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# Public News Arrival and the Idiosyncratic Volatility Puzzle<sup>☆</sup>

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## Abstract

This paper analyzes the effects of news and its sentiment on the idiosyncratic volatility (IVOL) – expected return relation. We postulate that the perceived negative IVOL-expected return relation could be the artifact of the confounding effect of public news arrivals. Using the stock return data from the Center for Research in Security Prices (CRSP) database and the news database from the RavenPack News Analytics over the period from 2000 to 2011, we show that the strength of the positive relation is reduced systematically by 50 per cent after accounting for the arrivals of good and bad news releases, which are defined by their sentiment scores. This finding is robust to numerous model specifications, and the inclusion of firm-level characteristics, liquidity risk and information risk. When we restrict the firm-specific news to value-relevant news, the positive relation disappears. We conclude that the public arrivals of firm-specific news play a significant role in explaining the IVOL puzzle.

*Keywords:* Idiosyncratic Volatility, Cross-sectional Returns, Public Information Arrival, News Sentiment

*JEL Codes:* G12, G14

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<sup>☆</sup>Abbreviations defined in this paper: Center for Research in Security Prices (CRSP), Mixture of Distribution Hypothesis (MDH), Exponential GARCH (EGARCH), New York Stock Exchange (NYSE) and American Stock Exchange (AMEX).

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