Research Working Papers

Risk-On/Risk-Off: Measuring Shifts in Investor Sentiment

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A new high-frequency measure of investor sentiment outperforms similar measures in forecasting investment activity in emerging markets.

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This paper defines risk-on risk-off (RORO), an elusive terminology in pervasive use, as the variation in global investor risk taking behavior. Our high-frequency RORO index captures time-varying investor risk appetite across multiple dimensions: advanced economy credit risk, equity market volatility, funding conditions, and currency dynamics. The index exhibits risk-off skewness and pronounced fat tails, suggesting its amplifying potential for extreme, destabilizing events. Compared with the ubiquitous VIX measure, the RORO index reflects the multifaceted nature of risk, underscoring the diverse provenance of investor behavior. Practical applications of the RORO index highlight its valuable role in understanding international portfolio reallocation and return predictability.

JEL Classifications: F21, F36, F65, G11, G12, G15, G23

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Article Citations

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Related Research

- Miranda-Agrippino, Silvia, and Hélène Rey. 2022. "The Global Financial Cycle." In *Handbook of International Economics*, edited by Gita Gopinath, Elhanan Helpman, and Kenneth Rogoff vol. 6, pp. 1–43. Elsevier. Available at https://doi.org/10.1016/bs.hesint.2022.02.008

- Bekaert, Geert, Eric C. Engstrom, and Nancy R. Xu. 2022. "The Time Variation in Risk Appetite and Uncertainty." *Management Science*, vol. 68, no. 6, pp. 3975–4004.

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