

Trend in idiosyncratic volatility: Role of market structure and correlation measurement

Michal Svaton

Department of Banking and Finance, UZH

Abstract:

We reexamine the evolution of idiosyncratic volatility of US firms between 1962 and 2016. We find that the trend prior to 1997 documented in other studies is driven by different characteristics of newly listed firms, but the subsequent reversal is not. The reversal is caused by an underestimation of correlations in the earlier period due to measurement errors of illiquid stocks. The main driver of the trend is higher variance of new stocks, which drives up both the idiosyncratic volatility, and the systemic components. The trend in the systemic risk is attenuated by a decreasing market concentration before 1997.