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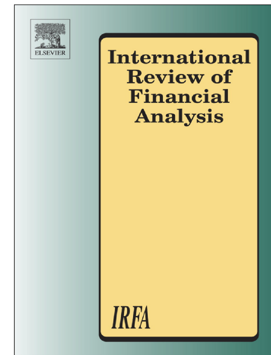


# Risk perception in financial markets: On the flip side

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PII: S1057-5219(18)30174-1
DOI: doi:10.1016/j.irfa.2018.03.005
Reference: FINANA 1202

To appear in: *International Review of Financial Analysis*

Received date: 3 June 2017
Revised date: 3 March 2018
Accepted date: 14 March 2018

Please cite this article as: Stelios Bekiros, Mouna Jlassi, Kamel Naoui, Gazi S. Uddin , Risk perception in financial markets: On the flip side. The address for the corresponding author was captured as affiliation for all authors. Please check if appropriate. Finana(2017), doi:10.1016/j.irfa.2018.03.005

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# RISK PERCEPTION IN FINANCIAL MARKETS: ON THE FLIP SIDE

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**ABSTRACT**

We propose an alternative approach to capture the asymmetric risk-return relationship in financial markets using affective cognitive analysis. Implied volatility is employed as a robust gauge of risk perception. Markets exhibit a dramatic increase in fear sentiment when extreme upper-quantile losses hit investors while conditional positive returns fuel exuberance. However, an inverse response is observed in Asian markets due to normative societal phenomena, such as herding. A cognitive paradigm provides with a better interpretation of contagion than classical leverage-feedback theories as risk perception evolves dynamically over time. Overall, the fear of losses is not the flip side of gains' exuberance.

*JEL classification:* G1; G14; G15; C5
*Keywords:* fear gauge; affective reaction; herding; implied volatility; behavioral bias

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We are grateful to faculty members of the Athens University of Economics and Business (AUEB) and Linköping University, as well as seminar participants at other institutions for helpful discussions. Gazi Salah Uddin is thankful for the financial support provided by the Jan Wallander and Tom Hedelius Foundation. Stelios Bekiros acknowledges financial support from the following programs, namely DRASH I-EP-2601-01 and Original Scientific Publications-EP-2658-01, funded by the AUEB. We particularly thank Ali Ahmed, Lutfur Rahman and Tapan Mahmud for valuable comments. The usual disclaimer applies.

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