Taylor & Francis
Online

Applied Economics ›
Volume 47, 2015 - Issue 6

4,853 Views | 81 CrossRef citations to date | 2 Altmetric

Original Articles

Pairs trading and selection methods: is cointegration superior?

Nicolas Huck & Komivi Afawubo

Pages 599-613 | Published online: 12 Nov 2014

Cite this article https://doi.org/10.1080/00036846.2014.975417

Check for updates

Sample our
Economics, Finance,
Business & Industry Journals
>> Sign in here to start your access
to the latest two volumes for 14 days

Full Article Figures & data References Citations Metrics

Reprints & Permissions Read this article Share

Abstract

Pairs trading is a popular dollar-neutral trading strategy. This article, using the components of the S&P 500 index, explores the performance of a pairs trading system based on various pairs selection methods. Whereas large empirical applications in the literature focus on the distance method, this article also deals with well-known statistical and econometric techniques such as stationarity and cointegration which make the trading system much more demanding from a computational point of view. Trades are initiated when stocks deviate from their equilibrium. Our results confirm, after controlling for risk and transaction costs, that the distance method generates insignificant excess returns. While a pairs selection following the stationarity criterion leads to a weak performance, this article reveals that cointegration provides a high, stable and robust return.

Keywords:

pairs trading | trading rules | distance | cointegration | stationarity

JEL Classification:

G11

Notes

[1] The sample really considers 500 stocks only at the end of the trading period due to initial public offerings/newcomers in the index: Google in 2004 for example.

[2] As an example, see Table 3, transaction costs for the 1-year formation period, distance method, 2 SDs are 0.38%. .

[3] The part of the initial deviation greater than the opening threshold plus the part exceeding the crossing with the equilibrium after convergence.

[4] Data and details on construction of these factors series can be found from Ken French's website:
http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html

[5] The fourth one, 2-year formation period, 2 SD, is significant at 10% level.

Related research

People also read | Recommended articles | Cited by 81

The profitability of pairs trading strategies: distance, cointegration and copula methods >

Hossein Rad et al.
Quantitative Finance
Published online: 27 Apr 2016

Does Simple Pairs Trading Still Work? >

Binh Do et al.
Financial Analysts Journal
Published online: 31 Dec 2018

Pairs trading >

Robert J. Elliott et al.
Quantitative Finance
Published online: 18 Feb 2007

View more

Information for

Authors
R&D professionals
Editors
Librarians
Societies

Open access

Overview
Open journals
Open Select
Dove Medical Press
F1000Research

Opportunities

Reprints and e-prints
Advertising solutions
Accelerated publication
Corporate access solutions

Help and information

Help and contact
Newsroom
All journals
Books

Keep up to date

Register to receive personalised research and resources by email

Sign me up

Copyright © 2026 Informa UK Limited Privacy policy
Cookies Terms & conditions Accessibility

Taylor & Francis by informa

Registered in England & Wales No. 01072954
5 Howick Place | London | SW1P 1WG