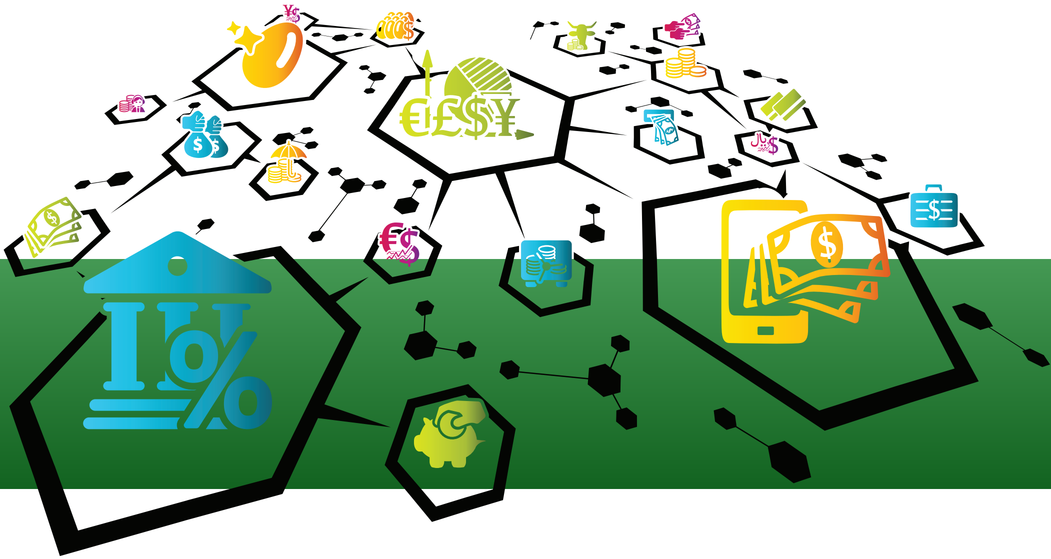
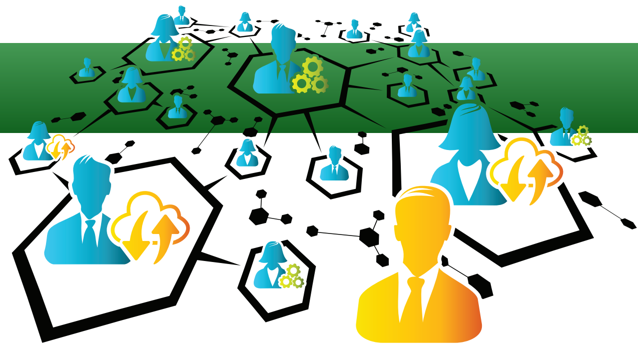
IFC Markets

CFD Trading
tutorial



CFD Trading



INTRODUCTION

Nowadays, we live in a constantly changing and developing world. The present life is so dynamic that today's innovation becomes yesterday's history. Under such conditions every modern person searches for new solutions and technologies. The emergence of Internet connection has expanded human's opportunities in career development. Almost all spheres of life have already been transferred to the Internet world. 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 visit your living place. 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, developed not so long ago. 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 market!

CHAPTER 1

THE BASICS YOU SHOULD KNOW ABOUT CFD TRADING

History of CFDs

CFDs are relatively new trading instruments. The history of CFD trading goes back to the early 1990s. We can explore the origination of other financial products, like futures (in 1730s), options (in 1973), etc. to make sure that CFDs are innovative instruments. Because of human being searching for new opportunities and solutions all the time, it is quite predictable that these new ones would have arisen a great interest in the financial market. Due to a range of advantages that you can enjoy while trading CFDs, they are gradually becoming more and more popular. Nowadays, we come across with more and more people, trying themselves in CFD trading. Every year new CFD books and tutorials are being published, new seminars and trainings are being organized, thus rising people's competence about this financial product.
CFDs were originated by a London derivative brokerage firm called Smith New Court which was later bought out by Merrill Lynch. 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 stock 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 were a way to avoid stamp duty which is an added bonus. Later on, CFDs stopped being used only by hedge funds and became widespread among retailers. The first CFD provider company was GNI, who launched GNI Touch online trading system. By using this system, the trader

had a direct access to the London Stock Exchange, getting an opportunity to see live quotes of each asset.
Starting from 2002, other countries of the world also opened their doors to this new instrument. The first country to do it was Australia. Since then, CFD trading has become more and more popular, spreading roots in Germany, France, Norway, Italy, Singapore, etc..
Nowadays, the number of people, interested in this kind of trading, are considerably increasing. The volume of CFD trades 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 increase of CFD traders is directly proportional to the increase of CFD providers. So, newer and newer CFD providers are appearing in the world, offering different services to their clients.

What is CFD?

If you have an intention to improve your skills in financial markets and you are exploring new spheres to try your hand at them, it is worth studying CFD trading and trying yourself in it. So let us see what the essence of this trading is.
CFD (Contract for Difference) is a derivative financial product, since it derives its value from another financial asset. CFDs will allow you trading on prices, moving up or moving down, 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 asset open price and its price at the moment of closing the contract 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 that you own that stock, aiming to buy or sell it for a profit. It means that you just trade the price difference of that instrument, 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 its price to go up in order to sell it later with higher price and vice versa, you sell a stock, expecting its 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, your trading completes with 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 between the current and future prices. Underlying asset is a term of derivative trading. As already has been mentioned, CFDs are derivatives, the prices of which are derived from underlying assets. Various products 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 that concrete 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 enjoy trading such popular stocks, as Google (**#S-GOOG**), Facebook (**#S-FB**), Apple Inc (**#S-AAPL**), Microsoft Corporation (**#S-MSFT**), etc. Do you wish to try yourself in European or Australian stocks? 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, and you can also encounter a provider, offering both at the same time.

Indexes are also widespread underlying assets in CFD market. ''What is an index?'' You may ask. It measures the price change of a particular number of stocks of a particular country. To make it more precise, let us suppose that we want to measure the price change of U.S. stock market. For example, we find 500 best operating companies in the USA, study stock prices of those companies and make a stock index. One of the most popular stock indexes is **SnP500** or Standard & Poor's 500, an index, based on 500 most widely stocks in NYSE (New York Stock Exchange). Another popular index is **CAC 40**, tracking 40 largest French stocks, or **DAX 30**, representing 30 largest stocks in Germany. Indexes are usually quoted against the currency of the country to which they belong. For example, CAC 40, being an index of French stock market, is quoted against Euro. So, Index

CFDs will allow you speculating on price changes of a number of stocks, creating some good trading opportunities for you.
"And what if I want to trade commodities?" One may ask. Commodity CFDs are also available. 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.

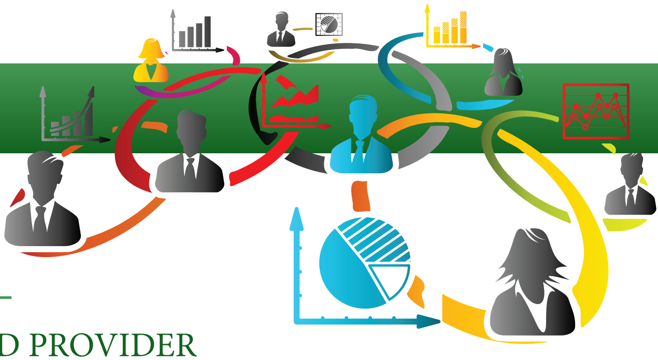
What is attractive in CFD market?

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 wide range of 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 track the price movement of a CFD with that of a common Stock, you will see that the Stock CFD moves the same direction as the physical Stock. 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. The conditions are different in CFD market. Here you need to pay only a small percentage of your trading capital. This percentage differs, depending on the Stock type and on a CFD provider. Some offer 1% margin, others 5%-10%. Let us agree that trading Stocks with lower investments are far more obtainable.
  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 stock increases in price, reaching $650,

thus making your profit $50. 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 movement of a trading instrument, without owning the physical stock.
- *No stamp duty*
  Unlike traditional stock trading, 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.
- *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 is that you can trade them without any expiry date, unlike other derivatives, that become worthless upon expiry. 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 account the way you like.
- *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 trading volume, charged only for opening a position.
- *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 enjoy various opportunities of American, Asian, Australian and European stocks. What you need to do is just to choose your CFD provider.



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 always 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 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 anyone, 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 entering any financial sphere, it is significant to know what your expanses are. Some providers charge service commissions. They may be commissions for opening and closing a position, sometimes only for opening a position, which may range from 0.1% - 1%. Commissions may be charged sometimes for only Stock CFD trading, in other cases 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 station, which will give you an access to live quotes of any asset that interests you, enabling you to track their price movements. Based on this station, you make predictions 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 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*

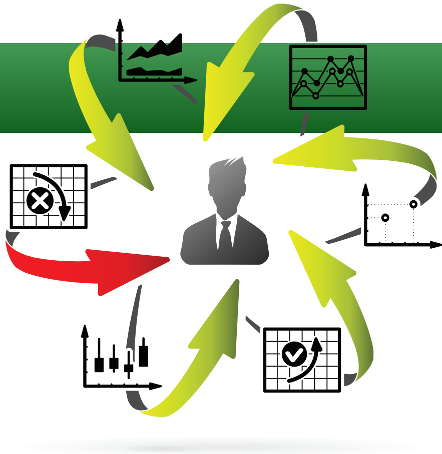
   The wider the range of CFDs is, the more trading opportunities you have. So, take under consideration CFD types that your provider offers. It will be better if you have an opportunity to trade Stock, Index and Commodity CFDs. Moreover, check to what markets your provider gives an access. Maybe you want to trade American Stocks, but the provider offers only European ones, or vice versa. Choose the one which satisfies your requirements and interests.

6. *Spreads, the difference between bid and ask prices*

   Tight and narrow spreads are also one of the indicators 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 a separate one and can manage your trading only in one account.
8. *Risk management tools*
   Check if your provider offers risk management tools, like for example stop-loss order, position hedging opportunities, etc..
9. *Customer service*
   It is not always easy to find necessary information about the 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 affect 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

Now when you already know all principles of CFD trading, have chosen your CFD provider, it is high time for you to see how a CFD deal is performed, based on a concrete example. We will use NetTradeX trading platform, offered by IFC Markets, to see step by step how the deal is made.

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. Due to leverage, we do not need to pay the whole sum. The minimum margin requirement, offered by IFC Markets is 2.5%, so we need to pay only a fraction of it, investing just $838.62. Let us not forget about commissions. IFC Markets holds just 0.1% of the position's volume for opening a Stock CFD position, which is deducted from the account's balance (in our example it is $33.54).

Closing the 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 - 33.54= $4951.46

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 0.1% commission of the position's volume is charged, which is deducted from the account's balance (in our example it is $33.53).

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 your 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 - 33.53= $4951.47

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

CHAPTER 4

CONSIDER AND MANAGE YOUR RISKS

Risk management tools

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 in a similar manner, 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 more easily predict its movement. Before opening a long or short position, consider the global news. Always follow what is going on in the world. All kind of events have a direct impact on the market. You can also make a technical analysis, using all technical tools, like indicators, graphical objects, offered by your CFD provider. Some CFD providers have their own analytical department which presents its 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 order

Check with your CFD provider if it offers stop-loss order. This is perhaps the most effective risk management tool. Stop-loss order has a power to automatically close your position at a price, set by yourself. 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 all is left to do is to protect your funds, otherwise losses are inevitable. Hedging by CFDs may be performed in two ways. You can either use CFDs for protecting your Stock positions in Stock market due to the ability to go short by CFDs or you may protect your CFD position by just opening an opposite 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

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