Sentiment in Financial Markets [Risk On and Risk Off]

Fear or **greed** among traders are **Fundamental analysis** factors that shape **price trends**. **Risk-averse sentiment** refers to the **fear** of **asset declines** and the tendency of traders to invest in **safe-haven assets** like **gold**.

On the other hand, **risk-on sentiment** reflects the **greed** of traders for **price increases** and opportunities to buy risky assets such as **cryptocurrencies** and **stocks**.



Sentiment in financial markets refers to the bullish or bearish feelings of traders

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What is Sentiment in Financial Markets?

Influenced by news, data, and existing risks, the market sometimes enters **risk-off sentiment** or **risk-on sentiment**.

Risk-On Sentiment

Risk-on sentiment usually arises when economic data points toward **expansionary monetary policy**. This Emotion occurs when the market expects lower interest rates, increased liquidity, and growth in the prices of risky assets.

However, **risk-on** Sentiment in Financial Markets is not solely driven by economic data. Generally, any factor that reduces uncertainty can increase risk-on sentiment in the market.

Example of Risk-On Sentiment in Financial Markets

For example, at the end of a contractionary cycle (high interest rates to control inflation), risk-on sentiment will emerge if inflation data is lower than expected and **expectations of interest rate cuts** strengthen. **Assets likely to grow in price during risk-on sentiment:**

- Stock market
- Cryptocurrency market

Risk-Off Sentiment

In risk-off sentiment, safe-haven assets such as gold and bonds are in demand. This sentiment arises when data points toward **contractionary monetary policy** or when **risk and uncertainty about the future** dominate the market.

Beyond economic data, **political** and **geopolitical risks** and any **uncertainty** about the future outlook can fuel risk-off sentiment.

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Example of Risk-Off Sentiment in Financial Markets

For example, at the end of a contractionary cycle, if **economic inflation** data is higher than expected, expectations of interest rate cuts weaken.

This may lead to risk-off sentiment as high interest rates continue to keep liquidity levels low.

Categorizing Assets Based on Their Fundamentals

After identifying market sentiment, the appropriate asset should be purchased based on market Emotions.

Some **Forex market** currencies have a risk-on or risk-off nature, which strengthens or weakens according to market sentiment. **Asset Fundamentals Table:**

Asset	Risk-On	Risk-Off	No Sentiment
CAD	✔	✘	✘
AUD	✔	✔	✔
NZD	✔	✘	✘
CHF	✘	✔	✘
JPY	✘	✔	✘
USD	✘	✔	✘
EUR	✘	✘	✔
GBP	✘	✘	✔
Gold	✘	✔	✘
Bonds	✘	✔	✘
Stock Market	✔	✘	✘
Bitcoin	✔	✘	✘
Ethereum	✔	✘	✘

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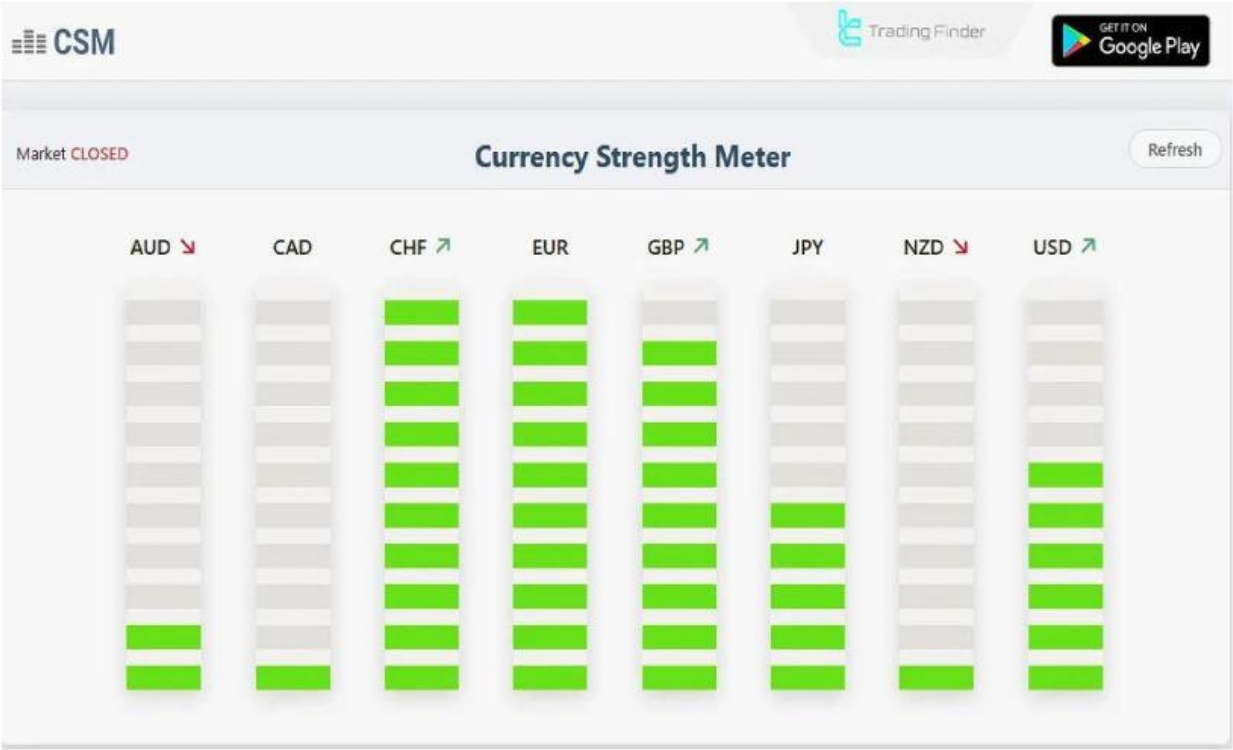
How to Identify Market Sentiment?

Market sentiment is reflected through asset fluctuations. For example, if risk-on currencies strengthen and safe-haven currencies weaken, it indicates a risk-on environment—because demand for riskier assets has increased.

Identifying Market Sentiment on CSM Website

Observing currency strength on the **CSM website** is one way to assess market sentiment. As shown in the image below, currency strength is indicated by the height of the bars. For example, given the strength of the **US Dollar**, **Japanese Yen**, and **Swiss Franc**, the market sentiment appears to lean more toward **risk-off**.

The strength of the **Canadian Dollar,** despite its **risk-on nature**, may be due to other factors such as **rising oil prices** or **domestic economic news from Canada**.



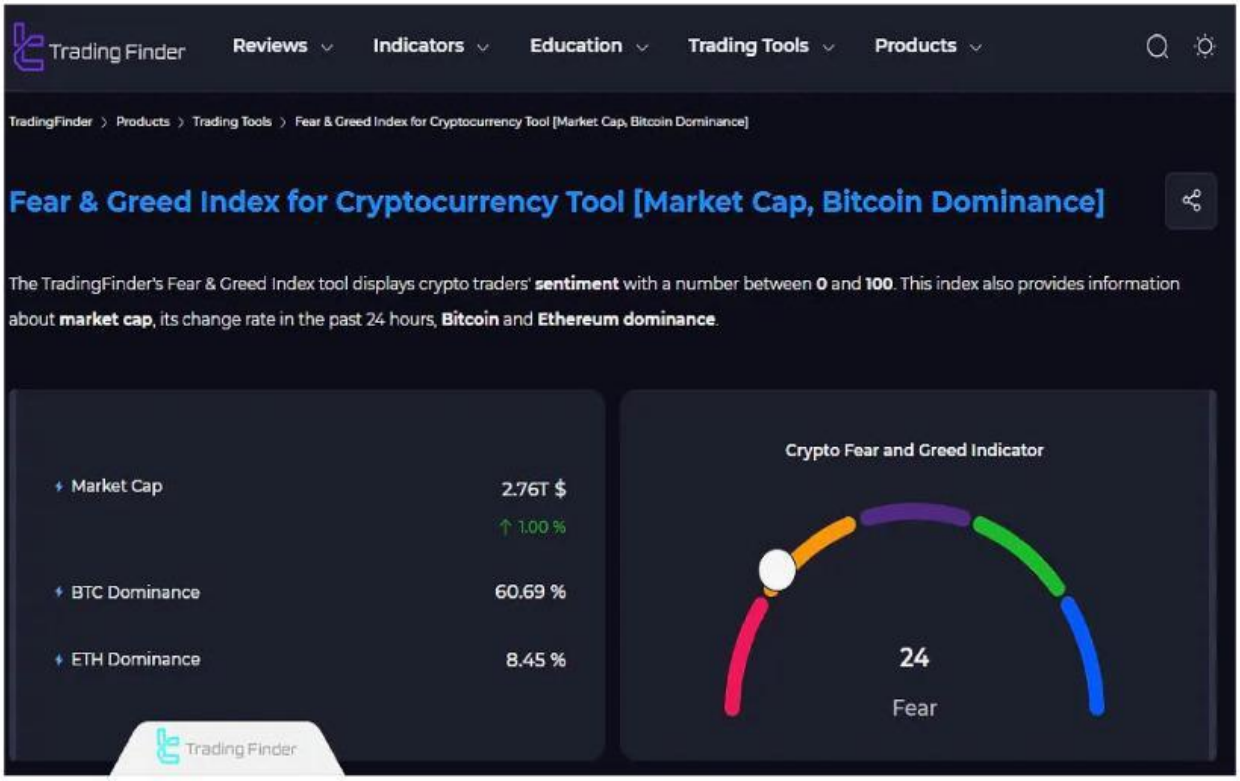
Identifying market sentiment using currency strength tools; Source: CSM website

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Fear and Greed Index in the Cryptocurrency Market

The **Fear and Greed Index** is used to assess trader sentiment in the cryptocurrency market. This index displays a number between **0 and 100**, and changes in this value indicate rising levels of fear or greed among market participants.

During sharp price declines, the index enters the “Extreme Fear” zone (below 25), which signals a potential buying opportunity. Conversely, during price pumps, the index moves into the “Extreme Greed” zone (above 75), which is considered a signal to sell or **take profit**.



Identifying cryptocurrency sentiment using the Fear and Greed Index. Source: TradingFinder

To check the sentiment of cryptocurrency traders, you can use TradingFinder **Cryptocurrency Fear and Greed tool**.

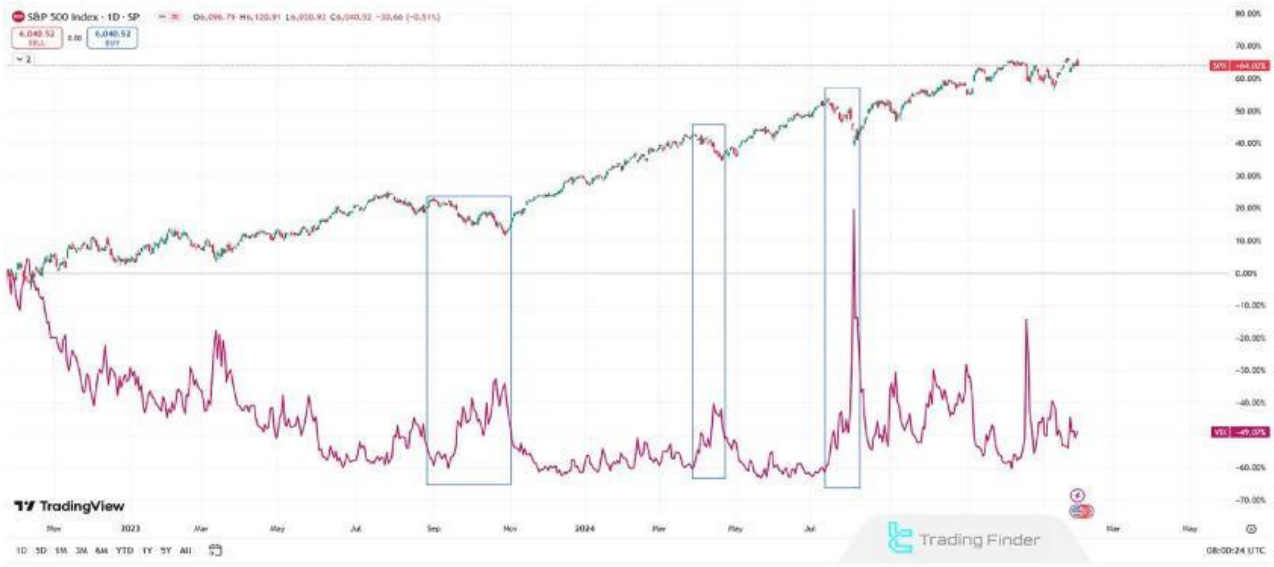
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VIX Fear Index

This index shows the **level of fear and uncertainty** in the market (Traders' sentiment). If the **VIX** index rises, fear and uncertainty (risk-off sentiment) will increase in the market.

Conversely, a downward trend indicates investors expect reduced volatility and uncertainty (risk-on sentiment).

Note: The **VIX** index has an **inverse relationship** with the US stock market. As the **VIX** rises (fear in the market), **stocks decline**, and vice versa.



Identifying US stock sentiment through the divergence of the VIX index and the S&P500 index

The index number is derived from traders' expectations of S&P500 volatility over the next 30 days.

Can the Market Lack a Specific Sentiment?

Sometimes, the market lacks a **specific sentiment**, and its movement proceeds naturally **without the influence of public Emotions**.

Sentiment forms in the market when significant events or **economic data**, such as **central bank meetings**, **key economic reports**, or specific news, are released.

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Conclusion

Traders' sentiment is a concept that drives market fluctuations. In such conditions, investors optimize their investments by **predicting Emotions** through **data and news**, **identifying sentiment** by **monitoring market fluctuations**, and **understanding the nature of assets**.

The **Fear and Greed Index**, **VIX**, and **currency strength** are tools to help **identify market sentiment**.

source:

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