Can Stock Market Investors Hedge Energy Risk?

Evidence from Asia

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Abstract:
The relationship between energy and stock prices is investigated in the context of Asia, including China and Japan. Oil, gas and coal prices are considered both individually and in an energy portfolio. Consistent with evidence from analysis of other asset prices in international markets, during the post Global Financial Crisis (GFC) period, Asian stock markets moved in tandem with oil prices. However, using asset pricing and portfolio theory we identify time-varying integration between individual stock markets and the energy portfolio, which in turn may limit the benefit of risk reduction through diversification. However, this relation can also be used to hedge the common factor arising from energy risk. Doing so provides benefits to investors in the form of positive risk adjusted returns, although these are episodic.

Highlights:

1. The relation between energy and stock prices is investigated in the context of Asia
2. There is time-varying integration between individual stock markets and the energy portfolio
3. This relation can successfully hedge the common factor arising from energy risk
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