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Stock Returns Under Political and Macroeconomic Instabilities: An Empirical Analysis from United Kingdom

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Abstract
The main purpose of our paper is to empirically explore the effect of political and macroeconomic risk on stock returns. We constructed a multivariate model to explore behavior of stock returns under political risk and macroeconomic uncertainty. The annual panel data of our study consists of 23 manufacturing firms listed at London Stock Exchange for period covering 2005 to 2016. We utilized robust two-step system GMM to estimate the empirical model of the study. The findings showed significance of uncertainties for predicting the stock returns in the UK. Specifically, it showed statistical but differential significant impact of political risk and macroeconomic uncertainty on stock returns of the firms that are listed at FTSE-100 index. However, macroeconomic uncertainty showed higher statistical impact on the stock returns as compared to political risk. Our study provides guidance to policymakers and investors. It provides guidance for investors to know about the timings of entry and exit into stock markets and helps managers and policy makers in risk management.
Keywords: Stock returns, Political risk, Macroeconomic uncertainty, and Two-step System GMM.
JEL Codes: D22, G11.

1. INTRODUCTION

The behavior and nature of stock markets have allured a lot of curiosity in policy and academic circles. Particularly, the effect of macroeconomic uncertainty and political risk.[1] It is debated that if value of firms depend on the health of economy then macroeconomic uncertainty would affect volatility of stock and market returns [see, Liljeblom and Stenius (1997)]. The studies that showed effects of macroeconomic uncertainty on volatility of market and stock returns include Fama (1981), Chen, Roll, and Ross (1986), Fama and French (1989), and Fama (1990), and many others.[2] There exists a handful acknowledged empirical literature on the effect of political uncertainty, particularly, on investment and growth, for example, Chase, Kuhle, and Walther (1988), Ozler and Rodrik (1992), Darby, Li, and Muscatelli (2000), Feng (2001), Campos and Nugent (2003), Jensen (2008), Del Bo (2009), Beazer (2015), Bekaert, Harvey, Lundblad, and Siegel (2016), Ana, Chen, Luo, and Zha (2016), Luo, Chenb, and Wu (2017), and many others; but very few on the effect of political uncertainty on stock market returns. It has an immense importance for us to know about risks and the precautions we can take to avoid those risks. For sure, we cannot avoid all risks but few of them. However, we take risks because the benefits from taking them is more than the costs. Moreover, the prediction of loss is balanced against the rewards since risks and returns are in future. It has become a worldwide phenomenon that the political uncertainty affects the financial markets adversely. Therefore, it is of great importance to investigate the effect of macroeconomic uncertainty and political risk on stock markets. The studies, among many others, that show the adverse effect of political uncertainty on financial markets include Addoum and Kumar (2016), Smales (2015), Smales (2014), Hartwell (2014), Goodell and Vahamaa (2013), Campos and Karanasos (2012), Mei and Guo (2004), Diamonte, Liew, and Stevens (1996), and Erb, Harvey, and Viskanta (1996). Chan and John (1996) states that the economic growth of a country is decreased by political instability, which, in turn, adversely effects the financial markets. The negative association between political risk and returns implies that decrease in political instability results in the increase of stock returns [see, Lehkonen and Heimonen (2015) and Diamonte, Liew, and Stevens (1996)]. Aggarwal, Inclan, and Leal (1999) showed that stock prices decreases with crises whereas returns volatility increases in developing markets. Shin (2005) showed the significant impact of Asian/Russian crisis on stock volatility behavior. Contrary to this, Fang (2001) showed that volatility of stock return in Taiwan increased during Asian crisis. The positive effects of political uncertainty on returns were shown by Perotti and van Oijen (2001). They stated that the positive association exists for politically safer countries. Raza and Malik (2013) states that volatility of stock market returns are highly affected by bad news as compared to good news in Pakistan but these effects are in short-run [Nazar, Younus, and Kaleem (2014)]. Mobarak (2005) showed the adverse effect of democracy on stock volatility. However, while there are plentiful literature on effect of political risk on returns, no published studies appear to reveal the magnitude and direction of the association of political

instability with stock returns.

However, among many other studies, few studies that showed the negative association of market and stock returns volatility with macroeconomic uncertainty which includes Jaffe and Mandelker (1976), Bodie (1976), Nelson (1976), Fama and Schwert (1977), Feldstein (1980), Fama (1981), Gertler and Grinols (1982), Solnik (1983), Harvey (1991), Smith and Sims (1993), Flannery and Protopapadakis (2002), Wongbangpo and Sharma, (2002), and many others. Adjasi (2009) states the implication of macroeconomic uncertainty on volatility of stock and market returns is vital to market analysts and traders for risk management.

Therefore, the primary purpose of our study is to explore the effect of political and macroeconomic risk on the stock returns of firms listed at FTSE-100 Index. The research questions of our study are simple, but important. Firstly, what is the effect of macroeconomic uncertainty on stock returns of firms listed at FTSE-100 Index in UK? Secondly, what is the influence of political risks on stock returns in UK?

For this purpose, we construct a multivariate model to explore the effects of political risk and macroeconomic risk on stock returns, In order to do so, our study sample consists of 23 manufacturing firms listed at FTSE-100 index of the London Stock Exchange for period covering 2005 to 2016. In doing so, we follow political risk literature, which states that all firms are not equally vulnerable to political risk as the risk is firm-specific, see, Korban (1982).

Also, we find many empirical studies that has taken different measures of political risk, there has not been a study to our knowledge, particularly, that utilized the measures of political risk that we have used in our study, which is explained in later section of this study. Moreover, effect of political uncertainty on financial markets is a proper appreciation that continues to be overriding interest of managers, investors, and academics. It provides guidance to policymakers and investors alike. First, it enhances the skills of investors in picking stocks by providing them with the knowledge of the impact of political risk on stock returns. It also shows if the returns of firms that have politicians as investors are higher? Second, the knowledge of the association of political risk and macroeconomic uncertainty helps the investors to know the appropriate timing of entry and exit into/from stock market. Third, the knowledge of the impact of macroeconomic uncertainty helps investors and managers in risk management. However, it helps the policymakers to develop economy and stock market by managing the macroeconomic factors efficiently. Lastly, it helps in portfolio allocation decision. Thus, our study makes it possible to assess how political instability and macroeconomic uncertainty influences stock returns, particularly, in the UK context. It abridges the literature gap by extending the literature on effect of various political measures and macroeconomic risk on stock returns.

Subsequent to introduction, the study is organized as follows. Section 2 presents review of empirical literature on the study subject. Section 3 presents econometric methodology. Section 4 outlines the study sample, data and variables measurement. Section 5 presents the empirical findings. Lastly, Section 6 provides discussion and conclusion on empirical findings along with practical implications and future research suggestions.

2. REVIEW OF EMPIRICAL LITERATURE

There are plentiful empirical literatures that investigated the relationship between stock returns and volatility, but there are few studies that examined the effect macroeconomic uncertainty and political uncertainty on both volatility of stock returns and market returns. However, among many others, the studies that showed the sensitivity of stock prices and market returns to political news include Hamaom Masulis, and Ng (1990), Arshanapalli and Doukas (1993), Flannery and Protopapadakis (2002), Nikkinen and Sahlström,[(2001, 2004)], Kimet al., (2004), and Hon, Strauss, and Yong (2004).[3] And empirical studies that revealed different impacts of macroeconomic uncertainty include Gultekin (1983), Solnik (1983), Ely and Robinson (1994), Groenewold, Rouke, and Thomas (1997), Caporale and Jung (1997), Barnes, Boyd and Smith (1999), and Boyd, Levine, and Smith (2001).

Feldstein (1980) examined the impact of macroeconomic uncertainty on market returns. He states that market returns are adversely affected by inflation uncertainty. It implies that earnings after tax reduces due to the additional tax liability for increased inflation, which, in return, reduces market returns. There is positive association between money supply and inflation, thus increase in money supply reduces stock returns (Dhakal, Kandil, and Sharma; 1993).Geske and Roll (1983) showed the positive impact of industrial output on stock returns, increase in production cost decreases cash flows and this adversely affects market returns (Anderson and Subbaraman, 1996). Thorbecke (1997) showed that there is inverse relationship between stock returns and interest rates. He states that decrease in interest rates results in to availability of cash in economy. This liquidity results in increase the demand for stocks which automatically increases the share prices, thus increasing the stock returns. Also, see, Patellis (1997) and Small and de Jager (2001).

Chan and Wei (1996) revealed that stock volatility in Hong Kong increased due to Sino-British political news. McDonald and Kendall (1994) showed abnormal returns in defense industry during politico-paramilitary and politico-military era. Aggarwal *et al.* (1999) attempted to determine the factors that apparently cause changes in volatility of financial markets in emerging economies. The sample of the study comprised of ten

emerging markets and six developed economies for period during 1985 to 1999. The findings of the study showed that sudden change in volatility of emerging financial markets is as result of political, social and economic instability.

Morelli (2002) examined the relationship between macroeconomic uncertainty and stock market volatility. The study sample consists of monthly time series data on United Kingdom for period covering 1967 to 1995. The author has utilized ARCH/GARCH models to estimate conditional volatility. The results of the study showed insignificant effect to macroeconomic volatility on volatility of stock market in UK and is consistent with Fraser and Power (1997) in UK and USA. While, Edem, Arsalan, and Edem (2005) showed that inflation and interest rates have impact on volatility of stock returns whereas output does not show impact on stock returns volatility.

Arzu (2011) examined the influence of political risk on daily stock returns and trading volume during the period 2009 to 2011. The study findings showed that killing of Governor Salman Taseer, attack on Sri Lanka cricket team, and murder of minorities' minister Shahbaz Bhatti, and Ashura attack resulted to negative association between stock return and trading volume, whereas, Restoration of Chief Justice and temporarily suspension of NATO supply resulted to positive association. She concluded negative impact of political events, terror attacks and instable economic conditions on stock and market returns. Similarly, Suleman (2012) states that political news adversely affects stock returns and volatility at KSE-100 index [also, see Bilal, Talib, Haq, Khan, and Islam (2012)]. The studies, that show market returns and trading volume depends on how positive or negative the event is, include Malik, Hussain & Ahmed (2009), Khan, Javed, Ahmad, Faisal, Mahreen and Shahzad (2009), Marwe and Smit (1997), and many others. The studies that showed that political instability results in negative association of political news with stock returns and market volatility include Mei and Guo (2002), Lin and Wang (2005), and Kongprajya (2010), whereas, the studies that showed that political stability results in positive association of political news with stock and market returns include Clark, Masood and Tunaru (2008), Kongprajya (2010), Torkzade and Moghadam (2012), and Ali and Afzal (2012).

Boutchkova, Doshi, Durnev, and Molchanov (2012) showed that political uncertainty effects the industry volatility. Paster and Veronesi (2013) examined the effect of political uncertainty on the movement of stock prices. They showed that the political uncertainty not only increases return volatilities and correlations but also equity risk premium. Nazir *et al.* (2014) scrutinized the effect of political risk on the stock index returns of KSE-100. They showed statistical and significant impact of political uncertainty on KSE-100 Index returns. Lehkonen and Heimonen (2015) examined the influence of political risk and democracy on performance of stock markets. The findings of the study showed significant impact of democracy and political risk on financial markets. Furthermore, they showed that negative relationship of political risk and market returns. Murtaza, Abrar, and Ali (2015) states that the overall market performance in Pakistan is affected by political risk that discourages the investors. Gulen and Lon (2016) utilizing the policy index of Baker, Bloom, and Davis (2016), showed that investments decline in the presence of policy uncertainty due to irreversibility of investment. Similarly, Kelly, Pastor, and Veronesi (2016) showed that political uncertainty has significant impact on equity option markets.

In spite of immense macro-factors and political effects on financial markets, there has been few empirical studies, particularly, on the effects of both macroeconomic risk and political risk on stock returns. In this paper, we focus on the relationship of political and macroeconomic factors with stock returns, focusing the United Kingdom. Particularly, from 2005 to 2016 for 23 firms that are listed at FTSE-100 Index. We predict that both macroeconomic and political uncertainties have significant impact on stock returns. But the effects of macroeconomic uncertainty is pronounced higher than the political uncertainty.

3. ECONOMETRIC MODEL AND ESTIMATION METHOD

3.1 Econometric model

In this section we put forward the econometric methodology implied to examine the effect of political risk and macroeconomic uncertainty on stock returns. We use the following econometric model to estimate empirical results for exploring the effects of political risk and macroeconomic uncertainty on stock returns:

$$SR_{it} = \beta_0 + \beta_1(GS_t) + \beta_2(SC_t) + \beta_3(IP_t) + \beta_4(IC_t) + \beta_5(EX_t) + \beta_6(CC_t) + \beta_7(MP_t) + \beta_8(LO_t) + \beta_9 \emptyset_t^{ipi} + \beta_{10}\emptyset_t^{ex} + \varepsilon_{it} \quad (3.1)$$

where, SR is stock returns. However, β_0 is intercept and β_1 to β_{10} are coefficients of explanatory variables. $\emptyset_t^{ipi}$ represents macroeconomic uncertainty related to industrial production index. $\emptyset_t^{ex}$ represents macroeconomic uncertainty related to exchange rate. ε is the disturbance term. Furthermore, GS, SC, IP, IC, EX, CC, MP, LO, are Government Stability, Socioeconomic Conditions, Investment Profile, Internal Conflict, External Conflict, Control on Corruption, Military in Politics, Law and Order, respectively.

3.2 Estimation method

We have used Two-step System GMM (Generalized Method of Moments) estimation technique put forward by

Blundell and Bond (1988) to estimate the econometric model of our study. It controls for endogeneity and heterogeneity problems. It also mitigates the biasness of the restricted data. The popularity of the estimator was pioneered by empirical studies such as Caselli, Esquivel, and Lefort (1996), Banerjee and Duflo (2003), Dalgaard, Hansen and Tarp (2004), Aghion, Bacchetta, Ranciere and Rogoff (2009), and many others.

3.3 Development of hypothesis

In order to investigate the impact of political risk and macroeconomic uncertainty on stock returns, we develop the following hypotheses:

- H_1: There is significant impact of macroeconomic uncertainty on stock returns.
- H_2: There is significant impact of political uncertainty on stock returns.

4. DATA AND SAMPLE

4.1 Data, sample and measurement

Our study model consists of a multivariate model as shown on Equation (3.1). The explanatory variables of our study consist of political uncertainty and macroeconomic uncertainty. However, the former is measured by political risk components that are maintained by Political Risk Services Group (PRS) and this index is used widely, for instance, Diamonte *et al.* (1996), Erb *et al*. (1996a), Bilson, Brailsford, and Hooper (2002), Bekaert, Harvey, and Lundblad (2011a, 2011b) and Asiedu and Lien (2011) and many others. However, the latter is measured by the conditional variances of Exchange Rate and Industrial Production Index estimated by ARCH/GARCH method. ARCH model was developed by Engle (1982) and generalized by Bollerslev (1986). We utilized monthly data sample period for estimating conditional variances from ARCH/GARCH models. After estimation, we annualized the data to make it similar to other variables' frequencies. Our study consists of 23 firms' stock returns that are listed at FTSE-100 during period 2005 to 2016. However, Table 4.1 represents the measurement and construction of the study variables.

4.2 Descriptive statistics

Table 4.2 presents the distinctive characteristics of the variables used in our study. It presents mean, standard deviation, minimum and maximum values of the variables. It can been seen from Table 4.2 that considerable variations exist in data which makes it adequate for analysis. We can see that Investment Profile depicts the highest mean value whereas the lowest mean value is shown by Industrial Production Index Uncertainty. Similarly, the highest value of standard deviation is exhibited by stock returns. It implies that 152.78% of the data is spread around the mean value. However, the lowest values of standard deviation is shown by exchange rate uncertainty which implies that 0.01% of the data is spread around the mean value. Additionally, we see that stock returns has minimum value of -0.92 and maximum value of 24.71.

4.3 Correlation analysis

Table 4.3 presents the linear dependency among variables.[4] It shows correlation coefficients along with their p-values. The most relevant measure of correlation is the Pearson's correlation coefficient, see [Babbie (2007), Silva and Carreira (2010), and many others]. Correlation coefficient ranges between +1 and -1, see Nasimi and Nasimi (2018) for more details about the correlation coefficients. Moreover, we see that multicollinearity does not exist in our study variables.

5. EMPIRICAL FINDINGS AND ROBUSTNESS CHECK

5.1 Empirical results

Table 5.1 presents the empirical results of our study. It presents diagnostic test and empirical results that were investigated while studying the impact of political risk and macroeconomic risk on stock returns of firms that are listed at FTSE-100 index during period 2005 to 2016.

On observing the diagnostic test, we see that it exhibits F-statistics, J-statistics along with number of groups, observations and instruments. F-statistics shows a value of 100.430 with the p-value of 0.000. It shows the fitness of the model for study. However, AR (2) shows a value of 0.990 with the p-value of 0.320. It implies that there is no serial correlation in our study variables, see Nasimi and Nasimi (2018) for AR (2) hypothesis. Furthermore, it shows J-statistic value of 20.440 with the p-value of 0.555 which implies the statistical independence of instruments from residuals. It shows the orthogonal condition of instruments, for more details see Hansen (1982).

From results, we see that government stability has a negative coefficient of 1.331 with the p-value of 0.000. The negative sign indicates the existence of negative relationship between stock returns and government stability. Additionally, it shows that a standard deviation increase in government stability results in 1.331 standard deviation decrease in stock returns, on average. This indicates that higher government stability in the economy provides an evidence on the existence of lower levels of systematic risk in stock markets. Hence, the stocks in

more unstable economy yield higher returns. Socioeconomic condition shows a positive coefficient of 1.220 with the p-value of 0.000. It implies a standard deviation increase in socioeconomic conditions will increase the stock returns by 1.220 standard deviation, on average. Socioeconomic condition refers to a situation in society that limits the actions of government and stimulates the dissatisfaction and this represents the weak form of market. In the presence of weak form of market, returns above the market averages can be achieved based on the past information reflected into security prices [see, Nasimi and Nasimi (2018) for efficient market hypothesis]. The negative coefficient of investment profiles shows the adverse relationship of investment profile and stock returns. It shows that a standard deviation increase in investment profile will decrease the stock returns by 0.504 standard deviation, on average.

However, internal and external conflicts have shown positive coefficients of 1.953 and 0.921, respectively. This shows that improvements in internal and external conflicts have positive affect on stock returns. It indicates that improvements attract foreign investors which in turn increases the stock returns. Moreover, we see that the coefficient of internal conflict is higher than the coefficient of external conflict. It reveals the immense importance of internal conflicts in financial markets as compared to external conflicts. Corruption shows a negative coefficient of 2.547 with the p-value of 0.000. It implies that a standard deviation increase in corruption will decrease the stock returns by 2.547 standard deviation, on average. Similarly, military in politics, and law and order have shown negative coefficients of 1.787 and 0.149, respectively. It indicates that a standard deviation increase in military in politics will decrease the stock returns by 1.787 standard deviation. Similarly, a standard deviation increase in law and order will decrease the stock returns on average by 0.149 standard deviation. Higher military in politics and strict law and order creates strong form of efficient market hypothesis. Hence, investors cannot achieve advantage above market averages and this in turn affects the stock returns adversely. Industrial production uncertainty has shown a negative coefficient of 2.524 with the p-value of 0.000. It implies that a standard deviation increase in industrial production index uncertainty will decrease the stock returns by 2.524 standard deviation. Lastly, we observe that exchange rate uncertainty has a positive coefficients of 6.538 with the p-value of 0.000. It indicates that a standard deviation increase in exchange rate uncertainty will increase the stock returns by 6.538 standard deviation.

We observed that macroeconomic uncertainty related to industrial production and exchange rate have high statistical coefficients but different signs. It shows that macroeconomic uncertainty has higher impact on firms' stock returns as compared to political risk. We found that our study findings are in consistent with empirical studies such as Boyd, Levine, and Smith (2001), Adjasi (2009), Rjoub, Tursoy, and Gunsel (2009), Ali and Afzal (2012), Addoum and Kumar (2016), MengYun, Imran, Zakaria, Lingrong, Farooq, and Muhammad (2018), and many others.

5.2 Robustness check

Table 5.2 shows the robustness check of our study results to confirm if our results are affected on how we estimate the model. We performed the robustness check and found that the results remain unchanged.

6. CONCLUSION, POLICY IMPLICATIONS AND LIMITATIONS

6.1 Conclusion and discussion

The major purpose of our study is to examine the impact of political risk and macroeconomic uncertainty on stock returns. We obtained the panel data for our study from 23 non-financial firms listed at FTSE-100 Index of the London Stock Exchange during period 2005 to 2016. The empirical model of our study comprised of various factors that enunciates the political and macroeconomic uncertainties prevailing in the economy. We employed robust two-step system GMM estimation technique.

The findings of the study showed significant relationship of political risk and macroeconomic uncertainty with stock returns. However, we see that government stability has a negative relationship with stock returns. This indicates that higher government stability in the economy provides an evidence on the existence of lower levels of systematic risk in stock markets. Hence, the stocks in more unstable economy yield higher returns. Socioeconomic condition has positive association with stock returns. Socioeconomic condition refers to a situation in society that limits the actions of government and stimulates the dissatisfaction and this represents the weak form of market. In the presence of weak form of market, returns above the market averages can be achieved based on past information reflected into security prices [see, Nasimi and Nasimi (2018) for efficient market hypothesis]. The negative coefficient of investment profiles shows the adverse relationship of investment profile and stock returns. However, internal and external conflicts have shown positive association with stock returns. This shows that improvements in internal and external conflicts have positive affect on stock returns. It indicates that improvements attract foreign investors which in turn increases the stock returns. Moreover, we see that the coefficient of internal conflict is higher than the coefficient of external conflict. It reveals the immense importance of internal conflicts in financial markets as compared to external conflicts. Corruption shows a negative coefficient that enlightens the negative association with stock returns. It discourages the investors from

investing in stock markets which ultimately declines the returns. Similarly, military in politics, and law and order have shown negative relationship with returns. Higher military in politics and strict law and order creates strong form of efficient market hypothesis. Hence, investors cannot achieve advantage over market averages and this in turn affects the stock returns adversely. Furthermore, with crucial political shifts usually looming over the economic outlook, political events play a key role in articulating the future framework of a country's monetary and fiscal policies, thereby affecting financial markets. Also, we analyzed that uncertainty related to industrial production index and exchange rates have negative and positive impact, respectively. In summary, the results showed significant impact of political risk and macroeconomic uncertainty on stock returns of UK firms listed at FTSE-100 index. However, the impact of macroeconomic uncertainty on stock returns in UK is pronounced more as compared to political risk measures.

6.2 Policy implications and further recommendations

Our study provides guidance to policymakers and investors alike. First, it enhances the skills of investors in picking stocks by providing them with the knowledge of the impact of political risk on stock returns. It also shows if the returns of firms that have politicians as investors are higher? Second, the knowledge of the association of political risk and macroeconomic uncertainty helps the investors to know the appropriate timing of entry and exit into/from stock market. Third, the knowledge of the impact of macroeconomic uncertainty helps investors and managers in risk management. However, it helps the policymakers to develop economy and stock market by managing the macroeconomic factors efficiently. Lastly, it also helps in portfolio allocation decision. Thus, our study makes it possible to assess how political instability and macroeconomic uncertainty influences stock returns in the UK context. We recommend further researchers to include other measures of political risk such as electoral periods, political turmoil, religious tensions, ethnic tensions, democratic accountability, bureaucracy quality, and others. Moreover, we recommend to include different economies for comparative analysis since political instability in neighboring countries have impact on a country's political stability. Furthermore, we recommend to include other macroeconomic variables such as consumer price index, interest rates, GDP for longer time period to provide more detailed impact of macroeconomic variables on UK firms' stock returns.

6.3 Research limitations

The findings of our study are consistent with empirical literatures. It is worthwhile mentioning the limitations we faced during our research. First, we included few measures of political risk due to complexity and multidimensional nature of data. Second, more economic variables could be added in the study model for analyzing its impact on stock returns.

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NOTES

[1]. We use macroeconomic uncertainty and macroeconomic risk interchangeably. We also use political risk and political uncertainty, interchangeably.
[2]. Also, see, Aggarwal (1981), Bahmani-Oskooee and Sohrabia (1992), Abdalla and Murinde (1997); Ajayi, Friedman, and Mehdian (1998), Muhammad and Rasheed (2002) and Bhattacharya and Mukharjee (2002).
[3]. Also, see, Boutchkova, Doshi, Durnev, and Molchanov (2012), Beaulieu and Cosset (2006), Bailey, Heck, and Wikens (2005), and Frey and Waldenstrom (2004), that revealed the negative effect of political events on financial markets' trading volume and returns.
[4]. According Nasimi (2016), correlation shows direction and strength of association among variables.

TABLES

Table 4.1: Construction and Measurement of Study Variables

Variables	Symbol	Measurement
Sock Returns	SR	*Current prices to previous prices minus 1*
Political Uncertainty		*Political Risk is measured by following risk components:*
	GS	*Government Stability*
	SC	*Socioeconomic Conditions*
	IP	*Investment Profile*
	IC	*Internal Conflict*
	EX	*External Conflict*
	CC	*Control of Corruption*
	MP	*Military in Politics*
	LO	*Law and Order*
Macroeconomic Uncertainty		*Macroeconomic Uncertainty by Conditional Variances using ARCH/GARCH method*
	$\emptyset^{ipi}$	*Conditional Variance of Industrial Production Index (IPI)*
	$\emptyset^{ex}$	*Conditional Variance of Exchange Rates*

Note: Table 4.1 presents construction and measurement of political risks measures and macroeconomic uncertainty index in order to explore the effect of macroeconomic uncertainty and political risk measures on stock returns for period during 2005 to 2016. These political risk components are assigned with risk points. The minimum risk point is assigned as zero while the maximum point depends up on the fixed weight that component has in overall political risk assessment which ranges from 4 to 12 risk points. However, lower risk points represent high risk whereas higher risk points represent low risk.

Table 4.2: Descriptive Statistics of Study Variables

Variables	Obs.	Mean	Std. Deviation	Min.	Max
Stock Returns	276	0.1799	1.5278	-0.9167	24.7143
Government Stability	276	7.5517	0.5109	6.5400	8.4600
Socioeconomic Condition	276	8.9383	0.8397	7.7100	10.4200
Investment Profile	276	10.9908	1.1780	8.5000	12.0000
Internal Conflict	276	9.3275	0.5166	8.5000	10.0000
External Conflict	276	8.2075	1.2294	6.5000	9.5000
Corruption	276	4.3467	0.3592	4.0000	5.0000
Law and Order	276	5.2742	0.2388	5.0000	5.5000
Industrial Production Uncertainty	276	0.0001	0.0002	0.0000	0.0008
Exchange Rate Uncertainty	276	0.0003	0.0001	0.0002	0.0006

Note: Table 4.2 presents descriptive statistics of the study variables for the sample period during 2005 to 2016.

Table 4.3: Correlation analysis between dependent variable and explanatory variables

Variables	Coefficients	P value
Government Stability	0.045	0.460
Socioeconomic Condition	-0.024	0.697
Investment Profile	-0.012	0.847
Internal Conflict	0.017	0.775
External Conflict	0.042	0.491
Corruption	0.076	0.206
Law and Order	-0.046	0.443
Industrial Production Uncertainty	-0.058	0.337
Exchange Rate Uncertainty	0.059	0.331

Note: Table 4.3 presents the correlation analysis of explanatory variables with the dependent variable "stock returns". It shows the coefficients of correlation along with the p-values. However, we analyze that multicollinearity does not exist among variables since multicollinearity arises at coefficient level of 0.80 and 0.90, see Gujarati (2003).

Table 5.1: Stock returns under uncertainties

Variables	Coefficients	Std. Err.	t	P>|t|
Government Stability	-1.331***	0.144	-9.260	0.000
Socioeconomic Condition	1.220***	0.094	12.970	0.000
Investment Profile	-0.504***	0.041	-12.400	0.000
Internal Conflict	1.953***	0.189	10.350	0.000
External Conflict	0.921***	0.155	5.930	0.000
Corruption	-2.547***	0.179	-14.260	0.000
Military in Politics	-1.787***	0.682	-2.620	0.016
Law and Order	-0.149	0.476	-0.310	0.757
Industrial Production Uncertainty	-2.524***	240.944	-10.480	0.000
Exchange Rate Uncertainty	6.538***	434.102	15.060	0.000
Diagnostic Test				
Number of Observations	276			
Number of Groups	23			
Number of Instruments	33			
F - Statistics	100.430			
P - Value	0.000			
AR (2)	0.990			
P - Value	0.320			
J - Statistics	20.440			
P - Value	0.555			

Note: Table 5.1 presents the result for the effect of political risk measures and macroeconomic uncertainty on stock returns of 23 non-financial firms listed at FTSE-100 index during 2005 to 2016. However, *, **, and *** represents significance level at 10%, 5%, and 1%, respectively.

Table 5.2: Robustness check

Variables	Coefficients	Std. Err.	t	P>|t|
Government Stability	-1.331***	0.378	-3.520	0.002
Socioeconomic Condition	1.220**	0.526	2.320	0.030
Investment Profile	-0.504***	0.190	-2.650	0.015
Internal Conflict	1.953***	0.656	2.980	0.007
External Conflict	0.921***	0.348	2.640	0.015
Corruption	-2.547**	1.274	-2.000	0.058
Military in Politics	-1.787***	2.196	-0.810	0.425
Law and Order	-0.149	2.397	-0.060	0.951
Industrial Production Uncertainty	-2.524	2047.509	-1.230	0.231
Exchange Rate Uncertainty	6.538	5606.872	1.170	0.256
Diagnostic Test				
Number of Observations	276			
Number of Groups	23			
Number of Instruments	33			
F - Statistics	8.980			
P - Value	0.000			
AR (2)	0.920			
P - Value	0.359			
J - Statistics	20.440			
P - Value	0.555			

Note: Table 5.2 presents the robustness check on the empirical findings of the study.