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Title: The Impact of Oil Price Shocks on the Stock Market  
Return and volatility relationship

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# **The Impact of Oil Price Shocks on the Stock Market Return and Volatility Relationship**

## Highlights

- Covariance of return and volatility is constructed from daily data
- Shocks to oil demand are associated with negative effects on the covariance
- Oil supply disruptions are associated with positive effects on the covariance
- Spillover between oil shocks and stock covariance is large and significant

## Abstract

This paper examines the impact of structural oil price shocks on the covariance of U.S. stock market return and stock market volatility. We construct from daily data on return and volatility the covariance of return and volatility at monthly frequency. The measures of daily volatility are realized-volatility at high frequency (normalized squared return), conditional-volatility recovered from a stochastic volatility model, and implied-volatility deduced from options prices. Positive shocks to aggregate demand and to oil-market specific demand are associated with negative effects on the covariance of return and volatility. Oil supply disruptions are associated with positive effects on the covariance of return and volatility. The spillover index between the structural oil price shocks and covariance of stock return and volatility is large and highly statistically significant.

*JEL classifications:* E44, G10, Q41, Q43

*Key words and phrases:* Stock return and volatility, oil price shocks, stock volatility, structural VAR

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## **1. Introduction**

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