

# The Intraday Option Information and Stock Return Predictability

I FAN CHIANG

27 April 2019

## Abstract

The Intraday IVS contains certain information about intraday stock  
return.

## 1 Introduction

It has been a fierce debate that the trading information from derivative markets lead the underlying markets. Prior studies hold different arguments toward this topic. Relevant papers, like Manaster and Rendleman Jr (1982), Anthony (1988), Chakravarty, Gulen, and Mayhew (2004), Cremers and Weinbaum (2010), Xing, Zhang, and Zhao (2010) have found that the information from option market take the lead of the information from stock market. When informed traders recieved private information, they prefer to trade in option market since there are several advatanges compare with the other one, like fewer limitation in trading, no short-sell constraint and high leverage properties<sup>1</sup>. While, other studies like Chan, Chung, and Johnson (1993), Stephan and Whaley (1990) find no evidence that option prices can be ahead of stock prices.

Based on the call and put implied volatilty spread(CPIV) propped by Cremers and Weinbaum (2010), we refine this approach and derive an intraday version which

---

<sup>1</sup>Black 1975; Fleming, Ostdiek, and Whaley 1996.

tells the predictability power toward future index returns within a single trading day. Within a single day, we would like to see whether the predictability power is stronger in open period, middle period or close period. Therefore, we partition a single day to 14 intervals, and each intervals we only include 5 minutes long in case the Put-Call parity would be unbalanced due to major difference between the underlying price( $S$ ) in call and put options.

The remainder of paper is organized as follows. In Section 2 we describe our research hypothesis, In Section 3, we describe our methodology and data. Section 4 presents the main empirical results on quote data on predicting index returns. Section 5 provides the results are robust to trade data given the identical sample period. Section 6 concludes.

## 2 Hypothesis Development

## 3 Data and Empirical Methodology

### 3.1 Deviation From Put-Call Parity

The put-call parity relations derived from Stoll (1969) is a classical options pricing concepts in finance. It characterized the relationship that must exist between European put and call options with the identical underlying asset, expiration and strike prices. The equation must hold for European options on no-dividends paying underlying in a perfect market.

$$C - P = S - PV(K) \tag{1}$$

Where  $C$  and  $P$  represent call prices and put prices, and  $S$  is Stock price. With same maturity and exercise price  $K$ , the arbitrage opportunity would exist if the equation is not hold. The Black and Scholes (1973) formula satisfies the put-call parity for

any assumed value of the volatility parameter  $\sigma$ , therefore,

$$C^{BS}(\sigma) + PV(K) = P^{BS}(\sigma) + S \quad (2)$$

where  $C^{BS}(\sigma)$  and  $P^{BS}(\sigma)$  indicate Black-Scholes call and put prices, respectively.

Combine the above equation, we can derive the equation

$$C^{BS}(\sigma) - C = P^{BS}(\sigma) - P \quad (3)$$

which implies that the implied volatility of call option and put option should be the same if all equation holds.

$$IV^{call} = IV^{put} \quad (4)$$

Of course the equation may not be hold once the option is American-style. However, our primary studies on SPX option is European style. Therefore, we do not need to consider the dividend payment or early exercise case in our further research.

Clearly, the larger implied volatilities are the higher the call or put option prices claim. Following Amin, Coval, and Seyhun (2004), we refer to the difference between call and put implied volatilities as the call-put implied volatility spread(CPIV). It is suggested that a positive(negative) CPIV could be viewed as a bullish(bearish) signal regarding the underlying stock.

The aggregate Intraday CPIV are construed as following steps:

1. We first divided a single day into 14 of 5-minutes interval. Each interval contains the tick data from 2.5 minutes ahead and behind. For example, the 9 a.m. interval, we collect valid data from 08:47:30 to 09:32:30 to represent this interval. As for open(close) interval, we choose to accumulate the full 5 minutes data behind(ahead)<sup>2</sup>

---

<sup>2</sup>We collect the whole transaction data in 5 minutes for trade data. However, the size of quote data is extremely unbalanced in different intervals, we restricted 1000 to 2000 quotes as maximum

2. Similar to Xing, Zhang, and Zhao (2010), in each interval, we eliminate an option from the sample if its time to expiration is less than 10 days or more than a year, if its open interest is negative, if its moneyness<sup>3</sup> is smaller than 0.9 or more than 1.1. Furthermore, the option quotes must not violate basic no-arbitrage relations.
3. Then, in each time interval, there must be several valid option pairs with identical maturity(T) and exercise price(K). For each option pair we choose only one pair to be the representative. For quote data, we choose the mean of best bid( $\beta^*$ ) best offer( $\alpha^*$ ) as the chosen call and put price. For trade data, we capture the transaction that is closet to the centering time.
4. After collecting several time interval valid option pairs. we calculated the CPIV by applying,

$$CPIV_t = IV_t^{call} - IV_t^{put} = \sum_{j=1}^{N_t} w_{j,t} (IV_{j,t}^{call} - IV_{j,t}^{put}) \quad (5)$$

$CPIV_t$  denotes the implied volatility spread on interval t;  $IV_{j,t}$  describe the B-S implied volatility, where the j refers to valid pairs of put and call options;  $w_{j,t}$  are weights, there are  $N_t$  valid pairs of option on interval t.

In our study, the amount of intraday CPIV should be  $38668(14Intervals * 2762Days)$ . However, most of the quotes are short date contract(less than 10 days) in the middle of month so that we have mutiple missing values by this approach.

## 3.2 Data

In our analysis, the primary quote and trade intraday data for SPX option originates from CBOE MDR. The sample period studied is from January 2007 to December 2017. The option data includes trade date, trade time, expiration date, put-call code, exercise price, maturities, bid price, ask price, underlying price. The size of

---

for call and put in collecting quote data.

<sup>3</sup>Moneyness is defined as the ratio of the strike price to the stock price.

the sample data is about 1-TB around and the amount is about 1 billion. After we exclude the tick data fall outside the 5-minutes intervals, it remains about 40 million. Furthermore, we follow the approach from Ofek, Richardson, and Whitelaw (2004) to exclude the invalid option pairs. Finally, we have 1,692,542 valid volatility spreads for SPX option from January 2007 to December 2017.

Following the prior studies Bollerslev, Tauchen, and Zhou (2009), several macroeconomic variable are suggested to be crucial and informative with regard to future returns. Specifically, we collect data of the default spread(between Moody’s BAA and AAA corporate bond spreads), the term spread(between the 10-year T-Bond and 3-month T-bill yields) <sup>4</sup> as control variables in our regression analysis. The daily price of S& P 500 index is obtained from Bloomberg. The zero-coupon bond (ZCB) rate represent risk-free rate in B-S formula are collected from WRDS with different duration.

Table 1 contains descriptive statistics on the volatility spread.

### 3.3 Figure

1stock trading volume, and stock returns data are taken from CRSP for the construction of control measures.

### 3.4 Variable Definitions

All measures using implied volatility are calculated using all options with 90 or fewer days to expiration. Following Cremers and Weinbaum (2010), CPIV is the open interest-weighted call implied volatility less open interest weighted put implied volatility. CPIV STD is the standard deviation of CPIV over the past 20 days. IV is the open interest-weighted implied volatility. ME is stock price multiplied by the number of shares outstanding at the end of the measurement period and

---

<sup>4</sup>The daily data are collected from the public website of the Federal Reserve Bank of St. Louis.

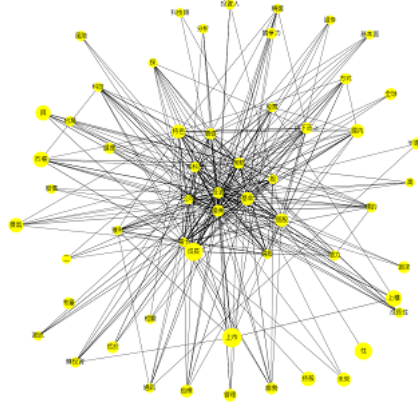


Figure 1: Network of words

is reported in billions. Return is the daily, weekly, or monthly return on the day, week, or month, respectively, following CPIV measurement. Reversal is return in the calendar month prior to CPIV measurement. Momentum is the cumulative return in calendar months in brackets relative to the date of CPIV measurement. Turnover is monthly volume divided by the number of shares outstanding over calendar months prior to CPIV measurement with months designated in brackets. Illiquidity is the illiquidity measure of Amihud (2002), the absolute value of the return divided by the dollar trading volume averaged over calendar days prior to CPIV measurement, with days designated in brackets.

### 3.5 Descriptive Statistics

This table presents descriptive statistics for xxxx.

Table 1: Multivariate Regressions of SPX Return on IVS and Controls -2

	12:00	12:30	13:00	13:30	14:00	14:30	15:00
Intercept	0.00	0.00	0.00	0.00	0.00	0.00	0.00
	-0.19	(-0.33)	-0.84	-0.50	-0.16	-0.35	-0.09
IVS	-0.03	-0.05	0.03	0.01	-0.01	0.00	-0.04
	(-1.08)	(-1.97)***	-0.87	-0.19	(-0.32)	(-0.02)	(-0.81)
DDEF	0.00	0.00	0.00	0.00	0.00	0.00	0.00
	(-0.82)	(-0.97)	(-0.55)	(-0.86)	(-0.68)	(-0.74)	(-1.01)
DTERM	0.00	0.00	0.00	0.00	0.00	0.00	0.00
	-0.54	-0.96	-0.99	-1.21	-1.02	-1.10	-1.14
lag_return	-0.10	-0.10	-0.10	-0.10	-0.10	-0.11	-0.10
	(-3.13)***	(-3.04)***	(-3.07)***	(-3.01)***	(-2.89)***	(-3.26)***	(-3.23)***
Adj Rsquare(%)	1.24	1.99	1.25	1.14	1.02	1.27	1.36

---

## References

- Amin, Kaushik, Joshua D Coval, and H Nejat Seyhun (2004). “Index option prices and stock market momentum”. In: *The Journal of Business* 77.4, pp. 835–874.
- Anthony, Joseph H (1988). “The interrelation of stock and options market trading-volume data”. In: *The Journal of Finance* 43.4, pp. 949–964.
- Black, Fischer (1975). “Fact and fantasy in the use of options”. In: *Financial Analysts Journal* 31.4, pp. 36–41.
- Black, Fischer and Myron Scholes (1973). “The pricing of options and corporate liabilities”. In: *Journal of political economy* 81.3, pp. 637–654.
- Bollerslev, Tim, George Tauchen, and Hao Zhou (2009). “Expected stock returns and variance risk premia”. In: *The Review of Financial Studies* 22.11, pp. 4463–4492.
- Chakravarty, Sugato, Huseyin Gulen, and Stewart Mayhew (2004). “Informed trading in stock and option markets”. In: *The Journal of Finance* 59.3, pp. 1235–1257.
- Chan, Kalok, Y Peter Chung, and Herb Johnson (1993). “Why option prices lag stock prices: A trading-based explanation”. In: *The Journal of Finance* 48.5, pp. 1957–1967.

- Cremers, Martijn and David Weinbaum (2010). “Deviations from put-call parity and stock return predictability”. In: *Journal of Financial and Quantitative Analysis* 45.2, pp. 335–367.
- Fleming, Jeff, Barbara Ostdiek, and Robert E Whaley (1996). “Trading costs and the relative rates of price discovery in stock, futures, and option markets”. In: *Journal of Futures Markets: Futures, Options, and Other Derivative Products* 16.4, pp. 353–387.
- Manaster, Steven and Richard J Rendleman Jr (1982). “Option prices as predictors of equilibrium stock prices”. In: *The Journal of Finance* 37.4, pp. 1043–1057.
- Ofek, Eli, Matthew Richardson, and Robert F Whitelaw (2004). “Limited arbitrage and short sales restrictions: Evidence from the options markets”. In: *Journal of Financial Economics* 74.2, pp. 305–342.
- Stephan, Jens A and Robert E Whaley (1990). “Intraday price change and trading volume relations in the stock and stock option markets”. In: *The Journal of Finance* 45.1, pp. 191–220.
- Stoll, Hans R (1969). “The relationship between put and call option prices”. In: *The Journal of Finance* 24.5, pp. 801–824.
- Xing, Yuhang, Xiaoyan Zhang, and Rui Zhao (2010). “What does the individual option volatility smirk tell us about future equity returns?” In: *Journal of Financial and Quantitative Analysis* 45.3, pp. 641–662.