

How the news affects stock prices



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Introduction There are various variables which can cause the stock prices to changes. From the major terrorist attacks like that of 9/11 to the subprime mortgage crisis, stock markets and prices are sensitive to these events and can significantly fluctuate to accommodate the news or the events happening.

This essay will look into how the prices will behave when a news arrive in the market. For this purpose, I am selecting Coke and Microsoft as two companies and the murder of US president in a terrorist attack and will then explore how the stock prices of both these companies behave to this news. Research suggests that there is a positive correlation between the political news and the stock prices. Asset prices and returns are determined by the changes in the economic as well as political variables and since the stock returns are expected values therefore the arrival of any news changes these expectations. (Elmendorf, Hirschfield and Weil). The event of 9/11 virtually forced the stock markets of the world to close for couple of days to accommodate the stock prices to adjust to this event and most of the companies especially in airline sector witness complete erosion of their market capitalization within the matter of days after the incident.

The Efficient Market Hypothesis suggest that all the news are being discounted into the stock prices as market expect them however with the news like the death of US President through a terrorist attack, this sudden and strong news will cause the major shake up in the stock market and the stock prices of Coke and Microsoft will certainly drop in order to account for the increase uncertainty and risk involved due to the death of US President. EMH suggest that only the unexpected part of the news has the power to shake the market therefore with the news of the murder of the US President

market will respond to it in negative way.

Previous research conducted on the correlation between the stock prices and the news suggested that there is hardly a correlation between the both however after allowing for different stages of the business cycles, the news has a very positive correlation to the stock prices. (McQueen and Roley). This is particularly true in the news event of the murder of Former Prime Minister Benazir Bhutto of Pakistan who was assassinated in the last week of Dec 2007. Though her death caused million of dollars loss to the government of Pakistan as there were widespread riots all over the country but stock prices did not reflected that political event in that much amount as the stocks went down for a very brief period of time and since at that time, Pakistan's economy were somehow showing the signs of improvement therefore stock exchange survived the murder of former Prime Minister.

Conclusion

Stock Prices can significantly reflect the power of news into them however this depends upon the stages of business cycles through which the economy is passing through. If it is at boom, it can survive therefore the stock prices of both Microsoft and Coke will behave to the news according to the current state of the business cycle in US.

References

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