ABSTRACT

The purpose of this study is to assess the correlation between sector return for the US, UK, China, Pakistan, and India and Economic Policy Uncertainty (EPU). The panel data, which plans the years 2010 through 2020 includes sector returns of stock market data for the sample nations and EPU. The wavelet coherence approach is employed to meet the research objectives. To evaluate short-medium and long-term changes in the relationship between two variables, researchers might look into how the coherence or correlation between these variables evolves over different periods and frequency components by the application of wavelet coherence analysis to the time series of data of sector returns and the uncertainty of the economic policy. The study finds that there are notable differences in the time domain and frequency domain between the stock market's reliance on the EPU and that the lead-leg relationship between them demonstrates time-varying characteristics. According to research, the influence of domestic EPU on sector returns is sustained at low frequencies throughout the sample period, but the combined effect of domestic and US EPU is the most enduring. Furthermore, a high Sharpe ratio (low Value at risk VaR) and a significant sector-moving US EPU are noted. Even as the US EPU is increasing, the portfolio optimization method recommends giving the sectors in China, India, and Pakistan more weight. Lastly, portfolio diversification benefits are obtained via the VaR exercise. Investor anxiety and uneasiness are generally reduced by the findings. It may result in a rise in investor confidence and a decline in risk aversion. Consequently, investors might become less circumspect and allocate more capital to industries that are more susceptible to shifts in policy, which would boost industry returns. The research's findings will provide investors, the government, and politicians with a framework for policy.

Keywords: EPU, Sector returns, Wavelet Coherence, VaR, Sharpe ratio