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Applied Financial Economics >

Volume 17, 2007 - Issue 9

944 33

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Hedging effectiveness and futures contract maturity: the case of NYMEX crude oil futures

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Pages 683-689 | Published online: 05 Jun 2007

66 Cite this article https://doi.org/10.1080/09603100600722177

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Abstract

This article examines the effect of the maturity of the futures conract used as the hedging instrument on the effectiveness of futures hedging. For this purpose, daily and monthly data on the West Texas Intermediate (WTI) crude oil futures and spot prices are used to work out the hedge ratios and the measures of hedging effectiveness resulting from using the near-month contract and those resulting from the use of a more distant (6-month) contract. The results show that futures hedging is more effective when the near-month contract is used. They also reveal that hedge ratios are lower for nearmonth hedging. Some explanations are presented for these findings.

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