

PAIR TRADING STRATEGY IN INDIAN CAPITAL MARKET: A COINTEGRATION APPROACH

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ABSTRACT

Pairs trading methodology was designed by a team of scientists from different areas to use statistical methods to develop computer based trading platforms, where the human subjectivity had no influence whatsoever in the process of making the decision of buy or sell a particular stock. Such systems were quite successful for a period of time, but the performance wasn't consistent after a while.

The objective of this study was to analyze the univariate and multivariate versions of the classical pairs trading strategy. Such framework is carefully exposed and tested for the Indian financial market by applying the trading algorithm over the researched data. The performance of the method regarding return and risk was assessed with the execution of the trading rules to daily observations of 26 assets of the Indian financial market using a database from the period of 2008 to 2010.

The research shows that the return from the pair trading strategy is much higher than the return from naïve investment.

Key Words: Pairs Trading, Multivariate, Bivariate, Hedgers