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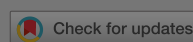
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Original Articles

Pairs trading and selection methods: is cointegration superior?

Nicolas Huck ✉ & Komivi Afawubo

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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

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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.

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