For Favour of Posting

THE CHINESE UNIVERSITY OF HONG KONG

Department of Statistics

will present a seminar entitled

The Smirk in the S&P500 Futures Options Prices: A Linearized Factor Analysis

by

Professor Andrew Carverhill
Department of Economics and Finance, University of Hong Kong

on

Friday, 10 November 2006
11:00am – 12:00 noon

in

Lady Shaw Building C2
The Chinese University of Hong Kong

Abstract:

We construct portfolios of S&P500 futures and their associated options, which are Delta (price) and Vega (volatility) neutral. These systematically earn negative excess returns, and suggest that out of the money puts are too expensive, relative to out of the money calls, consistent with an intuitive interpretation of the options smirk. We give evidence that these negative returns are not a payment for insurance against a market crash.

We then isolate a third ``smirk" factor. This is diffusive in nature, and hedging also against this, there are no residual excess returns, and the risk premium on this factor accounts for the smirk. The smirk factor is related to the small firm effect and is useful for hedging portfolios of index options.

This is a joint work with Dr. Terry H.F. Cheuk, Citigroup, Sigurd Dyrting, Deutsche Bank

All are Welcome