

**Title:**

Does sentiment drive the market?

**Abstract:**

A growing literature shows a predictability of stock returns based on sentiment proxies. More recently, it has been shown that also variables implied from single stock options markets carry predictive content for future equity returns. Where does this predictability stem from? Is it firm-specific information advantage or is it a firm-specific sentiment that is implemented in terms of option-based strategies and thus leads to return predictability?

In this work, we aim at answering this question. We distill sentiment from NASDAQ

news articles and examine the various sources of predictive power. We find that options markets react

to sentiment from NASDAQ articles in that higher implied volatility, higher out-of-the-money put prices and stronger smirk can be observed as more negative articles being posted which constitutes more negative sentiment. Next we inspect return predictability. We find that options variables indeed predict stock returns, yet sentiment variables, in particular, our index sentiment remains a highly relevant factor for individual stock returns. Firm specific-sentiment becomes weaker after controlling for information implied in options. We conclude that the predictability of options markets cannot exclusively be attributed to information asymmetry but also to sentiment.