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ANALYSIS OF GLOBAL EVENTS AND THEIR IMPACT ON SECURITIES MARKET

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ABSTRACT :

Financial markets are broadly taken to mean any market where the buying and selling of securities take place, such as the stock market, bond market, forex market, and derivatives market. Financial markets are very important for the efficient operation of the economy in every capitalist economy. Since financial markets hold such paramount importance in any economy it is crucial to understand and predict situations, such as - economic depression, recession, high inflation, wars, etc, and understand the possible impact these crises have on the financial markets.

The objective of analysing the impact is to avoid any such method that was taken in the past which impacted the stability of financial markets. This paper will cover historic events which had a major impact on the financial markets such as The Great Depression of 1929-39, The Wall Street Crash of 1929, international global scams etc.

Research Methodology

The authors have gathered substantial information on the topic and being mindful on relying only on secondary. To enhance the accuracy and credibility of the findings, there is focus on primary sources, including official documents, statutes, expert reports. By integrating the two sources, the authors aim to deliver a comprehensive and well-substantial analysis in the research paper.

Introduction

As far as recessions are concerned, the global economic system has endured its share of them. The most infamous in this respect are the Great Depression of the 1930s, the financial crisis of 2008, and the most recent pandemic due to COVID-19. These crises however also had effects on the securities market. In this paper, the author discusses the legal issues which arose during such crises and how they affected the securities market.

Financial Markets

A securities market is simply known as the stock exchange. This is a financial platform that allows investors and issuers to trade various financial securities like common stock, preferred stock, bonds and other types of well traded instruments. A securities market is a significant market in the economy as it enables businesses to raise the necessary funds and investors to make profits. In securities markets there are two important classifications that are, primary where the fresh issues of securities are made available for purchase by the investors e.g. an IPO, and secondary where investors and or traders buy and sell already existing ones e.g. stock exchange's NYSE or NASDAQ. There is a caveat in the securities market where investors are protected and there is assurance of fair trading. Supply and demand are responsible for the pricing of such markets, moreover the prices are also sensitive to a number of economic factors including but not limited to inflation, interest rates, economic growth, and company's overall performance. Other forums that trade undertaken include the securities market include the over the counter markets annoyed stakeholders where some securities whose operations are little regulated or are still in their infancy. The securities market stimulates growth of the economy, advances business cause expansion and provides a means for individuals to enhance their wealth through prudent investment. Key participants in the financial markets are individual investors, institutional investors, broker intermediaries and regulatory authorities.

The Economic Crises

There have been, ever since the industrial era, economic crises. Each one of them have had a severe impact on the securities market at a global scale. Some of these crises have been analysed.

1. **The 2008 Global Financial Crisis:**

The 2008 financial crisis is often compared to the Great Depression of the 1930s because of its far-reaching consequences. The principal trigger, in this case, was the interior implosion of the US housing market - one led by the irrational growth of sub-prime mortgages that were lent to untrustworthy borrowers. These mortgages were siphoned off into more sophisticated financial products known as mortgage-backed securities (MBS) and offered to the world's investors. When homeowners began to fail on payments however, the worth of such securities inexplicably declined.

The crisis brought the securities market downward as many of the financial institutions faced losses on investing into MBS and other complex by risky derivatives like collateralized debt obligations (CDOs). Some banks like Lehman Brothers went under while others were rescued by the governments in order to avert a chain financial disaster. Stock markets all over the world suffered heavy losses as the investors started to panic. For example, the Dow Jones Industrial Average has seen a slump of over 50% from its highest mark, leading to losses worth trillions of dollars.

In the wake of the crisis, legal measures such as the Dodd-Frank Act were passed to install new safeguards and ensure that such situations would never happen again. The existing securities market began operating under enhanced supervision that has placed more emphasis on instruments and risk management, and a demand for openness and accountability. Nevertheless, even long after the cessation of the crisis, its effects were still felt, characterized by stock markets recovering sluggishly and investors adopting a wait-and-see approach. In the aftermath of the 2008 financial crisis, several significant cases emerged, including SEC v. Goldman Sachs (2010), where Goldman Sachs was charged with defrauding investors by misstating and omitting key facts about a financial product tied to subprime mortgages.[1]

2. The 1997 Asian Financial Crisis:

The year of 1997 marked the onset of the Asian Financial Crisis when the government of Thailand had no other option than to allow the Thai baht to float in hand with the dwindling capital reserves of the central bank. The baht began to lose value at an alarming rate and before long, the crisis reached other East and Southeast Asian countries including South Korea, Indonesia, Malaysia, and the Philippines.

The securities markets in these areas went through a collapse. Stock exchanges experienced a stoppage of activities due to the withdrawal of foreign investments. In fact, during the turbulence, stock index values created in Thailand and Indonesia depreciated by more than half. The repayable loans were made in foreign currency on which the exchange rate was pegged to the national currencies which resulted in losses, bankrupting businesses, and raising the level of unemployment.

It was after the Asian Financial Crisis that it was made clear that there are real limits to external borrowing and the cross-border movement of money. In its wake, the regimes of the countries affected made sure that reforms were enacted to achieve economic stability and most included reforms in order and control of schedules of currencies together with a strengthening of the financial sector. It was observed that the capital markets, especially in the developing nations, were under more control to eliminate the formation of bubbles as well as ensure better controls on risks.

3. The Covid-19 Pandemic:

The COVID-19 pandemic, which started in early 2020, brought about the most serious global economic downturn in history as countries all over the world adopted strict measures including lockdowns to curb the spread of the disease. Economic activity virtually came to a standstill and majority of the industries, especially the airline, hospitality, and retail, suffered great losses. The outbreak of the disease also led to an unprecedented temperamental shift in the securities market, characterised by steep sustained falls in prices to a behavioural rise after a short period due to large government and central banks injections of cash into the economy.

In March 2020, there was a major bear market in the global stock exchanges, which was one of the quickest in the history of stock exchange trading. The S&P 500 index fell by more than 30 percent after a period of weeks, other key indices suffered the same fate. As most of the market players the investors panicked and started selling off, there was always an overhang of the markets with low turnaround due to the fear of how long the pandemic would horror the world. Nevertheless, central banks notably the U.S. Federal Reserve came in with far reaching stimulus layoffs that had never been seen including a cut on interest rates and making hours of purchase of assets for a long period of time to support the investment markets.

As noted, stock indexes started rebounding particularly in the second half of the year 2020 but mainly led by the tech-oriented stocks and also the news of vaccines. Conversely, the recoveries were not the same since some areas of the economy such as ware and tech infrastructures were doing quite well whereas the other such as oil and even further along manufacturing were still in recession. Actually, the COVID-19 recession highlighted the critical need for a well-diversified investment portfolio and the risks of sectors whose operations and sales heavily rely on travel and international supply distribution chains.

The developments in the securities markets experienced significant declines followed by several resurgences during all these three crises, the 2008 financial crisis, the 1997 Asian crisis, and the COVID-19 pandemic. These triggered a few issues, which included; the investor's scheme of things towards the market, the effects of globalization of the markets, and the need to have control systems to avert market failure.

In the wake of these crises, states and state-like entities took steps to make the financial systems more robust, enhance accountability, and avoid similar events in the future. Following the crisis in 2008, it became necessary to reinforce banks' capital buffers through regulatory measures such as Basel III guidelines. Nations that participated in the 1997 Asian crisis underwent restructuring of their financial systems as well to protect them against the sudden stop.

[1] U.S. Securities and Exchange Commission. (2010). SEC Charges Goldman Sachs With Fraud in Structuring and Marketing of CDO Tied to Subprime Mortgages. Retrieved from https://www.sec.gov/news/press/2010/2010-59.htm

The security markets as an indicator of economic performance can also be prone to shocks. Nevertheless, given the cycle of shocks and stresses seen in the operative environment, there is greater stability in bonds and equities. New risks like climate change and technology integration are also coming up.

Legal factors leading to economic crises

1. **Deregulation and Liberalization:**

The legal frameworks relating to financial markets have changed to embrace factors such as deregulation and liberalization. This is often considered legal causes for economic downfall. For example, the 2008 global financial meltdown was with the worst and best of financial crises attributed to a boom in the financial deregulation of the sector that led to reckless lending and investment patterns.[2] Kaufman, G. G also states that 'Deregulation in the financial sector has often been cited as a major legal factor leading to economic crises. For instance, the deregulation of the financial sector in the United States in the 1980s and 1990s, culminating in the repeal of the Glass-Steagall Act in 1999, is often cited as a major factor leading to the 2008 financial crisis'[3]

2. **Inadequate Regulations:**

A deficiency of regulatory supervision may cause disasters in the economy as it allows risky financial operations to be carried out without supervision. Where there is lax or no regulation, these institutions are prone to engage in risky practices such as excessive risk-taking, poor standards of lending, or making investments for the sole purpose of speculation. One instance is the 2008 crisis where mortgage related activities were over regulated due to lack of policies regarding subprime lending which involved high risk borrowers. These high-risk loans were further repackaged into risky securities which eventually failed due to homeowners' defaults. The unregulated nature of such behaviours caused the recession that resulted in banks collapsing, investors and the public losing their capital, and markets crashing. Stiglitz, J. confirming this states Inadequate regulatory oversight is another legal factor that has contributed to economic crises. The lack of effective oversight and enforcement of financial regulations can lead to risky behaviour by financial institutions, which can trigger a crisis.[4]

3. **Legal Loopholes and Tax Evasion:**

Legal loopholes that allow for tax evasion can also contribute to economic crises. For instance, the Panama Papers and Paradise Papers leaks revealed how legal loopholes in tax laws allowed corporations and wealthy individuals to evade taxes, contributing to economic inequality and instability.[5] Tax regulations hold paramount importance since they regulate the input and output of the securities. Having any loopholes within the taxing regulations will give the companies, investors etc an edge to gain unethically.

4. **Regulations: -**

The Dodd-Frank Wall Street Reform and Consumer Protection Act was enacted in response to the 2008 financial crisis to prevent future crises. The Dodd-Frank Act, also known as the Dodd-Frank Wall Street Reform and Consumer Protection Act, is an Act of Congress which was signed into law on July 21, 2010. A decade after the most devastating financial crisis recently termed the Great Recession, the law was enacted as a thorough measure to contain the excesses that may arise in the financial systems. The main aim was to make financial regulations tighter, increase transparency and curb the financial institutions' penchant for excessive risks. Dodd-Frank introduced and implemented, several measures most importantly, the establishment of the Consumer Financial Protection Bureau (CFPB) that protects consumers from unreasonable financial services and product offers and also created the Financial Stability Oversight Council (FSOC) which is tasked with identifying risks to the financial system as a whole.

The legislation also introduced the implications of recommendations of Basel III on the banks and other institutions, as well as the Volcker Rule which prohibits the banks from certain trading activities and owning hedge funds. The Dodd-Frank Act also set out to further increase accountability within the financial system and thereby making it impossible for any future financial crisis as severe as that of 2008. However, it has drawn some criticism from some quarters as being too radical. Nevertheless, Dodd-Frank history will be in the books as one of the most ambitious legislative efforts to promote market stability and consumer protection. However, critics argue that it has not been fully implemented and that it does not go far enough in regulating the financial sector. [6]

Impact on Securities Market

After understanding the legal factors leading to such crises, it is now therefore quintessentially important to understand the impact of such crises on securities market. Economic crises have a profound impact on securities markets, often leading to significant legal and regulatory changes. Understanding these changes is crucial for investors, regulators, and policymakers.

1. **Market Volatility:**

[2] Krugman, P. (2009). The Return of Depression Economics and the Crisis of 2008. W.W. Norton Company Limited.

[3] Kaufman, G. G. (2014). Too big to fail in banking: What does it mean?. Journal of Financial Stability, 13, 214-223.

[4] Stiglitz, J. (2010). Freefall: America, Free Markets, and the Sinking of the World Economy. W.W. Norton & Company.

[5] Obermayer, B., & Obermaier, F. (2016). The Panama Papers: Breaking the Story of How the Rich and Powerful Hide Their Money.

[6] Wilmarth, A. E. (2011). The Dodd-Frank Act: A Flawed and Inadequate Response to the Too-Big-to-Fail Problem. Oregon Law Review, 89(3), 951-1057

Economic crises often result in increased volatility in the securities market. This is due to the uncertainty and panic that typically accompany such crises.[7] When there are economic downturns or crises, one of the factors that we can be sure will be less stable is the market. This is because there is a high level of uncertainty and normal operations are disrupted, which is most likely to happen during a crisis. During such occurrences, the tendency for the investors is such that almost all of them become extremely averse to risk and start liquidating their positions at the fastest rate possible for majority, if not all, of such holdings or claims especially those in equities and other securities markets. Therefore, with the heightened inflow and outflow of funds within short periods, that is, the active transactions of buying and selling of particular assets in such a short span of time creates bulk of active scenarios whereby the wrong demands and supplies are created for certain assets leading to increases and decreases in their prices. The expectations volatility index VIX which is also known as the 'fear index' for investors, is always higher than usual in economic recessions.

However, as it likely happens in every crisis, there are a number of factors which push up the market volatility – falling corporate profits, decreasing consumer demand, and interrupted supply chain management among others. Moreover, the very fact that the crisis is of an unpredictable length and depth, causes investors to remain unable to economize on risks and opportunities, making everything even more volatile. There is the threat of a liquidity squeeze, which can constrain the ability of financial institutions to lend, hence worsening the credit market and deepening the crisis.

Another good example is how stock markets behaved during the Global Financial Crisis of 2008 and the COVID-19 Crisis, with their steep falls and sharp recoveries due to adverse news and government rescue operations. Such price behaviors pose a challenge to many investors in assessing the direction of the market and often result in losses, more so for those who are ill prepared for rapid declines. For this reason, financial crises alter the structure of the market by changing the ways investors operate and the financial choices made.

2. **Decreased Investor Confidence:**

Economic recessions tend to destroy investors' confidence levels because they bring about uncertainties as regards the performance of the financial markets and the economy. At the time of a crisis, revenues of firms are expected to fall, debts are expected to go up, and bankruptcies are expected to rise, hence lower earnings forecasts. In this case, investors are pessimistic and tend to avoid the market since they are afraid of making losses as a result of falling asset prices, poor performance by corporations and the general economy, and other unpredictable factors.

Often a decline in petrification is accompanied by indiscriminate selling of shares, debentures and other securities, as investors indulge in purchase of less risky assets, such as gold and treasury bonds. This 'flight to safety' further increases the uncertainty concerning the market resulting in the reduction of the price of risky assets and further pushing the investors out of the market. Moreover, concerns over liquidity, bank runs, and credit tightness usually discourage investors from entering and/or remaining in the market.

The global financial crisis of 2008 is a case in point, in which investors lost faith in much of the financial system primarily due to a number of high-profile financial institutions failing. In the same way, during the COVID-19 pandemic, concerns about a protracted economic downturn caused panic selling in markets across the globe, triggering a downturn in investor sentiment. In most instances, returning the confidence back takes a lot of government spending, policy changes and more, as investors will always want to see something stable before coming back into the market.

3. **Massive Sell-Offs:**

A massive sell-off is an event when investors sell their securities in a short period of time, owing to panic or some other deterrent elements, especially during financial crises. Such sell-offs may also be induced by other events that culminate to a detrimental economic impact, such as a downturn in prices, political unrest or war, or a general lack of confidence that results in the prices of generally all securities collapsing. When this occurs, the investors' focus shifts towards selling of their shares resulting in excess supply and no demand leading to further decline in asset prices.

Again, in the course of a massive sell-off, it is common for liquidity floats down, for the simple reason that no buyers can be found and the cos t of selling for the sellers begins to outweigh the utilities of remaining in the market. It aggravates the downward price movement further and pile steep losses on investors who may cut their positions, increasing the market volatility. In the year 2008, the global financial crisis was attributed to a 'Panic Sell' wave owing to the concerns of voters over the bailout of GM and the entrenchment that Adlai Stevenson.

Correspondingly, in December 2019, the world experienced a similar crash after the World Health Organization (WHO) declared the outbreak of COVID-19 a pandemic, where virtually all countries in the world experienced a lockdown selling the equities and assets in the market. Ex cessionary measures are also instituted on many occasions by central bank organizations and governments during such occurrences lower rates and purchasable making the market rehabitative and the downward trend cessation. Finally, massive sell-offs bring to focus the fragility of investor confidence during periods of crises which makes the reasonably predictable markets, difficult and risky to operate within.

4. **Decline in Asset Price:**

In times of economic crises, it is usual for asset values to plunge dramatically due to loss of confidence amongst investors. Equities, fixed-income securities, property, and any other investment instruments experience a fall in their acquisition levels as those participating in the market act defensively. All these transposes into lower earnings from the corporate sector, weaker macro-economic indicators, and doubts on the growth prospects of the market,

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[7] Brunnermeier, M. K. (2009). Deciphering the Liquidity and Credit Crunch 2007-2008. Journal of Economic Perspectives, 23(1), 77-100.

therefore making the investors reconsider the worth of their investments. Such slump factors may lead to many players suffering from losses in many pockets of the financial market.

To illustrate, in the financial crisis of 2008, prices of housing also went down steeply after the sub-prime mortgage market tucked in most of the mortgage-related securities including mortgage-backed securities. There were massive stock market losses and sell-offs that occurred, wherein even major stock index categories like the S&P 500 dropped by over 50 % value at some point. Again, during February 2020, stock indices in every part of the world experienced fast rates of asset price fall following the outbreak of the COVID-19 which paralyzed economies.

Panic selling, disinvestment because of unavailability of funds and pessimistic economic outlooks contribute to a decrease in asset values characteristic of a crisis period. This may then lead to a cycle since a decrease in prices will in turn trigger sell-offs increasing the crisis. In the extreme cases, public policies such as spending measures and interest rate cuts become necessary to reassure the market and prevent asset prices from falling.

5. Credit Market Disruptions:

The credit market is always disrupted in instances of economic recessions after the easy availability of credit is curtailed. With predictability and financial systems at stake, the unease that prevails causes a pandemic like situation. Resources from banks and other lending institutions are always in demand even during an economic crisis and therefore lending becomes impossible if they do not retreat. This credit crisis, resulting in credit rationing, shortfalls new money supply and makes loans to businesses or individuals to tide them over impossible.

To illustrate, in the financial markets of the United States in the year 2008, credit markets were almost completely shut down following the failure of prominent banks. Banks refused to lend at least not in the empirical sense, where if they lent even the slightest portion, they would simply be courting a credit crunch duly set in. This hampered the ability of companies to fund their operations, invest in expansion, or even satisfy short-term obligations, resulting in enormous losses and an increase in unemployment.

In the year of the COVID-19 virus outbreak, world economies experienced simultaneous lockdowns, that it was almost impossible for the ordinary economic activity to take place. Hence, while fiscal and monetary authorities around the world acted to help liquefy the economy credit markets still experienced some level of dislocations, especially in those sectors that were most exposed to lockdown measures. Sectors highly affected like the travel, hotel, and even retail sectors had few borrowers and so drew out credit which worsened the economic conditions created by the pandemic. Crises based on political intolerance and instability credit market disruptions bring forth the importance of availability of credit in facilitating economic equilibrium and aid in the improvement of an economy.

6. Flight to Safety:

“Flight to safety” represents an act of investors, who, during an economic recession or a period of increased uncertainty, remove their investments from risk-oriented assets to risk-averse ones. This is due to the expectation of continued losses and the urge to avoid risk. Investors will refrain from riskier assets such as equities, corporate bonds, or even commodities and turn their attention to less risky instruments like government coupon bonds, gold and hard currency.

For example, in the context of the housing bubble burst in 2008, stock exchanges plunged neither seen nor contained and investors turned to U.S.Treasury bonds which are deemed as the vice-free risk. Likewise, in the year, 2020 where a novel coronavirus caused a pandemic and led to a volatile global market, most of the investors again pulled back their sentiments towards fiscal safe havens and precious metals, thus assisting their price increase.

During times of economic distress, an increased demand for safe investment vessels can lead to deterioration in riskier markets. Investors are likely to experience this phenomenon often referred to as flight of capital at the expense of other divergent sectors of the economy. Even though this may shield the investors from losses in the near term, it has the effect of increasing market instability and worsening liquidity situations in the other financial markets. Investors often turn to safe havens even when there are higher returns offered elsewhere due to the fear of losing capital in high-risk assets making asset allocation due to risk management is key in investment.

Conclusion :

In closing, we can say that the influence of economic crises on the securities market is both complex and wide-ranging. Numerous factors such as increased market volatility, investors behaviors, and positive feedback mechanisms play a major part. The impact of these crises is mostly dependent on the legal, regulatory and policy environment that considers the crisis. For example, in 2008, there was a crisis that engulfed the entire globe, and it was largely due to the failure to regulate market activities that exposed many institutions to risks that they could not manage.

After the occurrence of the 2008 crisis in the United States, there were new pieces of legislation, for example, the Dodd-Frank Act, which were intended to regulate the financial markets and bring about order to the behavior of those in the financial sector. Though not in the exact chronology, the regimes in Asia (Southeastern) were however seriously exposed owing to what the 1997 Asian Financial Crisis termed as ‘inherent weak governance’ which led to massive capital flight as well as rooted financial systems corruption and other factors.

Indeed, the wide-ranging consequences of the COVID-19 crisis meant that state governments had to employ aggressive measures in the form of fiscal expansion and emergency laws which had the impact of quickened reaction of stabilizing the markets and improving the investor's confidence. In other words, it was more a restoration measure rather than concern of damage.

In the end, economic downturns bring out the link between economic, sociological, policies factors and the stability of the market. There should be strong regulatory framework in place that will not only assist in combating systemic risk, but will also help in transparency and restoring the faith of investors in such periods. The strength of future crystal building markets shall be shaped by pre-emptive regulation so that capital markets remain operational during economic downturns while supporting economic development.