Hedging with Chinese Metal Futures Contracts

Abstract

This paper evaluates different hedging strategies for aluminum and copper futures contracts traded at Shanghai Futures Exchange (SHFE). In addition to the usual candidates such as the traditional regression hedge ratio and the conventional dynamic conditional correlation (DCC) model, two advanced DCC models are proposed that accommodates the effects of the basis on market volatility and co-movements. Empirical results suggest that the basis has asymmetric effects on the market behaviors. Moreover, the optimal hedging strategy constructed from the asymmetric effect model produces the best in-sample and out-of-sample hedging performance during the period when the markets are sufficiently mature.