Accepted Manuscript

The Risk Premium that Never Was: A Fair Value Explanation of the Volatility Spread

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PII: \$0377-2217(17)30301-6 DOI: 10.1016/j.ejor.2017.03.070

Reference: EOR 14354

To appear in: European Journal of Operational Research

Received date: 9 March 2016 Revised date: 24 March 2017 Accepted date: 28 March 2017



Please cite this article as: Richard J. McGee, Frank McGroarty, The Risk Premium that Never Was: A Fair Value Explanation of the Volatility Spread, *European Journal of Operational Research* (2017), doi: 10.1016/j.ejor.2017.03.070

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Highlights

- We use a new framework to examine the economic importance of the volatility spread.
- Tail events incur high costs in volatility arbitrage.
- Adding the volatility spread reduces the impact of tail events.
- Removing the volatility spread yields no long term return premium.



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