# Journal Article

## Deep Learning from Implied Volatility Surfaces

November 1, 2026

Can machine learning uncover new information about future stock returns from options markets? In this paper, the authors apply deep learning techniques from image recognition to option-implied volatility (IV) surfaces, using convolutional neural networks (CNNs) to identify complex patterns that conventional measures may miss.

The resulting signals demonstrate strong predictive power for stock returns, with minimal overlap with existing option-implied characteristics and the potential for significant alpha relative to standard equity and options-based factors. The research also finds that combining multiple machine learning models improves risk-adjusted performance, while introducing a new methodology that shows why a small number of traditional volatility measures cannot fully capture the information embedded in IV surfaces. Results remain robust after accounting for estimated transaction costs and short-selling constraints.

**Key Takeaways**

- **Options markets contain untapped predictive information:** Deep learning techniques identify patterns in implied volatility surfaces that traditional measures, such as volatility level, slope, and skew, may overlook.
- **More complex models deliver stronger results:** Combining multiple neural networks into large ensembles improves out-of-sample risk-adjusted performance, with the resulting signals generating significant alpha relative to conventional equity and options-based factors.
- **Predictive information is difficult to simplify:** The authors introduce "principal linear features" and find that more than 100 such features are needed to capture the predictive relationships identified by their models, challenging the idea that a handful of volatility measures can explain future stock returns.
- **Findings remain meaningful after accounting for trading constraints:** Although smaller stocks contribute substantially to performance, the research finds that certain models retain significant results after estimated transaction and short-selling costs, including among stocks outside the micro-cap segment.

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