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

Ronald D. Ripple & Imad A. Moosa

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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 near-month hedging. Some explanations are presented for these findings.