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Index Futures Trading and Stock Return Volatility: Evidence from the Introduction of Mid Cap 400 Index Futures

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Abstract

The MidCap 400 stock index is used to provide new evidence on the relation between stock index futures trading and stock return volatility. The study documents a significant decrease in return volatility and systematic risk, and a significant increase in trading volume for the MidCap 400 stocks after the introduction of the MidCap index. A control sample of medium-capitalization stocks, however, exhibits similar contemporaneous changes in these measures. The MidCap stocks and the control stocks also experience a significant decrease in volatility and an increase in volume after the introduction of MidCap 400 index futures. Thus, the study finds no difference in the behavior of the MidCap 400 stocks and the control stocks and no evidence of a relation between index futures trading and volatility in the stock market.

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