

The Influence of Geopolitical Events on Combined Stock and Forex Returns

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DESCRIPTION

The influence of geopolitical events on financial markets has been a topic of considerable academic and practical interest, particularly in the context of combined stock and foreign exchange returns. Geopolitical events, encompassing a wide range of occurrences such as wars, terrorist attacks, trade disputes, sanctions, elections, and shifts in international alliances, often induce heightened uncertainty and volatility in global financial markets. These events can affect investor sentiment, capital flows, and risk perceptions, leading to simultaneous impacts on both stock prices and currency exchange rates. Understanding the interplay between these markets in response to geopolitical shocks is crucial for policymakers, investors, and risk managers seeking to anticipate market reactions and optimize portfolio performance.

The relationship between geopolitical events and financial markets can be analyzed through multiple theoretical frameworks. One approach is the uncertainty hypothesis, which posits that unexpected geopolitical developments create ambiguity about future economic and political conditions, prompting investors to reassess asset valuations. In stock markets, this often manifests as declines in equity prices due to anticipated disruptions in corporate earnings, trade, and investment. Simultaneously, forex markets may experience shifts as investors seek safe-haven currencies or adjust their expectations regarding interest rates, inflation, and balance-of-payments positions.

The impact of geopolitical events is not uniform across countries or sectors. Emerging markets often exhibit heightened sensitivity to such shocks because of weaker institutional frameworks, greater reliance on foreign capital, and limited economic diversification. Stock markets in these economies may experience prolonged periods of volatility following geopolitical disturbances, while their currencies may face substantial depreciation pressures. Developed economies, in contrast, may exhibit more muted stock market reactions but pronounced forex adjustments as international investors reposition capital. Sector-specific effects are also noteworthy; industries such as defense, energy, and commodities may benefit from certain geopolitical developments, while travel, leisure, and

international trade-dependent sectors often suffer losses. The combined effects on stock and forex returns highlight the importance of considering both markets simultaneously when analyzing the financial implications of geopolitical events.

Policy responses to geopolitical events play a crucial role in shaping financial market outcomes. Central banks, fiscal authorities, and international institutions often intervene to stabilize markets, provide liquidity, or mitigate currency volatility. For example, coordinated central bank actions during periods of geopolitical tension can dampen excessive currency fluctuations, while fiscal stimulus or trade facilitation measures can support equity markets. Conversely, inadequate or delayed policy responses may exacerbate market instability, intensifying negative returns in both stock and forex markets. Investors must therefore consider not only the immediate geopolitical shock but also the likely policy reaction when assessing potential market impacts.

Globalization has amplified the transmission of geopolitical shocks across borders, increasing the interdependence of stock and forex markets. Multinational corporations, cross-border capital flows, and interconnected supply chains mean that an event in one region can have far-reaching financial consequences. Trade wars, sanctions, or diplomatic disputes, for instance, can simultaneously affect stock valuations and currency exchange rates across multiple countries. Investors operating in this interconnected environment must adopt a global perspective, considering both direct and indirect channels through which geopolitical events influence financial returns.

Risk management strategies for combined stock and forex portfolios must account for the multifaceted impact of geopolitical events. Diversification across asset classes, sectors, and geographies can mitigate some risks, but the potential for heightened correlations during crises necessitates dynamic hedging approaches. Currency hedging, options strategies, and stress testing are commonly employed to protect against sudden adverse movements. Moreover, scenario analysis that incorporates potential geopolitical developments can help investors anticipate market reactions and adjust portfolios proactively, rather than reacting to shocks after they occur. As financial markets become increasingly interconnected,

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understanding the nuanced interplay between geopolitical developments and combined stock and forex returns is essential for effective investment decision-making, risk management, and policy formulation. By examining historical events, empirical patterns, and behavioral dynamics, investors and analysts can gain deeper insights into how global political forces shape financial outcomes, enabling more informed and resilient strategies in an uncertain world.

CONCLUSION

Geopolitical events exert a profound influence on combined stock and forex returns, mediated through channels of

uncertainty, risk aversion, capital flows, investor behavior, and policy interventions. The magnitude and direction of these impacts depend on the type of geopolitical shock, regional exposure, market structure, and investor psychology. Military conflicts, terrorist attacks, trade disputes, and political upheavals can generate immediate volatility and longer-term shifts in both equity and currency markets, often altering correlations and challenging traditional diversification strategies.