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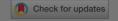
## Does VIX or volume improve GARCH volatility forecasts?

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Pages 1210-1228 | Published online: 02 Oct 2015

**66** Cite this article https://doi.org/10.1080/00036846.2015.1096004



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## **ABSTRACT**

This article considers whether the inclusion of two additional variables can improve

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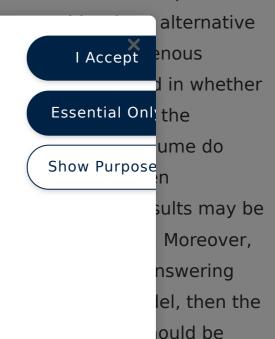
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Q KEYWORDS: GARCH volatility forecasting VIX volume

Q JEL CLASSIFICATION: C22 G15

## Notes

- <sup>1</sup> Based on S&P 500 data.
- <sup>2</sup> Because its (VIX) level indicates how much market participants are willing to pay in terms of implied volatility to hedge stock portfolios with S&P 100 index put options or to belong by buying S&P 100 index call options. In addition, extreme values of VIX are seen as trading signals, for example, with very high levels of VIX indicating that markets are pessimistic whereas a very low VIX often leads to an increase in stock prices.
- <sup>3</sup> Whaley (2009) explains that VIX should be seen the same way as a bond's yield to maturity.
- <sup>4</sup> Which is a better known index and because futures contracts on the S&P 500 are actively traded. Furthermore, S&P 500 option contracts are European-style, making them easier to value. Hence, the VIX is implied by the current prices of the S&P 500 index options and represents expected future market volatility over the next 30 calendar days (Whaley 2009).



- <sup>10</sup> There is one exception for the UK.
- <sup>11</sup> We choose to use a simple AR(1) model in order to keep the model parsimonious. However, several authors have considered including asymmetric terms (Giot, <u>2005</u>) or allowing for long memory effects (Konstantinidi, Skiadopoulos, and Tzagkaraki <u>2008</u>; Dunis, Kellard, and Snaith <u>2013</u>). While in the context of option pricing, Kanniainen, Lin, and Yang (<u>2014</u>) advocate the use of squared VIX.





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