**Evidence of Crude Oil Financialization from An Exogenous Shock Perspective**

**Background**

The sharp oil price rise from 2003 to 2008 has often been attributed to the role of speculation[[1]](#footnote-1) driven by a gradual acceptance of oil futures by institutional investors in a process known as financialization (Masters, 2008; Tang and Xiong, 2012; Hamilton and Wu, 2015). However, debate has arisen about the strength of speculation, with many academics questioning whether financialization or cyclical changes in fundamentals was the main driver over that period (Buyuksahin and Harris 2011; Fattouh, Kilian, and Mahadeva, 2013). Although it is hard to pin down the exact effects of financialization, literature suggests that commodities have turned from an asset class for investors to diversify from the equity market (Gorton and Rouwenhorst, 2006) to being increasingly correlated with the equity market (Buyuksahin and Robe, 2014).

Strong evidence of time-varying commodity futures risk premium attributed to financialization has emerged recently in the literature (Baumeister and Kilian, 2016), which extends to equity risk appetite (Cheng, Kirilenko & Xiong 2013; Boons, de Roon and Szymanowska, 2014; Isleimeyyeh, forthcoming). While Cheng, Kirilenko & Xiong (2013) has used the VIX index to approximate traders’ risk appetite for agricultural commodities, I believe no direct analysis between equity risk and the oil market has been conducted. My proposed research will give evidence on the effect of (perceived) equity risk given by the VIX on WTI futures, as well as changes over time. With this I hope to extend existing literature on financialization from a novel perspective that takes the risk premium literature into account while directly inferring the impact of stock market risk on crude returns.

**Research Questions**

1. What is the impact of shocks in the VIX on WTI futures returns?
2. How does that impact change over time as the oil market experiences financialization?
3. Does this effect extend to other forms of uncertainty such as geopolitical risk and economic policy uncertainty?

**Scope**

For my independent variable I will limit the uncertainty indices used to mainly the VIX, though will also explore EPU and GPR indices. I intend to include the VIX3M as part of my robustness check.

For my dependent variable I will use WTI futures of maturity 1M. Spot and 3M futures will be used for robustness checks.

1. Although no satisfactory definition for speculation exists, it is broadly defined as the purchasing of commodities for anything other than immediate use (Fattouh, Kilian and Mahadeva, 2013) [↑](#footnote-ref-1)