Option-implied information and return prediction

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ABSTRACT

We show the existence of a negative variance risk premium for major US stock indexes and stocks, except for relatively high market capitalization stocks. A zero net investment strategy based on log variance risk premium yields an annualized Sharpe ratio of 0.38 and an annualized certainty equivalent of 4.68%. We find that both the log variance risk premium and option-implied betas are negatively priced in contemporaneous and future returns, which is counter intuitive for option-implied betas, given the expected risk return relation.