

Pairs Trading and Cointegration

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Abstract:

As a trading strategy, statistical arbitrage is a heavily quantitative and computational approach to equity trading. It involves data mining and statistical methods, as well as automated trading systems. In this paper, I introduce two methods (pairs trading and cointegration) for trading against statistical arbitrage, and run a simulation over a particular set of data, namely the 20 equities from 11/3/2003 to 10/12/2007. The result of simulation shows that the performance of cointegration is more impressive and persistent than that of pairs trading and therefore more suitable to incorporate into an automated trading system.