Stocks dropped, with blue chips falling to two-month lows, as investors fretted over escalating tensions in Syria.

Low volumes exacerbated the effect of the selling, and the drop in the market's benchmark indexes to fresh lows for the month also soured the market's technical outlook, traders said.

While much of the chatter among traders Tuesday was about Syria, the sell-off extends a decline from recent weeks blamed on expectations that the Federal Reserve will decide in September to scale back its economic stimulus efforts. Adding to the negative tone Tuesday is increased saber rattling on Capitol Hill over the potential for a political battle over raising of the U.S. federal debt limit.

The Dow Jones Industrial Average shed 170.33 points, or 1.1%, to 14776.13. The Dow closed at the lowest level since June 25.

The S&P 500-stock index fell 26.30 points, or 1.6%, to 1630.48 and the Nasdaq Composite Index slid 79.05 points, or 2.2%, to 3578.52.

The S&P 500 has lost 4.6% from its all-time closing high of 1709.67 on Aug. 2, but is still up 14% so far this year.

"People are using Syria as an excuse to sell today," said Uri Landesman, president of New York-based hedge fund Platinum Partners. "The prospects of the U.S. [using military action] is not making investors particularly sanguine."

He said light volumes, which are the norm for this time of the year as investors take vacation ahead of the long Labor Day weekend, is exaggerating the impact of fears over Syria.

"Lower volume generally breeds greater volatility," Mr. Landesman said. "This is not the right week to have a crisis."

Financials and industrials led all 10 of the S&P 500 sectors lower. Within the Dow, Bank of America declined 2.6% and Microsoft fell 2.6% to pace declines in 28 of 30 components.

Ed Lashinski, director of global strategy and execution at RBC Capital Markets' Futures Group the drop in the S&P 500 below last week's low also drew in sellers.

"You're dealing with a thinner market," Mr. Lashinski said. "The technical backdrop is also becoming more pernicious."

Late Monday, Secretary of State John Kerry said the Syrian government's use of chemical weapons is a "moral obscenity" and that the Obama administration has developed conclusive evidence that chemical weapons were used last week. It was the clearest signal yet that the U.S. is considering an attack against President Bashar al-Assad's regime.
Despite the sharp declines, with the S&P 500 suffering the biggest one-day selloff since June 20, traders said the day's activity didn't reflect panic on the part of institutional buyers.

"Really there's no positive stuff to counteract what's going on in the geopolitical sphere," said Kanellas Cafcules, managing director of ETF trading at Cantor Fitzgerald. "In a liquidity void at this time of the summer, it makes sense that we're going to drift lower on this kind of news."

Meanwhile, the escalating tensions over Syria have pushed up oil prices and other assets seen as havens during times of crisis, such as U.S. Treasurys and gold.

October crude-oil futures climbed 2.9% to settle at a six-month high of $109.01 a barrel. August gold futures rose 2% to $1,420.60 an ounce, a three-month high. The yield on the 10-year Treasury note fell to 2.722% from 2.805% late Monday, as Treasury prices rose. The dollar slipped against the euro and the yen.

The Treasury Department also said late Monday that it would hit its borrowing limit in mid-October, which is sooner than many expected.

Platinum Partners' Mr. Landesman said that while market seems focused on Syria, "from a fundamental perspective, the budget [concerns] are potentially more ominous."

The S&P/Case-Shiller 20-City home price index for June rose 12.1% from the same period a year ago, compared with expectations of a 12.2% increase.

The Conference Board's consumer confidence index rose to 81.5 in August from 80.1 in July, compared with expectations of a slight decline to 79.1.

European markets slumped, with the Stoxx Europe 600 losing 1.8%, as worries about Syria and the U.S. debt ceiling overshadowed upbeat data out of Germany. The Ifo institute's business confidence index for Germany rose more than expected to 107.5 in August from 106.2 in July.

Asian markets ended mostly lower. Japan's Nikkei Stock Average shed 0.7% as a result of concerns over Syria. China's Shanghai Composite bucked the regional trend, rising 0.3% after data showed total profits among industrial firms in July grew 12% from June, accelerating from a 6.3% increase the previous month.

J.C. Penney declined 1.4%. Pershing Square Capital Management, run by Bill Ackman, disclosed late Monday that it had unloaded its entire stake of 39 million shares in the retailer. Mr. Ackman had resigned from the company's board earlier this month after he failed to push through a change in the company's management.

Tiffany declined 1% as the high-end jeweler reported fiscal second-quarter earnings that topped expectations and raised its full-year outlook, but revenue missed forecasts.

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