Manulife
Investment Management

Market Note

2 Oct 2025

The US Senate failed to pass a last-minute funding deal, triggering the first federal government shutdown in nearly seven years starting from 1 October. Our Multi-Asset Solutions Team shares insights on how markets have responded during past shutdowns, and how investors can position themselves amid the uncertainty.

Q&A: Potential market impact of a US government shutdown

1. **During past shutdowns, which market sectors have tended to be most vulnerable to short-term volatility and which have tended to show resilience?**

While government shutdowns can involve federal layoffs and the suspension of nonessential operations, the behaviour of market sectors during these times has been inconsistent. In the shutdown that began in December 2018—the longest in history at 35 days—defensive sectors such as utilities, consumer staples, and real estate fared relatively well amid short-term volatility. A 16-day shutdown in October 2013 resulted in broad gains across all sectors without a clear theme; conversely, during the 21-day shutdown that began in December 1995, sectors such as information technology, consumer discretionary, and materials struggled, whereas consumer staples and utilities were among the top performers. Overall, defensive sectors have typically moderately outperformed, but shutdowns have presented short-term windows that have been difficult to time.

2. **Looking at past shutdowns, what lessons stand out about how markets ultimately behaved versus how investors feared they would behave?**

Notably, no government shutdown has had a substantial adverse effect on the stock market. In each instance since 1980, the S&P 500 Index ended up higher one month after the start of a shutdown, indicating that the effects have been short-lived and relatively minor. While the 2018 shutdown was accompanied by a spike in market volatility, it wasn't significant compared with the effect of other major market events. Other shutdowns haven't caused large volatility shifts, as evidenced by the Cboe Volatility Index (VIX Index). In our view, it's crucial to recognise that shutdowns are often just one part of a broader market environment, with multiple macroeconomic and political factors in play. Although government instability can trigger volatility and reduce investor confidence, historical market performance suggests to us that the impact of shutdowns tend to be relatively minimal.

3. **To what extent—if any—should investors adjust their asset allocations or liquidity strategies ahead of a potential shutdown?**

Investors should consider liquidity needs as part of a broader financial plan but should likely avoid changes to their asset allocation just because of a potential government shutdown, in our view. If anything, market volatility during government shutdowns has presented buying opportunities for tactical investors aiming to capitalise on mispriced or oversold assets.

4. **For investors focused on retirement or wealth preservation, how should they frame a government shutdown within the context of their long-term plans?**

A government shutdown should be regarded as a short-term political disruption that likely shouldn't affect an investor's long-term financial plan. We believe an investor with a well-diversified portfolio designed for wealth preservation should remain steadfast and avoid impulsive decisions based on short-term political events.

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