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What drives idiosyncratic volatility over time?

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Abstract We document the patterns of market-wide and firm-specific volatility in the Portuguese stock market over the 1991–2005 period and test several explanations for the behavior of firm-level idiosyncratic volatility. Unlike previous studies we find no evidence of a statistically significant rise in firm-specific volatility. On the contrary, the ratio of firm-specific risk to total risk slightly decreases. We show that this result stems from new listings of large privatized companies that display lower firm-specific risk. Our findings are consistent with the idea that changes in idiosyncratic volatility are related to changes in the composition of the market.

Keywords Idiosyncratic volatility · Firm-specific risk · Volatility components

JEL Classification G15

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