IFC Markets

CFD Trading

tutorial

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INTRODUCTION

We live in a constantly changing and developing world. The life is so dynamic that today's innovations rapidly become yesterday's history. Under such conditions a modern person searches for new solutions and technologies. The emergence of Internet connection has significantly expanded human's opportunities in all areas of life. Many spheres of human activity have already been transferred to the world of the Internet. Do you want to get a medical consultation? You can get it easily just sitting at home in front of your computer. Do you want to watch films? You can do it without going to any cinema. Do you want to buy something from abroad? No need to go to that country just to get the item, simple online payment, and the item will be delivered to your house. Likewise, financial markets are now available via simple Internet connection. For investors, who are involved in Stock trading, held in a centralized place, and who are looking for more efficient trading instruments, will appreciate considerable advantages of CFD trading – a trading instrument, which has appeared relatively not so long ago in financial markets. In this tutorial you will find all main principles of CFD trading, which will lead to your better understanding of this innovative market and to more successful trading. Welcome to the world of CFD!

CHAPTER 1

THE BASICS YOU SHOULD KNOW ABOUT CFD TRADING

History of CFDs

CFDs are relatively new trading instruments. The history of CFD trading brings us back to the early 1990s. If we turn to the history of the origination of such popular financial products as futures (in 1730s), options (in 1973), etc., then we will see that CFDs are relatively new innovative instruments. Because of human being searching for new opportunities and solutions all the time, it is quite predictable that these instruments have significantly increased investors' interest in the financial market. Due to a number of useful features, CFDs are gradually becoming more and more popular. Nowadays, more and more traders try themselves in CFD trading. Every year, new CFD books and tutorials are being published, seminars and trainings are being organized, which leads to the growth of popularity of this financial product.

CFDs were originated by a London derivative brokerage firm called Smith New Court which was later acquired by Merrill Lynch. Economists Brian Keelan and Jon Wood played a great role in the invention of CFDs. So why did appear the necessity to invent CFDs? Clients of New Court wanted to hedge their positions on the London Stock Exchange, and CFDs were perfect tools to do it by going short, as well as getting an opportunity to trade on margin. Apart from that, CFDs allow avoiding stamp duty which is an added bonus. Later on, CFDs were used not only by hedge funds, but also gained wide acceptance among retail traders. The first CFD provider company was the company GNI, who launched GNI Touch online trading system. By using this system, the trader received a direct access to

the London Stock Exchange, which gave him the opportunity to see live quotes of each asset.
Starting from 2002, exchanges of many countries of the world also opened their doors to this instrument. The first country to do it was Australia. Since then, CFD trading has become more and more popular, making its appearance in exchanges of Germany, France, Norway, Italy, Singapore, etc.. Nowadays, the number of people, interested in this kind of trading, continues increasing. The volume of CFD trading is estimated about 25-30% of daily equity trades in the London Stock Exchange and 10-15% of the total transactions in the Australian Stock Exchange. The growth of CFD traders goes along with the growth of CFD providers. More and more CFD providers offer a wide range of services to their clients.

What is CFD?

If you want to improve your skills in financial markets, explore new instruments, then it is worth studying CFD trading. So, let us see what the essence of this trading is. CFD (Contract for Difference) is a derivative financial product, since its value is obtained through the value of another financial asset. CFDs will allow you to trade on prices, buy or sell without physically possessing the underlying asset. The underlying asset in most cases is a stock, but there are also CFDs for Indices, Commodities and other instruments.
According to the traditional definition, CFD is a contract between two parties, a buyer and a seller. If the difference between the price of an asset at the moment of opening a position on CFD and its price at the moment of closing this positon on CFD is positive, the seller pays to the buyer and, just on the contrary, if that difference is negative, the buyer pays to the seller.
CFD trading is almost like Stock trading. The only difference is that while you trade Stock CFD you do not own that Stock, you just use the price fluctuations of that Stock in order to speculate. Let us assume that you have decided to trade Google stocks in CFD market. The expression ''trading Google stocks" does not mean in this case that you own those stocks, aiming to buy or sell it for a profit. It means that you just trade the price difference of these stocks, going ''long" or ''short". So, technically, CFD trading is performed the same way as Forex trading. You trade in two directions, i.e. you buy a stock, expecting the price to go up in order to sell it later with higher price and vice versa, you sell a stock, expecting

the price to drop in order to buy it later with a lower price. In both cases you pursue only one purpose - to get a profit. If you fall short of expectations, then you will get losses.

What is an underlying asset?

If you have decided to trade a CFD, you are supposed to make an agreement to trade the price difference of the underlying asset. Underlying asset is a term used for trading derivative instruments. As already has been mentioned, CFDs are derivative instruments, the prices of which are derived from the prices of stocks or other assets. Various instruments can serve as underlying assets.

CFD traders are mainly involved in Stock CFD trading. In this case, Stock CFD derives its price from a Stock, and as the Stock price changes, your Stock CFD's price changes simultaneously. Actually, by becoming a CFD trader, you get a wide access to the world's largest stock markets. Are you interested in shares of U.S. companies? You have a real opportunity to trade such popular stocks, as Google (#S-GOOG), Facebook (#S-FB), Apple Inc (#S-AAPL), Microsoft (#S-MSFT), etc. Do you want to try yourself in European, Australian or other stock exchanges? You are free to do it. All you need to do is just to choose a CFD provider, which will correspond to your preferences. There are providers that offer only American stocks, others may be specialized in European stocks, there are also many providers offering CFDs on stocks of several countries simultaneously.

Indices are also very popular underlying assets in CFD market. So, what is an index? Index measures the average price of stocks of a certain group of companies-issuers of stocks of a particular country or a particular sector of the economy. To make it more precise, let us suppose that we want to measure the price change of U.S. stock market. For example, we collect 500 best operating companies in the USA, take the stock prices of those companies and make a stock index. One of the most popular stock indexes is S&P500 or Standard & Poor's 500, an index, based on stocks of 500 largest companies, the stocks of which are traded on NYSE (New York Stock Exchange). Stocks of these companies reflect the state of the main economic sectors. Another popular index is CAC 40, tracking stock prices of 40 largest French companies, or DAX 30, representing stocks of 30 largest companies in Germany. Indexes are usually quoted in the currency of the country, on the exchanges of which the corresponding stocks are traded. For

example, CAC 40, being an index of French stock market, is quoted against Euro. So, Index CFDs will allow you to speculate on price changes of a large group of stocks, creating some good trading opportunities for you.
One may ask - “And what if I want to trade commodities?”. Commodity CFDs are also available for trading. If you are specialized in Oil trading, are familiar with its price movements, then trading CFD, based on Oil, may be a real godsend for you. Trading price changes of Coffee, Cocoa, Wheat, Soybean, Oat, etc. may also be beneficiary for you.

What is attractive in CFD market?

The growing interest towards this financial product is the best evidence of its attractiveness. But what makes it so attractive? One may ask why to trade a CFD if I can trade a common Stock. Actually, there are a number of important differences between them, due to which many Stock traders have already passed to CFD trading market. Let us see the main differences:

- ***Leverage***
  If you compare the price movement of a CFD with that of a common Stock, you will see that the Stock CFD moves in the same direction as the Stock itself. The price of CFD repeats the price dynamics of the underlying asset. Then why do most people prefer trading CFDs? The answer is quite simple – the advantage of leverage, due to which you enhance your potential returns. In Stock market if, for example, an Apple stock’s price is $500, you should pay the whole sum in order to enter the market (purchase a stock). In the CFD market, you need to pay only a small percentage of your trading capital. This percentage depends on the Stock type and on a CFD provider. Some offer 1% margin, others 5%-10%. Let us agree that trading Stocks with lower percentages of margin are far more accessible to traders.
  However, leverage is a tool magnifying both your profits and losses. Being an advantage in one case, it may become a disadvantage in another case. Let us take that we want to buy an Apple stock, with the price of $500 and the margin of 10%. This means that we pay only $50 of the Stock actual price. The Apple stocks increase in price, reaching $550,

thus your profit is $50, i.e. you double your investment. Now imagine that the stock decreases in price, reaching $450. In this case you lose 100% of your investment. So, be quite careful while using leverage.

- *Trade on both rising and falling markets*
  Any CFD trader can get an opportunity to make a profit regardless of the market direction. What does it mean? This means that both rising and falling markets can equally bring you gains, as you trade the price dynamics of a trading instrument, without owning the physical asset. And in case of opening short positions when trading the underlying asset, your broker should loan you that asset, which is not always possible.

- *Dividend payment*
  Like stock providers, CFD providers also pay dividends to traders on long positions. So, dividend adjustment is credited to the client's account, in case of going long, and is debited from his account, in case of going short.

- *No expiry date*
  Another key advantage of CFD trading over the other derivative instruments (for example, futures) is that you can trade them without any expiry date. This means that you can keep your positions open as long as you wish. No limitation, no restriction. You are free to manage your CFD accounts without time limits.

- *Low commission*
  Low commissions, charged by CFD brokers, can also make it quite attractive to enter this market. Compared to Stock traders, CFD traders may get a real benefit from cheap commissions. Sometimes they can be as low as 0.1% of your investments.

- *Access to international markets*
  If you wish to trade American stocks, being in Australia at the moment, you do not need to change your location. The rise of Internet has made it possible to get access to any market. You can use all the opportunities of the American, Asian, Australian and European stocks. What you need to

do is just to choose your CFD provider.

- ***No stamp duty***
  Unlike traditional trading in a Stock Exchange, CFD trading does not require paying any stamp duty. It is quite logical as you do not own that Stock. Accordingly, you do not have any shareholder voting rights.

CHAPTER 2

CHOOSE YOUR CFD PROVIDER

Guidelines to choose your CFD provider

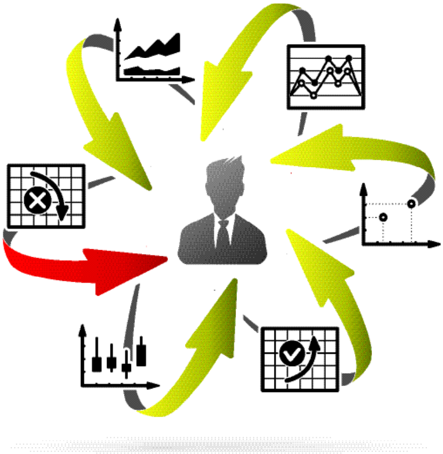
When we need to buy a product, we go to a shop. This is a simple real life situation. No matter how far the shop is from our living place, we prefer going to the best one. But what kind of shop is considered to be the best? - The one that offers a wide choice and fresh products. But this is not enough. Pleasant communication is just a necessity for a human being. Accordingly, while selecting a shop, we take into account high-quality customer service, as well. The same criteria are applied in financial markets. When we want to get financial services, we always seek for high-quality ones, be it a bank, an insurance company or a brokerage company. So, after determining to get involved in CFD trading, the first thing that you are planning to do is to choose your CFD provider. The growing interest in this derivative product has resulted in emergence of a large number of CFD providers. That is why the choice of your CFD provider has really become a difficult business. However, it can be simplified if you define specific criteria which will guide you on your way to orientate. Additionally, you can get use of guidelines that we offer.

1. ***The reliability of the provider***
   This point should be taken into account from the very beginning. It goes without saying that a company, operating since 2006, is far more reliable than the one, operating since 2011. This may serve as a benchmark to check the company's reliability. Another reliability indicator is if the company insurances its clients' funds, since any trader, before investing his money, wants to make sure that his money is in reliable hands.
2. ***The margin requirement level***
   Since the key advantage of CFD trading is that it allows trading on margin, knowing your provider's margin requirement level is a must. In most companies it usually ranges from 5% - 10%. So, consider how high the leverage that your provider offers is, never forgetting that high leverage is a tool to magnify your potential profits, as well as your losses.
3. ***Service charges***
   Before starting to invest, it is significant to know what your expanses are. Some providers charge service commissions. The commission may be charges for opening and closing a position, sometimes only for opening a position, and may range from 0.1% - 1%. Commissions may be charged sometimes for only Stock CFD trading, and in other cases only for Index CFD and Commodity CFD trading. As CFD trading is not a standardized procedure, these conditions vary from one provider to another.
4. ***Trading Platform***
   Trading platform is an online terminal, which will give you an access to live quotes of any asset that interests you, enabling you to track their price movements. Through this terminal, you make predictions, conduct technical analysis and decide in what direction to go, i.e. to become a bull or a bear. Additionally, due to the trading platform, you are able to manage your risks, by setting a range of stop-loss and take-profit orders. That is why it is so important to study the platform, offered by your provider, to see if it suits you and if it is easy to use.
5. ***The CFD types offered***
   The wider the range of CFDs is, the more trading opportunities you have. So, take under consideration CFD types that your provider offers. It will be better if you have an opportunity to trade Stock, Index and Commodity CFDs simultaneously. Moreover, check to what markets your provider gives an access. Maybe you want to trade American Stocks, but the

provider offers only European ones, or vice versa. Choose the one which satisfies all your main requirements and interests.s.

6. *Spreads, the difference between bid and ask prices*
   Tight and narrow spreads are also one of the parameters to choose your provider. The narrower the spreads, the more beneficial your trade will be. Additionally, check the spread type if it is fixed or floating. Which one of them is more beneficial, depends only on your preferences.
7. *CFD account opening procedure*
   This procedure should be easy to hold, not lasting more than one day. So, check with your provider what are the main procedures and requirements to open a CFD account. There are companies that offer universal accounts for trading both Forex and CFDs. So, in this case you do not need to open several accounts, as you can manage your trading only through one account.
8. *Risk management tools*
   Check if your provider offers risk management tools, for example, stop-loss orders, position hedging opportunities, etc..
9. *Customer service*
   It is not always easy to find necessary information about the CFD provider. Customer service is there to assist you. Actually, from the very beginning checking the customer support quality, you can make a general idea about that provider. So, customer service should be round-clock and competent to solve all your problems and to provide you with necessary information.

Whether you are an experienced trader or a beginner, your CFD provider has a direct effect on your trading results. Be sure that your success in many aspects depends on the provider you have selected.



CHAPTER 3

TRADING IN ACTION

An example of CFD trading deal

Going long

As already has been mentioned in Chapter 1, "going long" means you open a buy position, predicting its price to raise, aiming to sell it later with higher price, thus making profit.

Opening a Buy CFD position Let us suppose that we buy 500 Facebook stocks. On the trading platform we see buy/sell price of 1 Facebook stock which is 67.09/67.06. So we decide to buy 500 Facebook stock with buy price of $67.09 paying for it $33545. When trading with leverage, we do not need to pay the whole sum. The margin requirement, offered by IFC Markets is 2.5%, so we need to pay only 1/40 part, investing just $838.62. But let us not forget about commissions. For the US stocks, IFC Markets holds only $0.02 for 1 stock when opening and closing Stock CFD positions (in our example - $20+$20).

Opening a Buy CFD position

Some time passes, and if the market starts moving in your favor, i.e. Facebook stock increases in price, you decide to sell your stocks i.e. to close your CFD position with sell price of $77.06, getting for it $38530.

Calculating your profit

Since your position closing price is higher than your opening price, you have made a profit. This means that your profit is calculated by the following formula: (Closing price – Opening price) x 500 Facebook stocks - commission. (77.06 – 67.09) x 500 Facebook stocks - 40.00= $4945.

Going short

In CFD market you have an opportunity to make a profit on falling prices, as well. So "going short" means that you open a sell position, predicting its price to fall in order to buy it later with lower price, thus making profit.

Opening a Sell CFD position

Let us again suppose that we trade 500 Facebook stocks, but in this case we have decided to earn on the falling price. So we sell our 500 Facebook stocks by 67.06 rate, getting for it $33530. But as we can enjoy 2.5% margin, our actual investment will be $838.25. Again, $0.02 is charged for one stock when opening a position and $0.02 for one stock – when closing a position, which is deducted from the account's balance (in our example it is $20+$20).

Closing the CFD position

Some time passes and if the Facebook stock's price decreases, you decide to close your position, in other words to buy 500 Facebook stocks by 57.09 rate, paying for it $28545.

Calculating our profit

The calculation formula in this case is the following: (Opening price – Closing price) x 500 Facebook stocks - commission. (67.06 – 57.09) x 500 - 40.00= $4945.

So, based on the above mentioned examples, we see that profits can be formed both in rising and falling markets. Respectively, if our expectations are not justified, we complete with losses.

CHAPTER 4

CONSIDER AND MANAGE YOUR RISKS

Educational materials, trainings, seminars

Knowing how to trade CFDs is not enough to say that you are an experienced trader. What makes you an experienced trader is your ability to manage your trading and to protect your positions from any losses. CFD trade is a risky business, because of being based on margin trading. Margin trading enhances your profits and respectively, your losses. That is why it is highly recommended that you become aware of how to protect your losses both before starting your trade and during it. Educational materials, trainings, seminars Before starting your business and even when you are already involved in it, it is always worth attending some trainings and seminars, just to raise your educational level. If you are short of time or financial means, nowadays internet is full of free educational materials. Being educated and trained, may lead you to more successful trading.

Ability to analyze the market

By analyzing the market, you can better predict its movement. Before opening a long or short position, read the global news. Always follow what is going on in the world. All kind of events have a direct or indirect impact on the market. You can also make a technical analysis, using various technical tools, like indicators, graphical objects, offered by your CFD provider. Some companies have their own analytical department, which presents its useful analytics to the customers on a daily basis. You can either analyze yourself or trust your CFD provider. In any case, analysis is a prerequisite to successfully manage your trading.

Using stop-loss orders

Check, if it is possible to set Stop-loss orders on a trading platform offered by your CFD provider. This is perhaps the most effective risk management tool. Stop-loss order has a power to automatically close your position, if the price goes beyond the level set by you, exceeds the risk allowed by you. This is mainly useful, when you lack time to track your position or when your internet connection is poor. However, there are some circumstances in which stop-loss fails to be effective. For example, in case of gaps, your order may be executed not at the price, set by you, but at the first price in the market after the gap.

Hedging your positions

Hedging is a trading technique that allows you to protect his positions from unpredictable price movements. It goes without saying that your primary aim to enter the market is to make a profit, but in many cases the market volatility is not allowing you to do it and you need to protect your funds, otherwise losses are inevitable. Hedging by CFDs may be performed in two ways. First, you can either use CFDs for protecting your Stock positions in Stock market due to the ability to go short by CFDs keeping positions in the underlying asset (in stocks), which you may need for other non-trading purposes. Secondly, you may protect your CFD position by just opening an opposite CFD position on another underlying asset, if you believe that the movement in this protective asset will provide you with sufficient compensation in case of the development of an unfavorable situation in the protected position .

GET STARTED

Now then you have already learnt the basics of CFD trading, have been familiarized with all its benefits and disadvantages, you are ready to enter this market. A little practice, a bit of patience, positive thinking and you will be a success. Good luck to you!

CFD Trading Books

CFDs: The Definitive Guide to Contracts For Difference
By ***David James Norman***

CFDs Made Simple
By ***Jeff Cartridge & Ashley Jessen***

Supercharge Your Trading with CFDS
By ***Jeff Cartridge***

CFDs for Dummies
By ***David Land***

Making Money from CFD Trading
By ***Cat Davey***

Internet sources
http://www.ifcmarkets.com/en/cfds