Oil Returns and Volatility: The Role of Mergers and Acquisitions

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Abstract

This paper provides a novel perspective to the oil-stock market nexus by examining the predictive ability of mergers and acquisitions (M&A) over West Texas Intermediate (WTI) oil returns and volatility using a nonparametric quantile-based methodology. Our findings suggest that M&A activity carries significant predictive power over oil return and volatility, while predictability displays remarkably distinct patterns across various quantiles representing normal, bull and bear market states. We also observe that M&A activity by oil firms, i.e. both the acquiring and target firms considered active in the oil and gas (O&G) industry, generally carries greater predictive power over both oil returns and volatility compared to M&A activity by non-oil acquirers, i.e. acquirers that have entered the O&G industry by buying an oil company. Our findings imply that M&A activity in the O&G industry carries valuable fundamental information regarding future expectations on oil price dynamics and should be taken into account in forecasting exercises.

Keywords: Oil Returns and Volatility; Mergers and Acquisitions; Oil & Gas Industry; Nonparametric Quantile Causality.

JEL Codes: C22, C58, Q31.

1. Introduction

Crude oil is regarded as the most important commodity, given its influential role in the world economy relative to other commodities, particularly in terms of its causal effects on economic downturns (Hamilton, 1983, 2008, 2009, 2013; Elder and Serletis, 2010) and inflation (Stock and Watson, 2003). Considering the real economy, oil is indispensable for many sectors including industrials, transportation and agriculture, whether used as feedstock in production or as a surface fuel in consumption (Mensi, et al., 2014a). Moreover, oil market fluctuations are widely known to spill over to other commodity markets (see for example, Kang and Yoon, 2013; Kang et al., 2016, 2017; Mensi, et al., 2013, 2014b, 2015a) as well as

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