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Relationships Between Implied Volatility Indexes and Stock Index Returns

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Abstract

There is a negative and statistically significant relationship between the returns of the S&P 100 and the Nasdaq 100 stock indexes and their corresponding implied volatility indexes, VIX and VXN. For the S&P 100, the relationship is asymmetric, as negative stock index returns are more associated than positive returns with greater changes in VIX. VIX changes when negative stock index returns are observed are greater in low-volatility periods. For the Nasdaq 100, the asymmetric effect is rather weak, but the VXN and underlying index co-movement is also somewhat muted in high-volatility trading environments. There is some evidence that positive forward-looking returns are to be expected for long positions triggered by extremely high levels of the implied volatility indexes.

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