50	Hdfc Balanced Advantage Fund Direct Plan Payout Inc Dist Cum Cap Wdrl Opt
USA	Dow Jones Industrial Average	Vanguard Total Stock Mkt Idx Inv
DEU	Dax Performance-Index	Acatis Value Event Fonds B
ZAF	JSE Limited	Sanlam Global Investment XV AZA ZAR
CAN	S&P/TSX Composite index	RBC Select Balanced Portfolio O
AUT	Austrian Traded Index in EUR	Raiffeisen-Nachhaltigkeit-Mix R T
FRA	CAC 40	Ostrum SRI Money I1
DNK	OMX Copenhagen 20	Nordea Invest Aktier Ansvarlig KL 1
FIN	OMX Helsinki	Alandsbanken Global Aktie S
INA	IDX Composite	Reksa Dana Indeks Premier ETF Index IDX30
PRT	PSI20	IMGA Ações Portugal A FIAA
TWN	TSEC WEIGHTED INDEX	Yuanta Taiwan High-yield Leading Co A
KOR	KOSPI Composite Index	NH-Amundi Korea No.1 S-M Cap Conv Eq 2 A

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After collecting the data, we examined the market reaction using daily returns to separate the pre and post election periods, the daily return method examines the events that occur and draws conclusions regarding the impact of these events. We separate it into 3 periods namely 14 days, 21 days and 28 days (pre and post election period). Furthermore, following Cheng et al. (2020) to calculate the stock time series data, by comparing the rate of return across various time periods. The daily rate of return is calculated as follows:

$$Rt= Pt/Pt-1$$

After that we looked for the relationship between variables through the t-test. The t test is used to test whether the two samples are different and is usually used when the variances are also different. Here is the formula for the t test as follows:

$$t = \frac{r\sqrt{n-2}}{1-r2}$$

From here we use t-values and significance levels to find the relationship between variables. The t test will find volatility with significant and insignificant results. Hence the F test is required to compare the variance between the pre and post election period returns. Below is the formula of the F test:

$$F = \frac{\sigma(X1)2}{\sigma(Y1)2}$$

In the test, X1, X2 and X3 are pre-election sample periods, while Y1, Y2 and Y3 are post-election time periods. Then we look for the effect by involving the long-term pre-election variable (X3) with the short-term (X1), medium-term (X2) and long-term post-election (X3).

RESULTS AND DISCUSSION

Our assumption is that political events have a significant influence that causes great concern for investors. Political events are unpredictable, so the results of this study can be a consideration for investors choosing between stocks and mutual funds to ensure the right investment.

Table 2. Daily Average Return in Stock

NO	CTR	PRA			PASCA		
		Last 28 Days	Last 21 Days	Last 14 Days	Next 14 Days	Next 21 Days	Next 28 Days
1	BEL	-0,162	0,459	-0,039	-0,019	-0,007	0,021
2	UK	-0,040	-0,196	-0,127	0,240	0,161	0,119
3	IND	0,002	-0,003	0,142	0,077	0,068	0,034
4	USA	-0,097	-0,199	-0,200	0,350	0,258	0,187
5	DEU	-0,096	-0,085	-0,273	0,198	0,100	0,031
6	ZAF	0,009	-0,020	-0,095	0,051	-0,075	-0,012
7	CAN	0,017	-0,023	-0,077	-0,022	0,040	0,092
8	AUT	-0,156	-0,162	0,038	0,030	0,193	0,263
9	FRA	0,098	-0,032	-0,004	0,027	-0,007	-0,109
10	DNK	0,150	0,184	0,161	0,180	0,126	0,147
11	FIN	-0,001	-0,013	-0,021	-0,202	-0,102	-0,056
12	INA	-0,011	-0,021	0,013	0,064	0,051	0,074
13	PRT	0,010	-0,021	-0,061	0,028	0,062	0,025
14	TWN	-0,097	-0,073	-0,021	0,118	0,089	0,089
15	KOR	0,019	0,053	-0,083	-0,047	-0,015	0,027

Source: Data processed with excel, 2024

Table 3. Daily Average Return in Funds

NO	CTR	PRA			PASCA		
		Last 28 Days	Last 21 Days	Last 14 Days	Next 14 Days	Next 21 Days	Next 28 Days
1	BEL	-0,062	-0,062	0,007	0,047	0,026	0,041
2	UK	0,010	0,011	-0,004	0,056	0,011	0,005
3	IND	-0,022	-0,001	0,124	0,056	0,053	0,046
4	USA	-0,059	-0,185	-0,155	0,333	0,249	0,214
5	DEU	-0,025	-0,043	-0,020	-0,016	0,019	0,018
6	ZAF	0,029	0,052	0,034	0,114	0,083	-0,033
7	CAN	0,017	0,013	-0,001	-0,099	-0,059	-0,015
8	AUT	-0,091	-0,078	-0,019	-0,078	0,024	0,009
9	FRA	-0,001	0,000	0,000	-0,001	-0,001	-0,001
10	DNK	0,083	0,109	0,166	0,067	0,046	0,028
11	FIN	0,160	0,191	0,152	0,018	-0,025	-0,003
12	INA	-0,018	0,043	0,131	0,016	0,034	0,028
13	PRT	0,016	-0,016	-0,073	0,044	0,077	0,044
14	TWN	-0,050	-0,037	-0,114	0,047	0,042	0,039
15	KOR	-0,016	0,034	-0,127	-0,227	-0,145	-0,030

Source: Data processed with excel, 2024

Tables 2 and 3 report daily returns by splitting them into three different time horizons. The pre- and post-election panels test for differences in returns across instruments. We find that the impact of elections on stock and mutual fund prices varies across countries and has different patterns in the short, medium and long term. These results only provide a visual comparison but do not provide information on the magnitude of the effect. Hence, a t-test is used to compare them. Here are the results of the t-test:

Tabel 4. Stock Return T Test

		SHORT TERM PERIOD			MEDIUM PERIODE			LONG TERM PERIODE		
		X3 & Y1	X2 & Y1	X1 & Y1	X3 & Y2	X2 & Y2	X1 & Y2	X3 & Y3	X2 & Y3	X1 & Y3
BEL	Actual	4,953	4,617	3,179	3,903	2,886	3,179	3,137	2,886	3,179
	Sig.	0,001	0,001	0,011	0,002	0,012	0,011	0,006	0,012	0,011
UK(GBR)	Actual	0,434	0,438	0,240	-9,721	-6,946	-6,312	-10,027	-8,848	-6,312
	Sig.	0,674	0,672	0,815	0,000	0,000	0,000	0,000	0,000	0,000
IND	Actual	-4,966	-5,784	-7,080	-7,130	-6,924	-6,255	-5,318	-6,508	-6,255
	Sig.	0,005	0,000	0,000	0,000	0,000	0,000	0,000	0,000	0,000
USA	Actual	-3,698	-2,628	-3,638	-5,336	-4,410	-3,638	-5,423	-4,410	-3,638
	Sig.	0,005	0,027	0,005	0,000	0,001	0,005	0,000	0,001	0,005
DEU	Actual	5,194	6,275	0,060	6,297	0,781	0,060	3,198	0,781	0,060
	Sig.	0,001	0,000	0,954	0,000	0,448	0,954	0,005	0,448	0,954
ZAF	Actual	-3,120	-5,301	-4,952	-1,667	-2,525	-4,952	-0,390	-2,525	-4,952
	Sig.	0,012	0,000	0,001	0,118	0,024	0,001	0,701	0,024	0,001
CAN	Actual	4,739	8,352	8,040	6,324	8,114	8,040	3,115	8,114	8,040
	Sig.	0,001	0,000	0,000	0,000	0,000	0,000	0,006	0,000	0,000

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Table 4. (continued)

		SHORT TERM PERIOD			MEDIUM PERIODE			LONG TERM PERIODE		
		X3 & Y1	X2 & Y1	X1 & Y1	X3 & Y2	X2 & Y2	X1 & Y2	X3 & Y3	X2 & Y3	X1 & Y3
AUT	Actual	4,210	0,290	-1,977	1,131	-0,613	-1,977	-0,341	-0,962	-1,977
	Sig.	0,002	0,779	0,079	0,278	0,550	0,079	0,737	0,352	0,079
FRA	Actual	-1,096	1,901	1,944	1,134	3,068	2,322	2,831	3,314	2,322
	Sig.	0,309	0,099	0,093	0,279	0,010	0,045	0,012	0,005	0,045
DNK	Actual	-17,061	-20,729	-11,973	-16,681	-11,085	-11,973	-19,196	-11,085	-11,973
	Sig.	0,000	0,000	0,000	0,000	0,000	0,000	0,000	0,000	0,000
FIN	Actual	3,059	5,320	0,458	4,219	7,212	0,458	4,099	7,327	0,458
	Sig.	0,012	0,000	0,658	0,001	0,000	0,658	0,001	0,000	0,658
INA	Actual	-11,831	-7,911	-5,275	-9,963	-5,935	-5,275	-12,057	-5,935	-5,275
	Sig.	0,000	0,000	0,001	0,000	0,000	0,001	0,000	0,000	0,001
PRT	Actual	3,032	2,942	2,563	0,980	1,511	2,563	-0,402	0,847	2,563
	Sig.	0,013	0,015	0,031	0,345	0,155	0,031	0,693	0,411	0,031
TWN	Actual	1,285	0,434	-0,380	-0,951	-0,782	-0,380	-1,322	-0,782	-0,380
	Sig.	0,231	0,674	0,712	0,358	0,448	0,712	0,206	0,448	0,712
KOR	Actual	4,059	6,099	6,419	5,690	6,364	6,419	5,821	6,134	6,419
	Sig.	0,003	0,000	0,000	0,000	0,000	0,000	0,000	0,000	0,000

Source: Data processed with SPSS version 25, 2024

Table 5. Mutual Fund Return T-Test

		SHORT TERM PERIOD			MEDIUM PERIODE			LONG TERM PERIODE		
		X3 & Y1	X2 & Y1	X1 & Y1	X3 & Y2	X2 & Y2	X1 & Y2	X3 & Y3	X2 & Y3	X1 & Y3
BEL	Actual	3,325	3,248	1,885	2,509	1,463	0,909	0,629	0,156	0,909
	Sig.	0,013	0,014	0,101	0,029	0,171	0,387	0,538	0,879	0,387
UK(GBR)	Actual	-8,101	-4,082	-3,692	-1,748	-1,713	-1,660	-2,011	-2,110	-1,660
	Sig.	0,000	0,005	0,008	0,111	0,117	0,131	0,063	0,053	0,131
IND	Actual	-1,813	-4,176	-8,402	-3,849	-5,976	-7,801	-3,331	-5,853	-7,801
	Sig.	0,107	0,003	0,000	0,002	0,000	0,000	0,004	0,000	0,000
USA	Actual	-5,380	-3,587	-4,555	-5,380	-5,037	-4,555	-6,133	-5,037	-4,555
	Sig.	0,000	0,006	0,001	0,000	0,000	0,001	0,000	0,000	0,001
DEU	Actual	8,156	5,368	4,060	5,335	3,311	4,060	2,273	3,311	4,060
	Sig.	0, 000	0,000	0,003	0,000	0,005	0,003	0,035	0,005	0,003
ZAF	Actual	1,378	1,487	2,419	3,207	3,429	2,419	4,475	3,429	2,419
	Sig.	0,202	0,171	0,039	0,006	0,004	0,039	0,000	0,004	0,039
CAN	Actual	2,927	4,895	5,564	4,689	7,124	5,564	6,604	7,124	5,564
	Sig.	0,017	0,001	0,001	0,000	0,000	0,001	0,000	0,000	0,001
AUT	Actual	7,722	4,803	6,027	4,468	4,253	6,027	3,005	4,253	6,027
	Sig.	0,000	0,001	0,000	0,001	0,001	0,000	0,008	0,001	0,000
FRA	Actual	22,361	10,328	9,045	18,921	10,987	10,606	17,737	12,608	10,606
	Sig.	0,000	0,000	0,000	0,000	0,000	0,000	0,000	0,000	0,000
DNK	Actual	-3,639	-8,231	-5,823	-5,133	-8,337	-5,823	-6,661	-8,313	-5,823
	Sig.	0,005	0,000	0,000	0,000	0,000	0,000	0,000	0,000	0,000
FIN	Actual	-21,557	-14,392	-9,921	-20,297	-15,691	-9,921	-14,210	-15,691	-9,921

Table 5. (continued)

		SHORT TERM PERIOD			MEDIUM PERIODE			LONG TERM PERIODE		
		X3 & Y1	X2 & Y1	X1 & Y1	X3 & Y2	X2 & Y2	X1 & Y2	X3 & Y3	X2 & Y3	X1 & Y3
	Sig.	0,000	0,000	0,000	0,000	0,000	0,000	0,000	0,000	0,000
INA	Actual	-13,198	-5,627	-8,165	-6,798	-4,997	-8,165	-8,015	-4,997	-8,165
	Sig.	0,000	0,000	0,000	0,000	0,000	0,000	0,000	0,000	0,000
PRT	Actual	2,338	3,031	2,523	0,915	1,150	2,523	-0,200	1,150	2,523
	Sig.	0,048	0,016	0,040	0,380	0,274	0,040	0,844	0,274	0,040
TWN	Actual	5,702	1,368	0,127	1,969	0,554	0,127	1,507	0,554	0,127
	Sig.	0,000	0,205	0,901	0,069	0,589	0,901	0,153	0,589	0,901
KOR	Actual	10,387	11,633	17,120	14,424	12,421	17,120	11,640	12,421	17,120
	Sig.	0,000	0,000	0,000	0,000	0,000	0,000	0,000	0,000	0,000

Source: Data processed with SPSS version 25, 2024

The t-test is conducted to evaluate whether there is a statistically significant difference between the returns of the pre- and post-election periods. The results from table 1 and table 2 show that the t-test results have varying relationships. We find that all mutual funds experience volatility in the short term with variables X3 and Y1, but for stocks, some have no effect in that time frame. This finding accepts H1 that there is a significant impact in the short run for all funds and most stocks.

Table 6. F Test Comparing Pre- And Post-Election Stock Variances And Returns

	X3 & Y1		X3 & Y2		X3 & Y1	
	F-Test	Sig.	F-Test	Sig.	F-Test	Sig.
BEL	0,405	0.542	0,806	0.386	3,208	0.091
UK	3,374	0.104	1,542	0.243	0,133	0.721
IND	0,335	0.581	0,016	0.901	3,254	0.090
USA	5,144	0.053	0,326	0.578	1,674	0.213
DEU	2,967	0.123	4,114	0.064	14,925	0.001
ZAF	0,319	0.588	8,110	0.014	16,791	0.001
CAN	3,825	0.086	3,835	0.074	4,178	0.057
AUT	4,665	0.063	35,049	0.000	13,529	0.002
FRA	2,048	0.202	0,077	0.787	0,000	0.998
DNK	0,073	0.794	0,686	0.423	5,437	0.032
FIN	1,972	0.194	0,838	0.377	0,067	0.799
INA	7,692	0.024	1,353	0.267	8,361	0.011
PRT	4,674	0.059	1,306	0.275	0,768	0.394
TWN	10,492	0.012	1,352	0.266	0,717	0.411
KOR	0,008	0.931	0,316	0.584	0,781	0.391

Source: Data processed with SPSS version 25, 2024

Table 7. F Test Comparing The Variance And Return Of Pre- And Post-Election Mutual Funds

	X3 & Y1		X3 & Y2		X3 & Y1	
	F-Test	Sig.	F-Test	Sig.	F-Test	Sig.
BEL	23,324	0.003	33,329	0.000	29,683	0.000
UK	0,000	1.000	15,150	0.004	9,097	0.009
IND	1,757	0.227	9,827	0.009	0,263	0.615
USA	2,818	0.132	0,378	0.549	4,903	0.041
DEU	7,996	0.022	18,254	0.001	40,997	0.000

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Table 7. (continued)

	X3 & Y1		X3 & Y2		X3 & Y1	
	F-Test	Sig.	F-Test	Sig.	F-Test	Sig.
ZAF	0,319	0.588	8,110	0.014	16,79062	0.001
CAN	48,984	0.000	60,186	0.000	45,403	0.000
AUT	0,016	0.902	4,738	0.050	11,866	0.003
FRA	136,125	0.000	171,372	0.000	54,785	0.000
DNK	4,403	0.069	4,187	0.063	0,180	0.677
FIN	12,399	0.008	16,396	0.001	9,902	0.006
INA	10,046	0.013	0,162	0.694	0,183	0.675
PRT	0,118	0.739	0,118	0.739	0,222	0.645
TWN	11,353	0.010	0,939	.0350	0,483	0.498
KOR	0,101	0.759	0,886	0.365	0,016	0.902

Source: Data processed with SPSS version 25, 2024

Table 6 and Table 7 show the specific F-test values that have compared the variance of returns in the short-term, medium-term and long-term pre- and post-election periods. Here we find results that vary across countries, some significant and some insignificant. These results accept the H2 that stocks and mutual funds have a different impact on pre- and post-election volatility.

This study found that based on political events in 15 countries, each country has a different impact on election events. In addition, the market reaction of stocks and mutual funds does not always have the same impact. There are times when stocks provide high returns while mutual funds experience a decline, and vice versa.

We find in the t-test that mutual funds in 15 countries are significantly affected by political events in the short term as indicated by the X3 and Y1 variables. As for stocks, they are mostly influenced by the time horizon. This means that the 28-day pre-election daily return is very influential on the 14-day short-term daily return. However, when viewed from the overall test, political events provide high and low levels of returns. In line with research from Afnan et al. (2023) political instability has both positive and negative impacts. This sends a signal for investors to be careful in choosing investments ahead of political events, especially since politics affects the short term of investment instruments. In addition, investors do not assume that the same conditions will yield similar returns. A deeper understanding of volatility and market dynamics during political periods can help investors make more informed and strategic decisions.

CONCLUSION

The results show that there is a significant short-term impact across all funds and most stocks and elections have different impacts on volatility. Therefore, investors need to be cautious in choosing investments ahead of political events and not assume that the same conditions will result in similar returns. Investors are advised to conduct an in-depth analysis of volatility and market dynamics before making investment decisions, especially ahead of political events. More adaptive and informed investment strategies are needed to minimize risk and optimize returns in volatile market conditions. Further research can explore specific factors that affect volatility across different countries and investment types, as well as conduct longitudinal studies to observe the long-term impact of political events on investment performance.

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