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HOW MUCH HAPPINESS CAN WE FIND IN THE FEAR INDEX?

Abstract:

Many studies dealing with calendar market anomalies have ascribed positive or negative patterns detected in returns to investors' moods. However, in these studies, mood was not measured directly but rather speculated upon or inferred. This paper suggests capturing investors' moods by dividing the information contained in the VIX, popularly called the fear index, into two components: that which is correlated with volatility forecasts and information that is not. By doing so, we provide further evidence about the relationship between investor mood and risk aversion around joyful occasions (holidays) as well as for other occasions that may result in negative moods (the disruption of sleep resulting from the move to and from daylight savings time). We find that the actual values of the VIX and its cousin, the VXO, tend to be lower than their expected values in the case of joyful holidays, reflecting a more optimistic mood among investors, while during daylight savings time weekends, the actual values of the VIX and VXO tend to be higher than their theoretical values. Our results shed light on the information content of implied volatility beyond that captured in other volatility estimators.

Keywords:

Financial markets; Mood; Behavioral finance; Holiday effect, Risk aversion, Stock returns

JEL Classification: G10, G02, G14