

“Financial & investment strategies to captivate S&P 500 volatility premium”

AUTHORS	Alexandros Garefalakis George Alexopoulos Michael Tsatsaronis Christos Lemonakis
ARTICLE INFO	Alexandros Garefalakis, George Alexopoulos, Michael Tsatsaronis and Christos Lemonakis (2017). Financial & investment strategies to captivate S&P 500 volatility premium. <i>Investment Management and Financial Innovations</i> , 14(3), 39-53. doi: 10.21511/imfi.14(3).2017.04
DOI	http://dx.doi.org/10.21511/imfi.14(3).2017.04
RELEASED ON	Friday, 06 October 2017
RECEIVED ON	Tuesday, 11 April 2017
ACCEPTED ON	Friday, 11 August 2017
LICENSE	 This work is licensed under a Creative Commons Attribution-NonCommercial 4.0 International License
JOURNAL	"Investment Management and Financial Innovations"
ISSN PRINT	1810-4967
ISSN ONLINE	1812-9358
PUBLISHER	LLC “Consulting Publishing Company “Business Perspectives”
FOUNDER	LLC “Consulting Publishing Company “Business Perspectives”



NUMBER OF REFERENCES

35



NUMBER OF FIGURES

7



NUMBER OF TABLES

3

© The author(s) 2024. This publication is an open access article.



BUSINESS PERSPECTIVES



LLC "CPC "Business Perspectives"
Hryhorii Skovoroda lane, 10, Sumy,
40022, Ukraine

www.businessperspectives.org

Received on: 11th of April, 2017

Accepted on: 11th of August, 2017

© Alexandros Garefalakis, George
Alexopoulos, Michael Tsatsaronis,
Christos Lemonakis, 2017

Alexandros Garefalakis, Department
of Accounting and Finance, T.E.I. of
Crete, Heraklion, Greece.

George Alexopoulos, Department of
Business Administration, University
of Patras, Greece.

Michael Tsatsaronis, Department
of Shipping, Trade & Transport,
University of the Aegean, Chios,
Greece.

Christos Lemonakis, Department of
Business Administration, T.E.I. of
Crete, Agios Nikolaos, Greece.



This is an Open Access article,
distributed under the terms of the
[Creative Commons Attribution-Non-
Commercial 4.0 International license](https://creativecommons.org/licenses/by-nc/4.0/),
which permits re-use, distribution,
and reproduction, provided the
materials aren't used for commercial
purposes and the original work is
properly cited.

Alexandros Garefalakis (Greece), George Alexopoulos (Greece),
Michael Tsatsaronis (Greece), Christos Lemonakis (Greece)

FINANCIAL & INVESTMENT STRATEGIES TO CAPTIVATE S&P 500 VOLATILITY PREMIUM

Abstract

So as to enhance the risk of balanced execution of their portfolios, speculators look to broaden by including new resources, new sorts of monetary instruments or even new resource classes. Like wares, volatility rose as an unmistakable resource class and included the speculation portfolios particularly by multifaceted investments.

This paper examines the volatility premium of S&P 500 record choices and contrasts with different venture methodologies in view of offering alternative structures, for example, straddles and strangles utilizing diverse measures or risk and return. The outcomes demonstrate that the speculation procedures used to catch the instability premium through offering choices structures give higher exhibitions contrasted with the S&P 500 benchmark index.

Keywords

capital flows, volatility risk premium, accounting and
financial measures, investment strategies

JEL Classification G11, G31, G32

INTRODUCTION

Speculators look to broaden their portfolios with a specific end goal to enhance the risk of balanced execution. For this reason, the broadening is acknowledged through different means, for example, including new resources, new sorts of budgetary instruments or even new resource classes in their accounting and finance portfolios. Like products, instability developed as an unmistakable resource class included the venture portfolios particularly by multifaceted investments. A large literature in accounting and finance establishes that volatility is customarily exchanged through budgetary alternatives or through later instruments like fluctuation swaps or fates on various instability lists. Eraker (2009) accentuates that, overall, the inferred instability of file alternatives is higher than the unqualified annualized standard deviation. This distinction, the volatility premium, can be interpreted into considerable returns for the merchants of record alternatives.

An assortment of authors (e.g., Bakshi & Kapadia, 2003a; Buraschi & Jackwerth, 2001; Coval & Shumway, 2001; Pan, 2002) has demonstrated that presentation to market risk is not adequate to clarify choice returns and that some extra wellsprings of risk appear to be estimated. As guessed in those papers, risk of instability and hop risk are clearly applied as extra risk variables. This paper offers a broad investigation of risk components influencing choice returns, both in an unequivocal and a contingent resource evaluation system. The investigation is done both for the three principal worldwide markets, and all-inclusive

for the pooled world market to deliver issues identified with global market combination, contagion and the advantages of universal broadening. The restrictive examination means to give understanding into the time-varying of risk premia and risk introduction.

In an exemplary paper, Merton (1973) examined the big history of the hypothesis of choice value started in 1900 when the French mathematician Louis Bachelier found an alternative estimation form in view of the suspicion that stock costs take after a Brownian movement with zero float. Since that time, various specialists have added to the hypothesis. The paper starts by finding an arrangement of restrictions on choice value equations from the presumption that investors incline toward additional to less. These confinements are important conditions for an equation to be predictable with a sound value hypothesis. Consideration is given to the issues made when profits are paid on the underlying basic stock and at the point when the terms of the choice contract can be changed expressly by an adjustment in work out cost or certainly by a move in the venture or capital structure strategy of the firm. Since the inferred limitations are not adequate to exceptionally decide a choice value form, extra suspicions are acquainted with look at and broaden the original Black-Scholes hypothesis of alternative evaluation. Express equations for valuing both call and put alternatives also as for warrants and the new “depressed” choices are determined. The impacts of profits and call arrangements on the warrant cost are analyzed. The potential outcomes of assisting the expansion of the hypothesis to the evaluation of corporate liabilities are examined.

Hodges (1996) demonstrates that by citing a choice as far as a positive inferred instability, all Type I limits are consequently ensured. This property makes it exceptionally alluring for market producers to quote and overhaul inferred volatilities in view of choices request streams while utilizing a robotized framework to redesign the alternative costs at whatever point the basic security value moves.

In a related work, Bakshi and Kapadia (2003b, 2003c) clarify whether the volatility risk premium is negative by inspecting the measurable properties of delta-supported alternative portfolios (purchase the choice and fence with stock). Inside a stochastic instability structure, we exhibit a correspondence between the sign and extent of the unpredictability risk premium and the mean delta-supported portfolio returns. Utilizing a specimen of S&P 500 record choices, they give experimental tests that have the accompanying general outcomes. To start with, the delta-supported procedure fails to meet zero expectations. Second, the achieved underperformance is less for choices far from the cash. Third, the underperformance is more prominent now and again of higher instability. Fourth, the volatility risk premium fundamentally influences delta-supported increases, even subsequent to representing bounce fears. The confirmation is strong of a negative market volatility risk premium (Lemonakis et al., 2016).

To conceive the delta-supported positions, Engle and Figlewski (2015) have designed a model for the Implied Volatility (IV) which reflects both expected exact unpredictability and furthermore risk premia. Stochastic variety in both of them makes unhedged chance in a delta supported alternative position. They create EGARCH/DCC models for the progression of volatilities and connections among day-by-day IVs from alternatives on twenty-eight huge top stocks. The information unequivocally bolsters a general connection structure and furthermore a one-factor is demonstrated with the VIX record as the basic factor. Utilizing IVs from stocks that are either connected with the objective stock’s IV or in a similar industry together with the VIX can fundamentally enhance support of individual IV changes (Garefalakis et al., 2011).

A developing rundown of studies expand upon this variance risk change measure, creating hypotheses clarifying the vast difference risk premium (Baele et al., 2014; Drechsler & Yaron, 2011), displaying the fluctuation swap term structure and creating fluctuation swap assignment systems (Egloff et al., 2010; Garefalakis et al., 2016b), archiving difference chance premium in different markets (Mueller et al., 2012), relating the value fluctuation chance premium to other monetary markets (Bollerslev et al.,

2009; Zhang et al., 2009). Carr and Wu (2006) stated that pricing choices include an volatility input. Since unpredictability is not straightforwardly noticeable and it additionally differs stochastically after some time, risk of instability is a huge problem for most alternative brokers. As anyone might expect, at that point, there has dependably been impressive enthusiasm for the CBOE's VIX instability record, albeit moderately small exchanging of subordinates in light of it. The first VIX was a weighted normal of Black-Scholes suggested volatilities, which made it (on a basic level) a great estimator of future unpredictability, however difficult to reproduce with exchanged securities. The first VIX has been as of late supplanted by another equation that is not subordinate. In this article, Carr and Wu (2006) audit the old VIX (now called the VXO) and the new VIX and present a wide assortment of results on their conduct. An intriguing contrast is that the new VIX, squared, is a decent fence for acknowledged difference. This makes the new VIX basic for volatility subsidiary contracts, which are currently being propelled into the commercial center by the CBOE. The article analyzes the execution of the two files as conjectures of acknowledged unpredictability, and shows how the VIX reacts around a vulnerability lessening data occasion, gatherings of the Federal Open Market Committee. Carr and Wu (2006) likewise acquire fascinating outcomes on the market's volatility risk premium from coordinate estimation of risk neutral volatility in the VIX. Jiang and Tian (2005) broaden their model free inferred unpredictability to resource value forms with jumps and build up a basic strategy for utilizing watched alternative costs. Furthermore, we play out an immediate trial of the educational effectiveness of the alternative market utilizing the model free suggested unpredictability. The outcomes from the Standard and Poor's 500 record (SPX) alternatives recommend that the model of free inferred instability subsumes all the data contained in the Black-Scholes (B-S) suggested unpredictability and past acknowledged instability and is a more effective estimate for future acknowledged volatility. Heath et al. (1992) show forward financing costs which can on a fundamental level be used for assessing subordinates made on the recommended volatility surface. What this study fails to see is that the learning of the current recommended instability surface spots acquires the assurance of the steady martingale fragment for its future stream. In this paper, instead of neglecting these confinements, they use them in building an essential link between the current situation with the deduced instability surface and its nearby term movement. The nearness of the volatility premium can be actually elucidated.

Our new system gives a stage to investigating risk of instability and volatility risk premium in every alternative contract, without turning to choice portfolio detailing.

The following studies attempted to revise volatility with dubious results. Avellaneda and Zhu (1998) examined a risk of unbiased stochastic instability and demonstrate use of no-arbitrage evaluating standards. At that point they contemplate the conduct of the suggested instability of alternatives that are somewhere down all through the cash agreeing in this model. The inspiration of this examination is to demonstrate the distinction in the asymptotic conduct of the circulation of the appropriation tails between the standard Black-Scholes log-typical conveyance and the risk of nonpartisan stochastic instability dispersion.

In the second part they additionally investigate this risk unbiased stochastic volatility model by a Monte-Carlo contemplate on the inferred instability bend (suggested instability as a component of the alternative strikes) for close to the-cash choices. They ponder the conduct of this "grin" bend under various decisions of parameter for the model, and decide how the shape and skewness of the "grin" bend are influenced by the volatility of volatility ("V-vol") and the relationship between the basic resource and its instability. Ledoit and Santa-Clara (1998) examined another approach for valuing choices on resources with stochastic unpredictability. They begin by building the "surface" of Black-Scholes inferred volatilities for (promptly discernible) fluid, European call choices with changing strike costs and developments. At that point, we demonstrate that the suggested instability of an at-the-cash call alternative with time-to-development going to zero is equivalent to the hidden resource's quick (stochastic) unpredictability. At that point they show the stochastic

procedures taken after by the suggested volatilities of alternatives of all developments and hit costs mutually with the stock cost, and discover a no-arbitrage condition that their float must fulfill. At long last, they utilize the subsequent without arbitrage joint process at the stock cost and its unpredictability to cost different subordinates, for example, standard yet illiquid choices and in addition exotic choices utilizing numerical strategies. The considerable favorable position of their approach is that, when estimating these different subsidiaries, they are secure in the information that the model estimates the supporting instruments – to be specific the stock and the straightforward, fluid choices – reliably with the market. Their approach can without much of a stretch be reached out to take into consideration stochastic loan costs and a stochastic profit yield, which might be especially significant for the evaluation of cash and product choices (Garefalakis et al., 2016a). They can likewise stretch out their model to value security choices when the term structure of loan fees has stochastic instability. Schonbucher (1999) examined a stochastic instability display which is exhibited that specifically endorses the stochastic improvement of the inferred Black-Scholes volatilities of an arrangement of given standard alternatives. In this way the model can catch the stochastic developments of a full-term structure of suggested volatilities. The conditions are inferred that must be fulfilled to guarantee nonattendance of arbitrage in the model and its numerical execution is under discussion. Fengler (2005) examined a semiparametric factor model, which approximates the inferred unpredictability surface (IUS) in a limited dimensional capacity space. Not at all like standard main segment approaches ordinarily used to decrease unpredictability, this approach is customized to the worsened plan of IVS information. Specifically, they just fit in the nearby neighborhood of the plan focuses by misusing the expiry impact exhibit in choice information. Utilizing DAX file alternative information, they gauge the nonparametric parts and a low-dimensional time arrangement of inactive elements. The displayed approach is finished by examining vector autoregressive models fitted to the dormant components.

Daglish et al. (2007) suggested that volatilities are now and again used to cite the costs of alternatives. The suggested instability of an European alternative on a specific resource as an element of strike cost and time to development is known as the advantage's unpredictability surface. Dealers screen developments in unpredictability surfaces nearly. In this paper they build up a no-arbitrage condition for the advancement of an unpredictability surface. They look at various dependable guidelines utilized by brokers to deal with the instability surface and test whether they are predictable with the no-arbitrage condition and with information on the exchanging of choices on the S&P 500 taken from the over-the-counter market. At last they evaluate the elements driving the unpredictability surface in a way that is predictable with the no-arbitrage condition.

The above models help us to study the initial instability of our model to levels of uncertainty. Through these studies we try to build the limitations of the model's instability, as well as the permitted arbitrage values.

The rapprochement is contiguous to the Heath et al. (1992) whose research exhibits a unifying hypothesis for estimating unforeseen claims under a stochastic term structure of loan costs. The system, in view of the identical martingale measure method, takes as given an underlying forward rate bend and a group of potential stochastic procedures for its resulting developments. A no-arbitrage condition confines this group of procedures yielding valuation formulae for loan fee touchy unexpected cases which don't expressly rely upon the market costs of risk. Cases are given to show the key outcomes.

Most financial specialists have positions in various resources, for example, stocks or accounting files. With a specific end goal to diminish their value at risk, they will pay a premium, producing along these lines a characteristic interest for purchasing instability. Christensen and Prabhala (1998) analyzed the connection between suggested and acknowledged instability, demonstrating that inferred volatility outflanks past instability in gauging future instability. Birkelund et al. (2015) demonstrated that the suggested instability has a positive inclination against the acknowledged volatility for the Nordic Power forward market. This out-

come shows that there is a risk premium forced by alternative brokers. A few papers attempted to measure this premium, otherwise called difference chance premium. Carr and Wu (2009) examine the authentic conduct of the difference chance premium on 5 stock lists and 35 singular stocks. Trolle and Schwartz (2010) concentrated on the vitality items showcase. Coval and Shumway (2001) report annualized Sharpe proportions close to 1 for procedures in view of offering money secured straddles. Driessen and Maenhout (2013) concentrate on record choices frame on a few markets in US, Europe and Asia.

This paper dissects the volatility risk premium of S&P 500 record choices and looks at different speculation methodologies in view of offering choices structures utilizing distinctive measures or risk and return. The outcomes demonstrate that the instability premium is joining positive long-run esteem and techniques in light of offering choices structures, for example, straddles and strangles outperform the benchmark interest in the S&P 500 file. The rest of the paper is organized as follows. In the following section, database and approach are displayed, the accompanying section portrays the outcome, while the last section gives the results of the study.

1. DATA AND METHODOLOGY

The database consists in the daily closing prices of the American S&P 500 index, the daily closing values of the S&P 500 volatility index (VIX), computed based on the implied volatility of the options having the S&P 500 index as underlying, traded during the day, Euro Overnight Index Average (EONIA), Euribor 6 monts, all for the period between December 8, 2005 and November 8, 2016 (12 years). In total, there are 2750 daily observations for each series.

The initial step of the technique comprises looking at the development of S&P 500 record and its inferred instability (VIX indicator) for the period. The fundamental clear measurements of the two indicators and their day-by-day logarithmic returns are registered.

Afterwards, I investigate the advancement of the suggested unpredictability of the S&P 500 indicator, presented by the VIX indicator, and the acknowledged instability for the accompanying time frame. The acknowledged instability is figured for a one month time frame, in view of day-by-day logarithmic returns, and annualized.

$$Realizedvolatility_{1M} = \sigma_{1M} \cdot \sqrt{252},$$

where is the standard deviation of the logarithmic every day returns of the S&P 500 indicator over a one month time span (σ_{1M}).

For disentangling reasons, a year is considered having 252 business days and a month having 21 business days.

The unpredictability premium is processed as the distinction between the suggested and the acknowledged instability. The development of the unpredictability premium is further analyzed. I additionally surveyed the advancement of the supreme and relative unpredictability premium mean for the period. The relative unpredictability premium is registered as the instability premium partitioned by the inferred unpredictability.

The investigated methodology used to catch the unpredictability premium comprises in offering straddle and choke structures. A straddle comprises offering a call and a put choice with a similar development and a similar strike. On account of the choke, the strikes vary, the strike of the call being higher than the put strike. The alternative premium is processed utilizing the Black-Scholes (1973) equation.

$$\begin{aligned} C &= S \cdot \Phi_{(d_1)} - e^{-r\Delta t} \cdot K \cdot \Phi_{(d_2)}, \\ P &= e^{-r\Delta t} \cdot K \cdot \Phi_{(-d_2)} - S \cdot \Phi_{(-d_1)}, \end{aligned} \quad (1)$$

where C is the price of the call option, P is the price of the put option, $\Phi(X)$ is the normal cumulative function of the standard normal distribution, S is the price of the underlying, K is the exercise price (strike), r is the risk-free rate, t is the time to maturity, while d_1 and d_2 are given by the following formulae:

$$d_1 = \frac{\ln\left(\frac{S}{K}\right) + \left(r + \frac{\sigma^2}{2}\right) \cdot \Delta t}{\sigma \sqrt{\Delta t}}, \quad (2)$$

$$d_2 = d_1 - \sigma \sqrt{\Delta t}. \quad (3)$$

The ordinary combined capacity of the standard normal distribution has the following form:

$$\Phi_{(x)} = \frac{1}{\sqrt{2\Pi}} \cdot \int_{-\infty}^x e^{-\frac{z^2}{2}} \cdot dz. \quad (4)$$

As said above, the option strategies considered are straddles and strangles. The straddles include offering two at-the-cash spot alternatives. In this manner, the strike of the call and put alternatives is equivalent to the S&P 500 index price at the inception. The strangle structure includes offering two out-of-the-cash spot alternatives: a call and a put. The strikes of the two choices are symmetrical to recognize (the S&P 500 index price) at commencement. For instance, if the strike of the call alternative is 5% higher than recognize, the strike of the put will be 5% lower contrasted with spot. There are 4 methodologies considered in the examination: a straddle and 3 strangles. The three strangle structures assume offering alternatives with strikes 5%, 10%, individually 15% higher/lower than the spot at origin.

The venture techniques that are dissected comprise every day offering various straddles, individually chokes, having a similar development. There are 3 isolated developments analyzed in a 6-month period. In this manner, 12 isolate elective speculations are examined: 4 choices structures (1 straddle and 3 chokes) for 1 development (6 months).

The notional estimation of the structure is set so as to stay away from influence at any minute in time. In this manner, the notional estimation, in light of the quantity of S&P 500 index price records set as hidden, is constantly equivalent with the sum accessible for venture. The main special case is made toward the start of the period, when the notional estimation of the sold alternatives slowly increments until it achieves the venture sum.

With a specific end goal to encourage the comprehension of the venture mechanics, I expect that toward the start of the period (December 8, 2005) the sum accessible for the speculation is 1.000.000 EUR. The speculator can put this sum in purchasing the S&P 500 index price. This speculation will create an indistinguishable returns from the S&P 500 index price record for the period (this can be viewed as the market execution, or the benchmark). Other option is to put the cash in an overnight store, all the returns being re-contributed once a day. The loan cost of this store is given by EONIA. The arrival of this speculation is thought to be the risk free rate. Then again, the speculation can comprise offering straddles or chokes with various developments. To delineate these speculations, I will represent, for instance, straddles having development of 1 month. Keeping in mind the end goal to stay away from a utilized system, the notional estimation of the straddles, in view of the quantity of records set as fundamental, ought not to be higher than the sum accessible for speculation. For the next days, a similar philosophy is utilized to decide the quantity of straddles that are sold, mulling over the new estimation of S&P 500 index price λ list and the new estimation of the accessible speculation sum (that is altered by the consequences of the venture technique). Given that the methodology comprises offering alternatives, for which the financial and accountant specialist gets a premium, the venture sum is accessible as a financial asset. This sum is put resources into an overnight store (or an edge store) paid by EONIA. Consequently, the aggregate return of the methodology in light of offering 1 month straddles is given by the risk free rate (EONIA), the alternative premiums and the outcome at development (the payout). A similar strategy is used for chokes and for structures with development of 6 months.

The following stride of the strategy comprises the examination of the different venture systems in light of various measures of risk and return: the annualized mean return, the cumulative return for the entire period, the annualized standard deviation and the annualized Sharpe ratio. The annualized mean return is registered by increasing the normal day-by-day

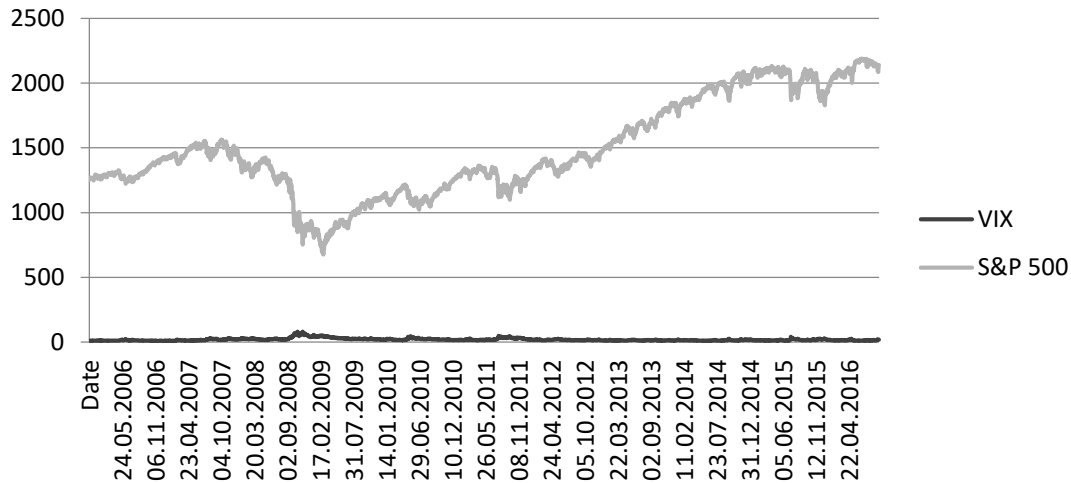


Figure 1. Evolution of S & P 500 index and implied volatility VIX

return with 252 (the quantity of business days in a year). The aggregate return for the whole time frame is gained by showing between the speculation sum toward the end of the period (November 8, 2016) and the venture sum toward the beginning of the period (December 8, 2005) to the venture sum toward the begin of the period. The annualized standard deviation is figured by duplicating the standard deviation of the day-by-day returns for the whole example with the annualized Sharpe ratio is gotten by showing the distinction between the annualized mean return of a particular procedure and the annualized mean return of the risk free rate (EONIA) to the annualized standard deviation of the contrast between the day-by-day venture technique returns and the day-by-day risk free returns.

$$SharpeRatio = \frac{r_s \cdot 252 - r_f \cdot 252}{\sigma_{r_s - r_f} \cdot \sqrt{252}}. \quad (5)$$

So as to check for the vigor of the speculation systems returns, I run an affectability investigation of the different measures of risk and come back to the progressions in implied volatility (VIX index).

For this reason, I rehash the strategy depicted above utilizing a suggested instability bring down with 5%, 10%, separately 15% than the one utilized as a part of the initial scenario.

2. RESULTS

Figure 1 and Table 1 show the advancements of S&P 500 list and its inferred unpredictability for the broke down period, together with their fundamental unmistakable insights. The S&P 500 file had a sideways advancement amid the initial segment of the example, times of monetary turmoil like those in 2000–2002, the money related emergency from 2007–2009 or Greek obligation emergency in 2011 rotating with times of financial recuperation and value rising. The last time frame is set apart by a supported uptrend filled particularly by assumptions with respect to the quantitative facilitating program keep running by the European Central Bank (Garefalakis et al., 2017).

It can be additionally seen as the unpredictable development of S&P 500 file, with a base estimation of around 700 and a most extreme of just about 2100. Another indicator that can be mentioned is that of the instability, tending to spike in times of emergency with falling stock costs. Both value/unpredictability arrangement and their day-by-day returns display asymmetric and leptokurtic appropriations, a norm for monetary information.

In Figures 2 and 3, there are introduced the advancements of inferred and acknowledged unpredictability, individually instability premium. For the dissected period, the suggested unpredictabil-

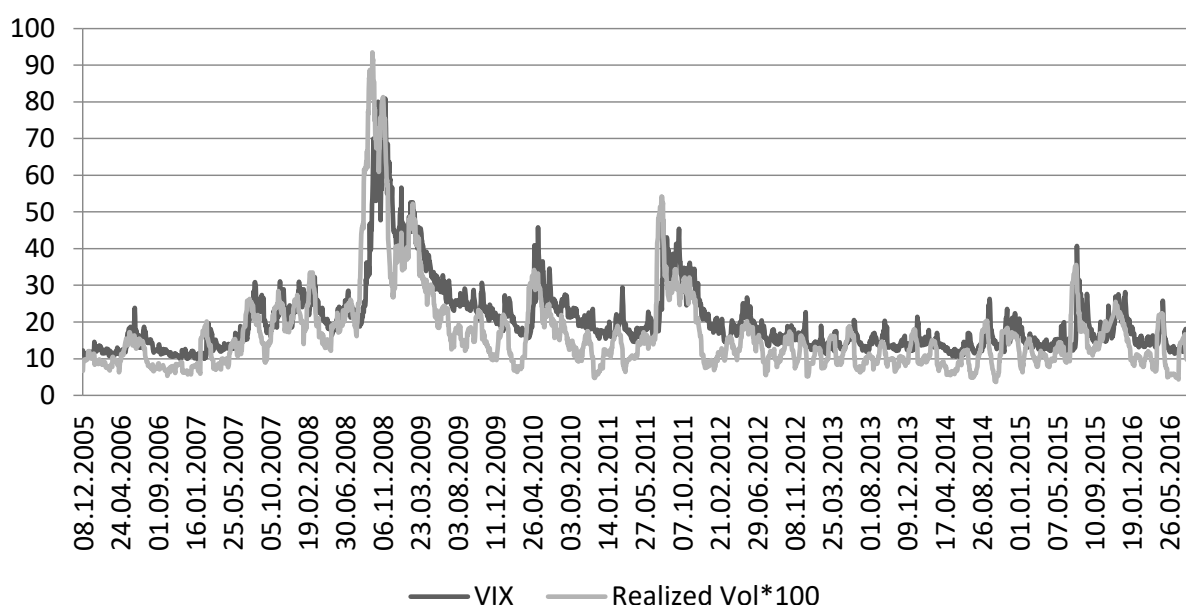
Table 1. Descriptive statistics

Descriptives	S&P 500 return	VIX return	S&P 500	VIX
Mean	0.000199	0.000133	1486.694	20.05202
Median	0.0007	-0.0053	1397.11	17.23
Maximum	0.1096	0.496	2190.15	80.86
Minimum	-0.0947	-0.3506	676.53	9.89
Std. Dev.	0.012764	0.073345	372.4707	9.586041
Skewness	-0.333955	0.713875	0.326063	2.386488
Kurtosis	13.55065	6.763419	2.100339	10.52203

ity is generally higher than the understood, the norm of this distinction being around 2.47 percent. This reality can be clarified by the request in abundance of the hedgers that are normally long stocks and need to purchase alternatives to cover their positions. The instability premium dives to negative qualities amid scenes of emergency, however, it recuperates quick over the long run average.

In Figure 4, there are delineated the developments of the outright and relative instability premium means. It can be seen that both information arrangements focus on a long-run balanced esteem, as more information focuses are mulled over. The long-run instability premium mean is around 2.47 percent, which implies 8.46% contrasted with the suggested unpredictability.

The following stride of the investigation comprises figuring the profits of the different speculation techniques. Table 2 shows the principle measures of risk and return used to think about the execution of the procedures: the annualized mean give back, the total return for the whole time frame, the annualized standard deviation and the annualized Sharpe ratio. The outcomes are combined for the interest in S&P 500 index, in overnight stores and in various systems in light of choices. The documentations in the table are the accompanying: 85-115 speak to the procedure in light of offering chokes with strikes that are 15% higher or lower than the spot, 90-110 speak to the system in view of offering chokes with strikes that are 10% higher or lower than the spot, 95-105 speak to the methodology in light of offering chokes with strikes that are 5% higher or lower than the spot, while

**Figure 2.** Evolution of implied volatility VIX and one month realized volatility

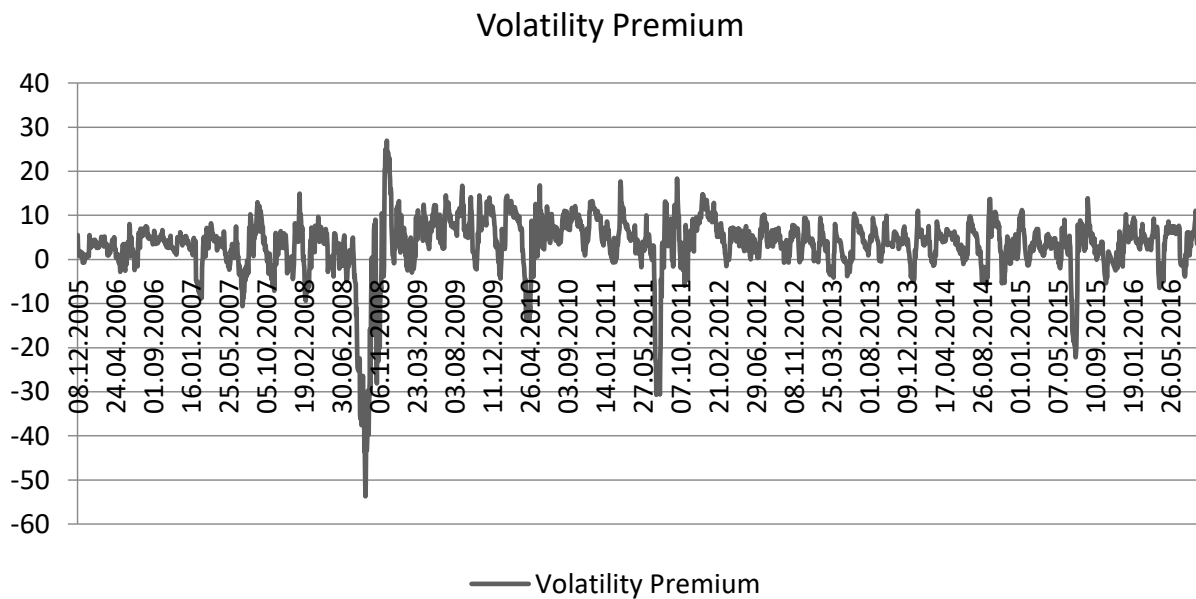


Figure 3. Evolution of 1 month volatility premium

100-100 speak to the technique of offering at-the-cash spot straddles. It can be noted that the most astounding returns (both the annualized mean return and the total return for the whole time frame) are gained on account of the methodology in view of offering straddles with developments of 6 months. The combined return of 45.04% of this procedure is more than 40% higher than the arrival amid the time of the interest in the benchmark indicator S&P 500 and more than 1.3 times

higher than the risk free investment in overnight deposits. Be that as it may, the most elevated annualized Sharpe ratio is acquired by the interest in offering strangles with strikes 5% higher or lower than the spot. In spite of the fact that the arrival of this system is smaller than the arrival of the straddles methodology, the risk is additionally much smaller, edging to an annualized Sharpe ratio of -0.98 . The procedure with the most minimal level of risk (barring the venture at the risk free rate) is

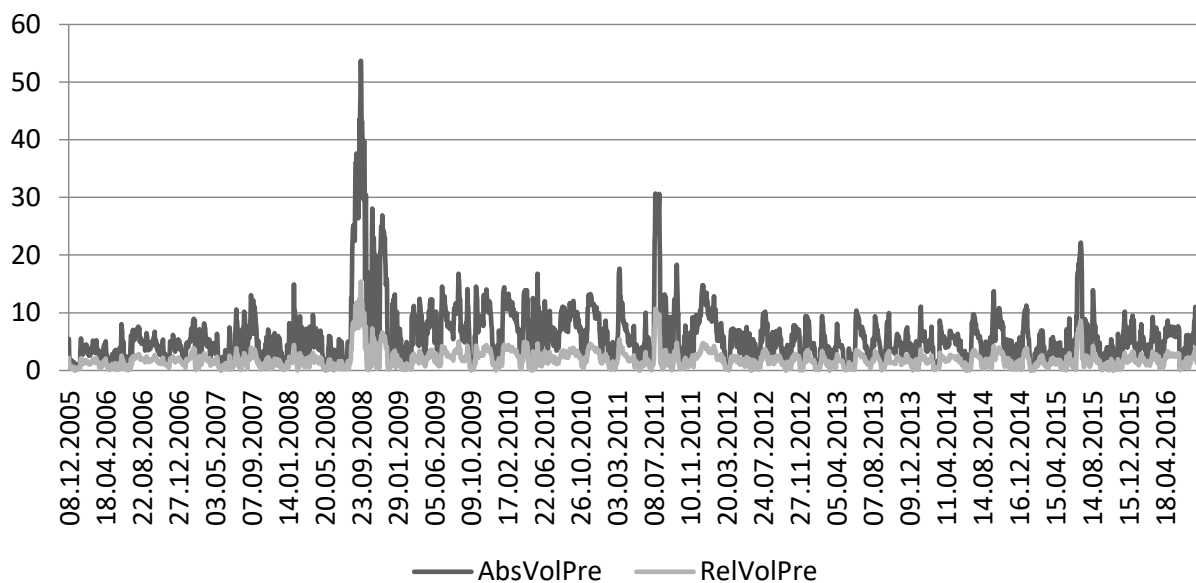


Figure 4. Evolution of absolute and relative volatility

Table 2. Measures of risk and return (6M option)

Volatility coefficient	Annualized mean return	Cumulative return	Annualized Std. Deviation	Annualized Sharpe ratio
S&P500	0.32%	38.46%	20.26%	-0.63
EONIA	21.24%	44.41%	25.75%	0.00
100-100	1.358%	45.16%	29.99%	-1.19
85-115	1.355%	45.04%	32.27%	-0.98
90-110	1.356%	45.08%	32.00%	-0.99
95-105	1.357%	45.12%	20.42%	-1.05

the one in view of offering straddles with strikes 15% higher or lower than the spot. The measures of return and Sharpe ratio decay as the development of the alternatives are expanded. Be that as it may, as far as Sharpe ratio, just the methodologies in view of 6 months straddles and 95-105% strangles exhibit worse results than the investment in the S&P 500 index. Abridging, the information in Table 2 demonstrates the prevalence of the alternative methodologies thought about over the interests in the benchmark S&P 500 index.

Figure 5 shows the developments in the estimation of the ventures in view of 6 months alternatives, together with the advancements in the estimation of the interests in S&P 500 index and in the risk free rate for examination purposes. It can be

seen that 3 out of 4 investments in view of alternatives are better than the S&P 500 index interest in combined return terms with less risk. The main choices based system that shows a somewhat bring down combined return toward the end of the period than the S&P 500 index is the 95-105% strangles strategy. Be that as it may, this methodology includes much less risk. In this way, by permitting influence, the methodology would display a higher give back that the benchmark still at a lower risk.

Figure 5 demonstrates the developments in the estimation of the speculations in view of 6 months choices, together with the advancements in the estimation of the interests in S&P 500 index and in the risk free rate for examination purposes. Every one of the alternatives based methodologies in-

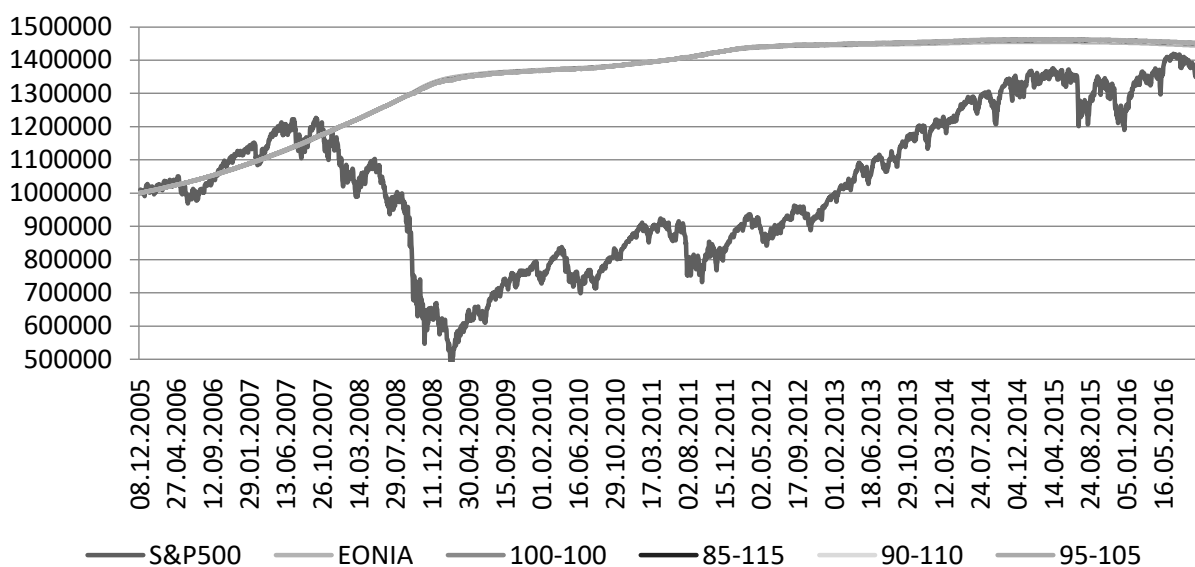
**Figure 5.** Evolution in the value of the investments based on 6M options

Table 3. Results of sensitivity analysis run for the 6M options based strategies

Sensitivity	100%					
Volatility coefficient	S&P500	EONIA	100-100	85-115	90-110	95-105
Annualized mean return	0.32%	21.24%	1.358%	1.355%	1.356%	1.357%
Cumulative return	38.46%	44.41%	45.16%	45.04%	45.08%	45.12%
Annualized St. Deviation	20.26%	25.75%	29.99%	32.27%	32.00%	20.42%
Annualized Sharpe ratio	-0.63	0.00	-1.19	-0.98	-0.99	-1.05
Sensitivity	95%					
Volatility coefficient	S&P500	EONIA	100-100	85-115	90-110	95-105
Annualized mean return	0.30%	21.24%	1.358%	1.355%	1.356%	1.357%
Cumulative return	37.69%	44.41%	45.16%	45.05%	45.09%	45.12%
Annualized St. Deviation	19.24%	25.75%	29.99%	32.26%	32.00%	20.42%
Annualized Sharpe ratio	-0.64	0.00	-1.19	-0.98	-0.99	-1.05
Sensitivity	90%					
Volatility coefficient	S&P500	EONIA	100-100	85-115	90-110	95-105
Annualized mean return	0.29%	21.24%	1.358%	1.355%	1.356%	1.357%
Cumulative return	36.77%	44.41%	45.16%	45.05%	45.09%	45.12%
Annualized St. Deviation	18.23%	25.75%	29.99%	32.25%	32.00%	20.42%
Annualized Sharpe ratio	-0.65	0.00	-1.19	-0.98	-0.99	-1.05
Sensitivity	85%					
Volatility coefficient	S&P500	EONIA	100-100	85-115	90-110	95-105
Annualized mean return	0.27%	21.24%	1.358%	1.355%	1.356%	1.357%
Cumulative return	35.71%	44.41%	45.16%	45.06%	45.09%	45.13%
Annualized St. Deviation	17.22%	25.75%	29.99%	32.24%	31.99%	20.42%
Annualized Sharpe ratio	-0.66	0.00	-1.19	-0.98	-0.99	-1.05

clude less risk than the interest in the benchmark S&P 500, however, the profits are lower.

So as to check for the strength of the speculation procedures returns, we run an affectability investigation of the different measures of risk and come back to the progressions in implied volatility (VIX). For this reason, we rehashed the approach depicted above utilizing an inferred unpredictability bring down with 5%, 10%, separately 15% than the one utilized as a part of the initial scenario (see Appendix, Figures 6 and 7).

In Table 3, there are combined the consequences of the affectability investigation keep running for the 6 months choices based techniques. So as to acquire lower volatilities than those in the underlying situation, I multiplied the VIX with a coefficient: 0.95 for volatilities 5% lower, 0.90 for volatilities 10% lower and 0.85 for volatilities 15% lower. These new volatilities were then used to register the alternatives' premiums and the

speculations come about. It can be noted that the choices based techniques give preferable Sharpe ratios over the S&P 500 index benchmark regardless of the possibility that the instability is 10% lower. Just when the volatilities get to be 15% lower contrasted with the underlying case, the S&P 500 index gives a superior Sharpe proportion. This outcome is steady with the perception that in the long run, the relative instability premium mean is 12.09%, an estimation somewhere around 10% and 15%.

In Table 3, there are integrated the aftereffects of the affectability investigation keep running for the 6 months choices based methodologies. By bringing down the suggested unpredictability, the choices based methodologies display lower Sharpe ratios than the benchmark, by and large negative, mostly as an aftereffect of the way that their profits turned out to be small, lower than the risk free return. Now and again, even the combined returns of these methodologies get to be negative.

CONCLUSION

Keeping in mind the end goal to enhance the risk of balanced execution of their accounting and finance portfolios, speculators try to broaden by including new resources, new sorts of money related instruments or even new resource classes. Like wares, volatility emerged as a distinct asset class included the venture portfolios particularly by speculative hedge funds. In this paper, we examined the volatility premium of S&P 500 index options and thought about different investment strategies in view of offering straddles and chokes utilizing diverse measures of risk and return. The venture procedures that are examined comprise day by day offering a number of straddles, respectively, strangles, having a similar development. There are isolated developments of 6-month period investigation. Subsequently, there are investigated isolate elective speculations: alternative structures (1 straddle and 3 chokes) for 1 development (6 months). The different venture techniques were studied in light of various accounting and financial measures of risk and return: the annualized mean return, the aggregate return for the whole time frame, the annualized standard deviation and the annualized Sharpe ratio. The outcomes demonstrate that the instability premium is merging to a positive long run value of 2.74 percent and procedures in view of offering alternative structures outperform the benchmark interest in the S&P 500 index. The most elevated returns (both the annualized mean return and the total return for the whole time frame) are gained on account of the procedure in light of offering straddles with developments of 1 month. The cumulative return of this technique is more than 4 times higher than the arrival for the time of the interest in the benchmark index S&P 500 and more than 10 times higher than the risk free interest in overnight stores. Likewise, the annualized Sharpe ratio is 1.32, essentially higher than the Sharpe ratio of the S&P 500 index. Keeping in mind the end goal to check for the strength of the speculation systems returns, we run an affectability examination of the different measures of risk and come back to the progressions in implied volatility (VIX). For this reason, we rehashed the procedure utilizing an inferred instability bring down with 5%, 10%, separately 15% than the one utilized as a part of the underlying situation. The methodologies in view of offering 1 month choices gave preferable Sharpe ratios over the S&P 500 index benchmark regardless of the possibility that the unpredictability is 10% lower.

The outcomes demonstrate that the speculation techniques used to catch the volatility premium through selling options structures such as straddles and strangles give higher exhibitions contrasted with the S&P 500 benchmark index. The study is valuable for the speculators attempting to enhance the execution of their portfolios by including new resource classes.

In any case, there are various further upgrades that can be made to this study. For instance, with a specific end goal to process the development of the day-by-day venture esteem, there are considered only the underlying premiums of the choices and the payout at development. Actually, the estimation of the alternatives changes every day and for more precise results a day-by-day revaluation of the choices qualities is fundamental. This won't affect the cumulative return for the whole time frame, yet it will affect the risk of the investment.

REFERENCES

1. Avellaneda, M., Zhu, Y. (1998). A risk-neutral stochastic volatility model. *International Journal of Theoretical and Applied Finance*, 1, 289-310. <https://doi.org/10.1142/S0219024998000163>
2. Baele, L., Driessen, J., Londono, J. M., Spalt, O. G. (2014). *Cumulative prospect theory and the variance premium* (Unpublished working paper). Tilburg University. <http://dx.doi.org/10.2139/ssrn.2564498>
3. Bakshi, G., & Kapadia, N. (2003a). Delta-Hedged Gains and the Negative Market Volatility Risk Premium. *Review of Financial Studies*, 16, 527-566. <https://doi.org/10.1093/rfs/hhg002>
4. Bakshi, G., Kapadia, N. (2003c). Volatility risk premium embedded in individual equity options: some new insights. *Journal of Derivatives*, 11, 45-54. <https://doi.org/10.3905/jod.2003.319210>
5. Birkelund, O. H., Haugom, E., Molnár, P., Opdal, M., & Westgaard, S. (2015). A

- comparison of implied and realized volatility in the Nordic power forward market. *Energy Economics*, 48, 288-294. <https://doi.org/10.1016/j.eneco.2014.12.021>
6. Black, F., & Scholes, M. (1973). The Pricing of Options and Corporate Liabilities. *Journal of Political Economy*, 81(3), 637-654. <https://doi.org/10.1086/260062>
 7. Bollerslev, T., Tauchen, G., Zhou, H. (2009). Expected stock returns and variance risk premia. *Review of Financial Studies*, 22, 4463-4492. <https://doi.org/10.1093/rfs/hhp008>
 8. Buraschi, A., & Jackwerth, J. (2001). The Price of a Smile: Hedging and Spanning in Option Markets. *Review of Financial Studies*, 14, 495-527. <https://doi.org/10.1093/rfs/14.2.495>
 9. Carr, P., Wu, L. (2006). A tale of two indices. *Journal of Derivatives*, 13, 13-29. <https://doi.org/10.3905/jod.2006.616865>
 10. Carr, P., & Wu, L. (2009). Variance Risk Premiums. *Review of Financial Studies*, 22(3), 1311-1341. <https://doi.org/10.1093/rfs/hhn038>
 11. Christensen, B. J., & Prabhala, N. R. (1998). The relation between implied and realized volatility. *Journal of Financial Economics*, 50(2), 125-150. [https://doi.org/10.1016/S0304-405X\(98\)00034-8](https://doi.org/10.1016/S0304-405X(98)00034-8)
 12. Coval, J. D., & Shumway, T. (2001). Expected Option Returns. *The Journal of Finance*, 56(3), 983-1009. <https://doi.org/10.1111/0022-1082.00352>
 13. Daglish, T., Hull, J., Suo, W. (2007). Volatility surfaces: theory, rules of thumb, and empirical evidence. *Quantitative Finance*, 7, 507-524. <http://dx.doi.org/10.1080/14697680601087883>
 14. Drechsler, I., Yaron, A. (2011). What's vol got to do with it. *Review of Financial Studies*, 24, 1-45. <https://doi.org/10.1093/rfs/hhq085>
 15. Driessen, J., & Maenhout, P. (2013). The world price of jump and volatility risk. *Journal of Banking & Finance*, 37(2), 518-536. <https://doi.org/10.1016/j.jbankfin.2012.09.008>
 16. Egloff, D., Leippold, M., Wu, L. (2010). The term structure of variance swap rates and optimal variance swap investments. *Journal of Financial and Quantitative Analysis*, 45, 1279-1310. <https://doi.org/10.1017/S0022109010000463>
 17. Engle, R., Figlewski, S. (2015). Modeling the dynamics of correlations among implied volatilities. *Review of Finance*, 19, 991-1018. <https://doi.org/10.1093/rof/rfu024>
 18. Eraker, B. (2009). *The volatility premium* (Technical report, Working paper).
 19. Fengler, M. R. (2005). *Semiparametric Modeling of Implied Volatility*. Springer-Verlag, Berlin.
 20. Garefalakis, A., Dimitras, A., Koemtzipoulos, D., Spinthiropoulos, K. (2011). Determinants factors of Hong Kong stock market. *International Research Journal of Finance and Economics*, 62, 50-60. Retrieved from <https://ssrn.com/abstract=2200671>
 21. Garefalakis, A., Mantalis, G., Lemonakis, C., Spinthiropoulos, K., (2016a). Determinants of profitability in aviation industry of Europe and America. *International Journal of Supply Chain Management*, 5(2), 131-137. Retrieved from <http://www.ojs.excelingtech.co.uk/index.php/IJSCM/article/viewFile/1189/pdf>
 22. Garefalakis, A., Mantalis, G., Vourgourakis, E., Spinthiropoulos, K., & Lemonakis, C., (2016b). Healthcare Firms and the ERP Systems. *Journal of Engineering Science and Technology Review*, 9(1), 139-144. Retrieved from <http://jestr.org/downloads/Volume9Issue1/fulltext91212016.pdf>
 23. Garefalakis A., Dimitras, A., Lemonakis, C. (2017). The effect of Corporate Governance Information (CGI) on Banks' reporting performance. *Investment Management and Financial Innovations (IMFI)*, 14(2), 63-70. Retrieved from <https://businessperspectives.org/journals/investment-management-and-financial-innovations/issue-251/the-effect-of-corporate-governance-information-cgi-on-banks-reporting-performance>
 24. Heath, D., Jarrow, R., Morton, A. (1992). Bond pricing and the term structure of interest rates: a new technology for contingent claims valuation. *Econometrica*, 60, 77-105. Retrieved from <http://www.jstor.org/stable/2951677>
 25. Hodges, H. M. (1996). Arbitrage bounds of the implied volatility strike and term structures of European-style options. *Journal of Derivatives*, 3, 23-32. <https://doi.org/10.3905/jod.1996.407950>
 26. Jiang, G., Tian, Y. (2005). Model-free implied volatility and its information content. *Review of Financial Studies*, 18, 1305-1342. <https://doi.org/10.1093/rfs/hhi027>
 27. Jones, C. (2001). A Nonlinear Factor Analysis of S&P 500 Index Option Returns? Manuscript, University of Rochester. <http://dx.doi.org/10.2139/ssrn.275892>
 28. Ledoit, O., Santa-Clara, P. (1998). Relative pricing of options with stochastic volatility (Unpublished working paper). University of California, Los Angeles. <http://dx.doi.org/10.2139/ssrn.121257>
 29. Lemonakis, C., Vassakis, K., Garefalakis, A., Papa, P. (2016). SMEs performance and subsidies in it investments: A vis-à-vis approach. *Journal of Theoretical and Applied Information Technology*, 87(2), 266-275. Retrieved from <http://www.jatit.org/volumes/Vol87No2/12Vol87No2.pdf>
 30. Merton, R. C. (1973). Theory of Rational Option Pricing. *The Bell Journal of Economics and Management Science*, 4(1), 141. <https://doi.org/10.2307/3003143>
 31. Mueller, P., Vedolin, A., Yen, Y.-M. (2012). *Bond variance risk premia* (Working paper). London School of Economics. Retrieved

- from <http://www.lse.ac.uk/fmg/workingPapers/discussionPapers/fmgdps/dp699.pdf>
32. Pan, J. (2002). The Jump-Risk Premia Implicit in Options: Evidence from an Integrated Time-Series Study? *Journal of Financial Economics*, 63, 3-50. [https://doi.org/10.1016/S0304-405X\(01\)00088-5](https://doi.org/10.1016/S0304-405X(01)00088-5)
 33. Schonbucher, P. J. (1999). A market model for stochastic implied volatility. *Philosophical Transactions: Mathematical, Physical and Engineering Sciences*, 357, 2071-2092. <https://doi.org/10.1098/rsta.1999.0418>
 34. Trolle, A. B., Schwartz, E. S., Balbas, A., Brennan, M., Cartea, A., Crouhy, M., Tjur, T. (n.d.). Variance risk premia in energy commodities. <https://doi.org/10.3905/jod.2010.17.3.015>
 35. Zhang, B. Y., Zhou, H., Zhu, H. (2009). Explaining credit default swap spreads with the equity volatility and jump risks of individual firms. *Review of Financial Studies*, 22, 5099-5131. <https://doi.org/10.1093/rfs/hhp004>

APPENDIX

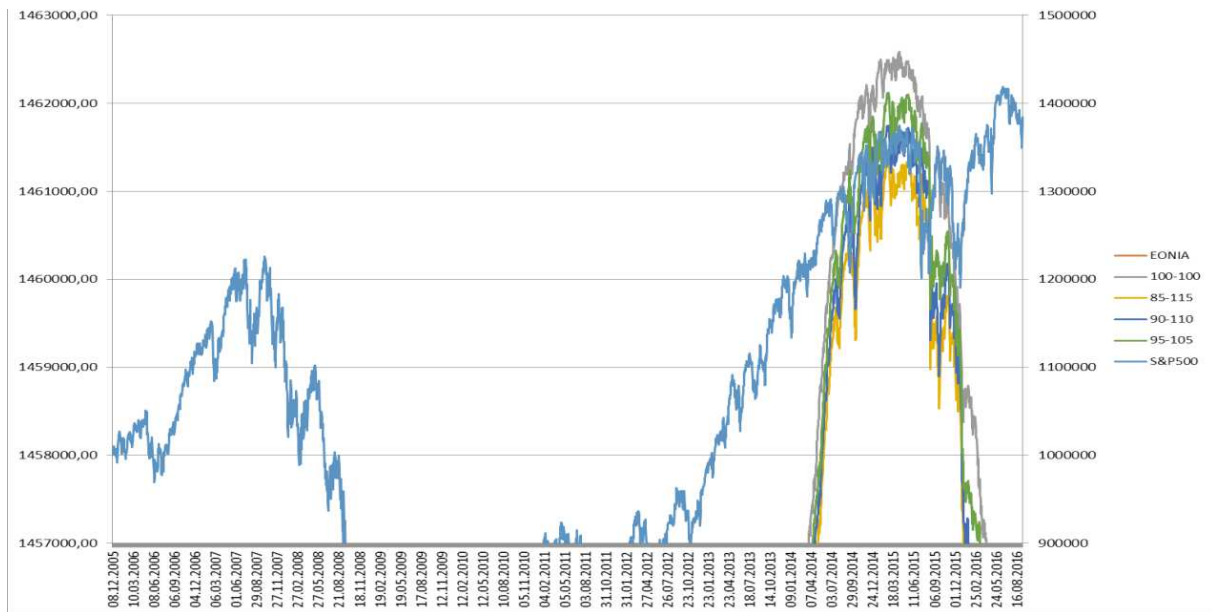


Figure 6. Implied volatility (VIX) scenario for all coefficients

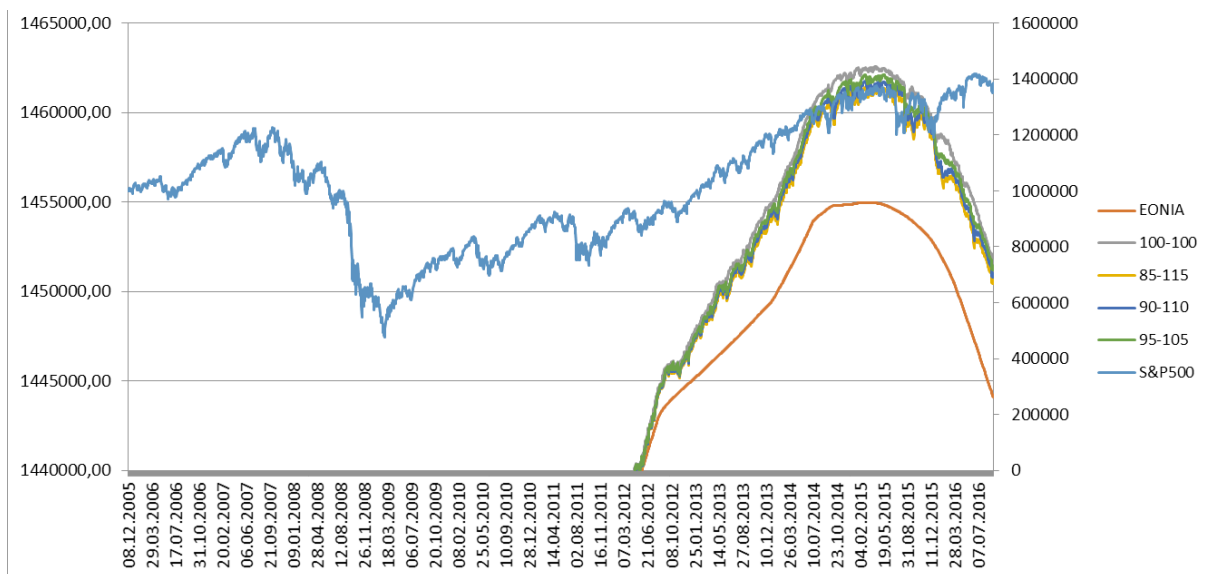


Figure 7. Implied volatility (VIX) as a part of the initial scenario for all volatility coefficients