Hedging Volatility of Cash Markets with Financial Futures

ABSTRACT

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The purpose of this paper is to measure the degree of predictive capability of selected financial futures instruments to forecast the underlined cash market (spot) instruments in order to assess how well the instruments serve to establish a hedging strategy. The research focuses in the application of time series methodologies and models to simulated situations that investors face regarding interest rate volatility, which affect their portfolio values. Managing changing volatility is an issue that has fostered the need for traditional mean variance and more sophisticated estimation and prediction models applied to financial market instruments analysis. Hedging with financial futures is now more than ever an alternative for risk averted and risk neutral investors to help them manage their portfolio's interest rate risk during volatile periods and periods of active monetary policy.

This area of study should bring challenging opportunities for conducting research about current events developing in financial markets and could be developed by the researcher into further studies towards a graduate doctoral dissertation. The testing of hedging effectiveness or optimal hedging capability will be assessed by making comparisons of latest frontier methodologies versus traditional, and alternative extensions will be presented.