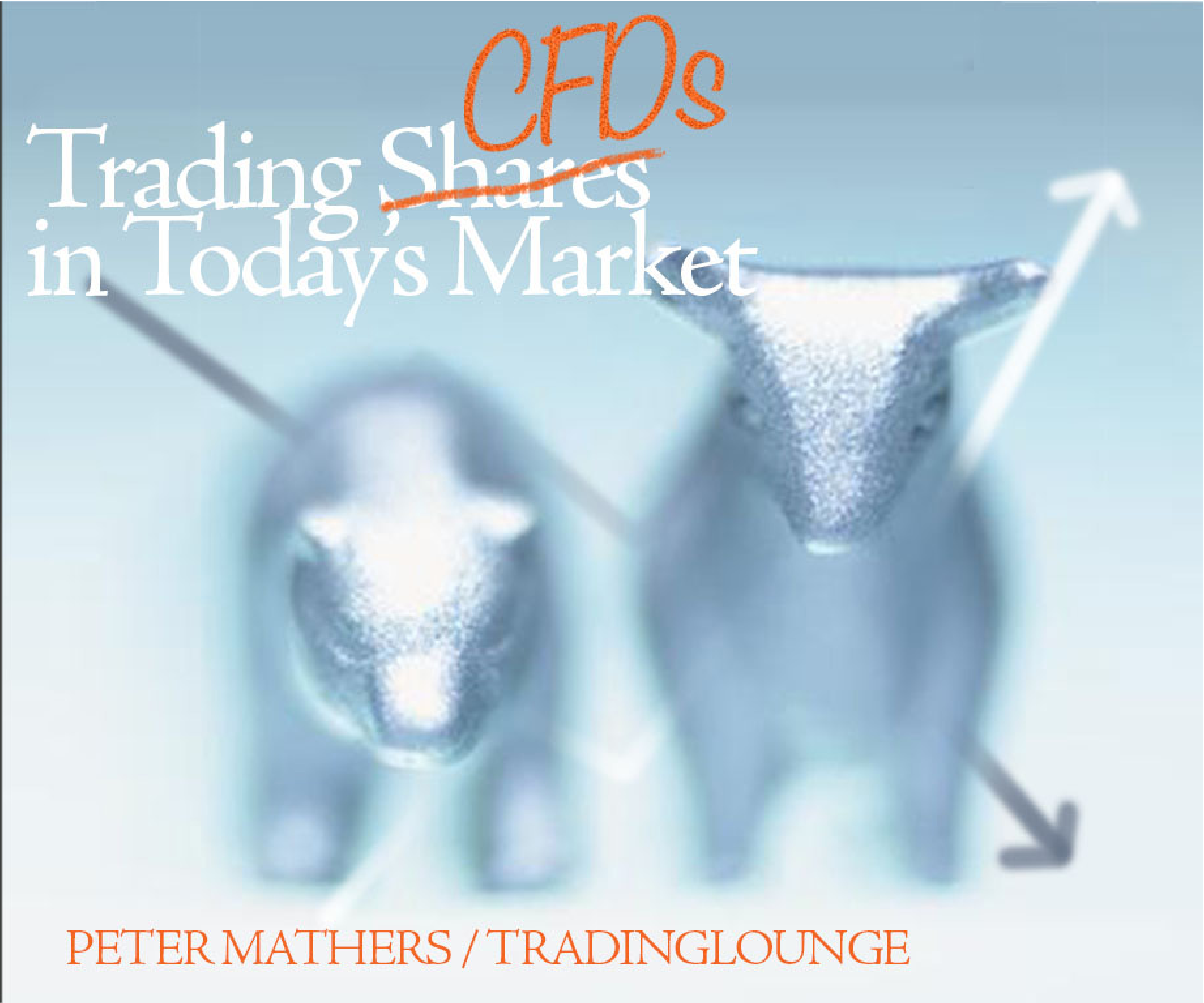
STEP BY STEP GUIDE TO THE CFD MARKET

Trading ~~Shares~~ CFDs in Today's Market



PETER MATHERS / TRADINGLOUNGE

"Peter discusses the place of CFDs within an investment portfolio, as opposed to a trading account. Overall this book provides a lucid description of many aspects of CFD trading. It is easy to read, yet contains quite detailed information… a great overview for those who wish to begin their CFD trading career with the terminology and information necessary to place opening, closing and contingent orders."
- Your Trading Edge magazine

"Make no mistake, trading CFDs is a high-risk strategy. … 'Trading CFDs in Today's Market', a concise book aimed at newcomers, is a good place to start."
- Money magazine

Trading ~~Shares~~ CFDs in Today's Market

CFDs – the easiest way to trade markets up or down

PETER MATHERS / TRADINGLOUNGE

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Foreword

Embracing new possibilities

In the very early 80s I remember sitting in my Japanese trading office of Hoei Shoin, hand drawing charts and programming the calculation of RSI into our computer manually, along with the limited ability to track a handful of markets. How slow and cumbersome by today's standards.

I now sit at my own trading desk and trade the global markets 24/6. I wonder what the future holds?

I've embraced the change by taking advantage of new products including new computer software programs, faster data feeds as well as more intelligent brokerage companies who now offer more variety, new products to trade and at much cheaper rates than the old regular stock brokers did.

I like to take a considered view of every trading possibility in the market place but I also understand that I must maintain a trading edge by using the bettr products.

For example, why pay the full amount for a share when you can pay between 1-10 % using a CFD? Why use a limited share trading platform that only trades local Australian shares when you can use a CFD platform and trade global markets 24 hours a day? Why trade shares that can return profits only moving up when you can trade CFDs up or down? Why trade options that have time decay when CFDs just roll on. With CFDs I can trade currencies, commodities, global share CFD's at a fraction of the price of any other product. I trade local and global markets from the same keyboard, even place orders via mobile phones – it is the easiest, fastest and cheapest way to trade.

Given the changing environment in the global and local financial markets, where people are always on the look out for better and more efficient trading instruments on the one hand, and new products and regulations being introduced on the other hand, it can be said that CFDs are here to stay. With most investors and traders benefiting from share/equity trading, it is only a matter of time for the level of CFD trading to mirror that of the actual share trading. Some CFD providers have said they were pleasantly surprised with the growth they've experienced over the years.

This book aims to play a modest part in the ongoing appliction of CFDs – that is, to provide a basic step-by-step 'manual' in understanding CFDs. It will present the basic information about ;understanding and trading CFDs as well as give you some tried and tested trading strategies that you can implement to start making money trading CFDs.

Now I'd like to give you the benefit of the research I've done, Peter.

About Peter Mathers

Peter Mathers, Director, TradingLounge, has been trading since 1982. He started his professional trading career with Japanese futures company Hoei & Shoin, who mentored and taught him the Japanese analysis techniques of Candlesticks and Renko. Practical experience of the Elliott Wave Theory followed with Australian company Tradewinds Pty Ltd, specialists in futures trading both in Australia and the USA. In London Peter traded commodities, derivatives and securities with Corporate Services International.

Back in Australia Peter has continued to refine his skills and constantly upgraded his knowledge of all current and well established theories and trading programs and on line brokering platforms. Peter specialises in CFDs, shares and forex analysis, strategies and education for a growing number of followers. He is a trading educator as well as being a regular contributor to trading magazines, e-zines and newspapers.

About TradingLounge

TradingLounge exists to provide home traders with all the facilities and education they may require to get them started and keep them focussed and informed.

We provide low cost online services to allow you to get you up and running without having to outlay lots of money for expensive charting programs, seminars and mentoring. We can guide you through the most effective analysis techniques and point you in the right direction for downloading the data you want onto your own computer.

Its all possible and its really just a matter of one step after another.

01 Why trade CFDs?

"**Why should I** trade CFDs if I can trade shares," asked one of the seminar attendees to the speaker who talked about how he moved from options and share trading to trading Contracts For DSifference (CFDs).

And the speaker said, "Well if you have been trading shares for a while now and you haven't looked or considered trading CFDs, you may be missing something."

Since CFDs have been introduced in Australia (late 2001) the number of CFD traders utilising the power of CFDs been growing by the day. The volume and value of trades backed by CFDs have also grown exponentially. There are estimates that about 10-15% of the total transactions in the Australian Stock Exchange are now backed by CFD trades. In the United Kingdom, where CFDs originated, it is estimated that CFD-backed trades account for about 25-30% of the daily equity trades in the London Stock Exchange.

The growth and popularity of CFDs has been tremendous over the past few years and now there are more countries accommodating these financial instruments to be made available and tradeable in their jurisdictions.

WHAT ARE CFDS?

A Contract For Difference (CFD) is a derivative trading instrument that allows you to trade the price movements (when you enter and exit a trade), without owning the underlying instrument, in most cases shares or equities.

Compared to share trading, CFD trading is almost the same except that when you trade a CFD you don't own the actual share. If you trade a CFD on Google or BHP Billiton, you are trading the price difference between your entry point and your exit point. You don't own the Google or BHP Billiton shares, you are only counting on their price going up or down.

The most common type of CFDs is share CFDs, but there are also other CFDs for Sectors, Indices and other financial instruments such as commodities and treasuries. A full list of tradeable CFDs can be found on page 27.

WHAT MAKES CFDS ATTRACTIVE TO TRADE?

Since 2002 when CFDs were first introduced to retail traders in Australia, CFDs have enjoyed a growing popularity among traders and investors alike. While the numbers are still increasing by the way, it is estimated that there are approximately XXXXX (how many in total if you add up all CFD providers' numbers) CFD traders in Australia in June 2006.

In the UK, it is estimated that CFD-backed trades account for approximately 25-30% of the daily trades transacted at the London Stock Exchange. While the percentage in Australia may not be that high, it is estimated that the number of trades at the Australian Stock Exchange backed by CFD trades will also increase in proportion in the coming years.
As a financial instrument, CFDs possess some features that make them attractive to traders and investors alike. These features will be discussed in more detail in other sections of the book and they include:

Easy to understand and easy to trade – CFD trading has often been described as share trading with bells and whistles. This is because everything you know about shares and share trading applies and can easily be used to trade CFDs because the price of CFDs moves as the actual share price moves. For example, if share ABC is worth $5.00, a share CFD on ABC is also $5.00.

Tradeable on margin – this means you only need a small percentage of your trading capital to open up larger or more positions that you can normally open. Some CFDs require only as little at 1% margin, some 3% and others 5-10% margin depending on the share CFD and the CFD provider. For many investors and traders being able to trade on margin is the biggest attraction of CFDs because it increases the opportunity to make profit using a small capital. Though, it must be remembered that the ability to trade on margin can be a two-edged sword, in that it both magnifies potential profit and losses. However, when used wisely and appropriately, trading on margin can be a big boost to profitability and capital building.

Can be traded long or short – this is one of the most attractive features of CFDs because it means you can trade long and make money on a rising market or trade short and make money when the market is falling. (Short trading and its mechanics is explained in more in detail in Chapter 3)

Dividend payment – similar to dividend paying shares, CFDs also pay dividends on long positions. Most CFD providers even pay the dividend amount on the day of distribution, which makes it even more attractive because you don't have to wait for weeks or months before you get your cheque in the mail or before the amount is reflected in your bank account.

No expiry – unlike other derivatives that have expiry date and that become worthless upon expiry, CFDs don't have expiry date. This means you can hold CFDs for as long or as short a period as you like. Like shares/equities, the price of the CFD moves as the price of the actual share.**Low commission/brokerage cost** – compared to the brokerage fee you pay when you trade with your regular stock broker, commission charges when trading CFDs are relatively cheap. Some CFD providers charge as low as $10 for trades of up to $10,000. Any trade more than $10,000 may be charged 0.01% of the total trade amount.

Ability to trade international markets – CFDs open up a whole new world of financial markets including those in the US, UK, Europe and Asia which were not accessible to Australian traders before. Many CFD providers offer CFDs on international shares, indices and sectors.

HOW DO CFDS STACK UP AGAINST OTHER DERIVATIVES AND SHARES?

All financial instruments – from the simplest to the most complex – have their own individual features that make them attractive or not attractive to investors. Though there is a misconception that derivatives are all about high risks, if considered properly and traded according to your personal risk profile, derivatives – including CFDs – may play an important part in growing your investment portfolio.

On the next page is a tabular comparison of CFDs, shares, options and warrants that may help you understand them all in context.

POINT OF COMPARISON	CFDs	Shares	Options	Warrants
Ease of trading	Easy to trade like actual shares	Easy to trade and most investors start with a share portfolio	Different from share trading and can be complex for beginners in the market	Different from share trading and can be complex for beginners in the market
Price movement	Similar to shares	Actual price movement	Price movement is affected by many factors; not similar to share price	Price movement is affected by many factors; not similar to share price
Tradeable on margin	Yes	No	Yes	Yes
Can be traded long or short	Yes	Short selling is complex and expensive due to additional broker fees	Yes	Only a few providers allow you to go short on warrants
Dividend payment	Similar to share dividend payment	Not all shares pay dividends	No	No
Expiry date	No expiry date	No expiry date	With expiry date and can expire worthless	With expiry date
Stop loss orders	With stop loss orders	No stop loss orders	No stop loss orders	No stop loss orders
Spread	Similar to actual shares	Actual price	Can be wider than the underlying instrument	Can be wider than the underlying instrument
Number of tradeable instruments	Thousands including Australian, US, UK, European & Asian CFDs	Approximately 1900 companies listed in the ASX as of June 2006	Limited to about the top 50-70 listed shares in the ASX	

ARE CFDS FOR YOU?
WHERE DO THEY FIT IN YOUR INVESTMENT PORTFOLIO?

After learning more about CFDs and its features, you must be wondering where these financial instruments fit in your investment portfolio. You may already have a healthy share portfolio that you want to keep growing. While CFDs may not be the ideal vehicle for the long term buy-and-hold investing, it definitely has a place in any investor's portfolio.

Cheap entry into trading – because you only need to pay a small percentage of the total value of the transaction to open a CFD trade, CFDs can be seen as a relatively cheaper way to get started in trading. Some CFD providers require a deposit amount of only about $5,000. As long as you maintain your leverage exposure to a reasonable level, CFDs can be an efficient entry into trading the markets.

For example, you want to buy 1,000 shares of XYZ company at $8.00 a share. This means you need at least $8,000 to open a trade. If you trade CFDs of XYZ company, you would only need about 5% of the total amount to open the trade.

Here's how it works:

XYZ Company	Actual share	CFD
Price	$8.00	$8.00
Quantity bought	1,000	1,000
Broker fee/Commission	$19.95	$10.00
Total capital outlay	$8,019.95 ($8.00 x 1000 shares + broker fee)	$410 ($8.00 x 1000 CFDs x 5% of total amount + commission)

You need quite a substantial trading capital to get into this trade if you buy the actual share and it will limit your ability to open other trades if you have a small capital.Trading CFDs means you can start with a small trading capital at a cheaper price.

PORTFOLIO HEDGE
TRADER EXAMPLE

John, has built up his portfolio and now has 1000 shares in Rio Tinto but now feels the need to protect his Rio Tinto shares as the global gold market is easing off.

Without 'Shorting' here is John's possible outlook:

SHARE PORTFOLIO:
1. RIO shares 1000 @ $85 per share
   Total $85,000
2. RIO currently trading at (say) $64
3. Current shares loss $21 per share. Total value loss $21,000
4. New Balance **Total $64,000**

With 'Shorting' here is John's possible outlook:

PORTFOLIO HEDGING
USING CFDS
1. John buy's 1000 RIO CFDs
   @ 3% of total value of $85,000
   which equals only $2,550
2. Hedging strategy is to 'Sell Short' 1000 RIO share CFDs at a total cost of $2,550 at the trading price of $85
3. RIO price moves down, trading at $64
4. Current CFD profit $21 per CFD
5. Total value gain $21,000
6. Total loss on Shares $21,000
7. Total gain on CFDs $21,000
8. New Balance on Rio Tinto
   Total $85,000

Portfolio diversification – whether you're a long-term buy and hold investor, you can use CFDs to take advantage of short-term profitable moves in the market without affecting your long-term investment. This means while your long-term positions are growing over time, you can trade CFDs to deliver profit from short to medium-term trades. To introduce diversification in their investment portfolios, some people prefer to maintain their share/equity portfolio for capital gains and ongoing dividend income while also maintaining a CFD portfolio for short to medium-term investment or trading.

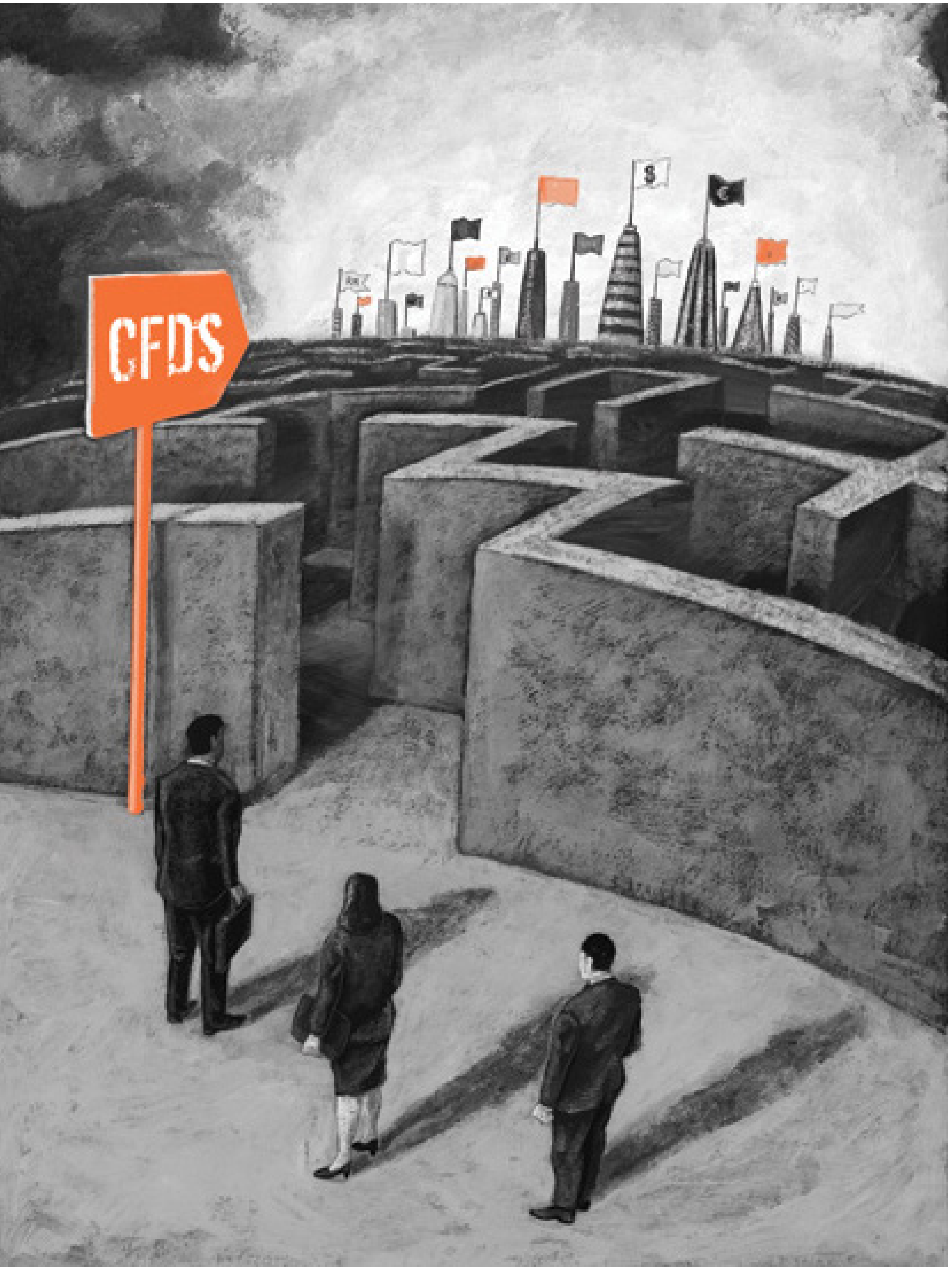
Portfolio hedge – hedging means protecting or trying to minimise any risk that may affect your existing investment portfolio. Many people are now using CFDs as a hedge to protect their share/equity investment.

For example, say you have bought 1,000 BHP shares at $28.00 expecting that the price will go higher in the months to come because of the global demand for resources. You intend to keep your BHP shares as a long-term investment. However, after a few days of buying the shares the price went down and it is now trading at $27.75. You still believe that BHP shares will go higher in the medium to long-term period, but in the mean time the share price has been going down for the past few days.

You can short sell 1,000 BHP share CFDs to hedge your share position in the short term. This is because every cent movement in the physical shares (in this case it is going down, therefore you are losing) will be matched by the same movement in the share CFD (in this case, because you have a short position you are making money if the price of the share CFD goes down). This means your losses in the physical shares are being offset by your winnings in your short CFD trade (not withstanding personal tax treatments abd brokerage rates applicable).

things to remember:

- You can easily trade CFDs as you trade shares because the price of a CFD mirrors the price of the actual share.
- CFDs are much simpler and easier to understand and to trade compared to other derivatives such as options and warrants.
- Consider CFD as a tool to diversify or hedge your existing investment portfolio.



02 How do I trade CFDs?

One of the first and most important things to consider when you're starting to trade CFDs is to know your CFD provider. Similar to buying shares or any big ticket item for your house, you want to know who are the players out there. You only want to be dealing with the most reliable, dependable, trustworthy and service oriented providers who can help you with your trading.

The number of CFD providers is still growing. Whether you are in the UK, Australia or Asia Pacific, you will notice that there are existing CFD providers and there are new companies coming into the picture every now and then. While this is good as it increases the competition in terms of you being able to choose only the best CFD providers, you have to do your own homework. Research and compare all the pros and cons of each CFD provider and chose the one that meets all your requirements.

KNOW YOUR PROVIDER

The following is a tabular list of current CFD providers in Australia. Expect this list to change as new companies come into the picture and existing companies expand their offerings. An electronic copy of this list can be found at (www.tradinglounge.com), who update the lists on an ongoing basis.

CHOOSING YOUR CFD PROVIDER: YOUR CHECKLIST

Use the attached table as a reference if you want to do more research to find out more about your potential CFD provider. Here are some guidelines or questions that you should be asking when considering who to sign up with.

Q: How long has the provider been operating as a CFD provider?
A: You would like a reliable, dependable CFD provider that has a good track record in the industry.

Q: What is the provider's core business?

A: You want to be dealing with people who have expertise in their products and services. Some CFD providers operate as part of a larger fund, investment banking or FX provider. Depending on what you want from your provider, you have to consider if they have the CFD expertise that you need. on a wider product offering

Q: What are the charges?

A: Like dealing with stock brokers to trade physical shares, you will also incur expenses when you trade CFDs. These may include commission (broker fee), the initial margin required and financing charges. Commission may vary from one provider to another and you should consult your CFD provider if they offer other commission rates if you're a frequent trader. A detailed explanation of the components of your CFD trade can be found in Chapter 3 (Nuts and bolts of CFD trading).

Q: How much do I need to open an account?

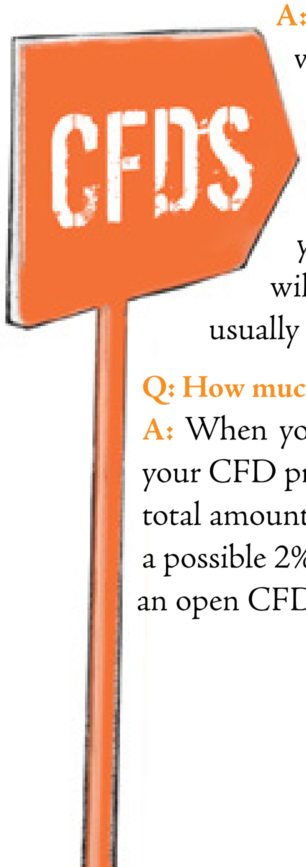
A: The amount of money you need to open an account may vary from one provider to another. Some require $5,000 and others require $10,000. There are also providers that offer a credit account that may require more financial and credit checking and proof of your financial stability.

Q: How soon can I open an account and start trading?

A: Opening an account may vary from a few hours to a few days or a week. But with all the credit and financial checks and validations, be prepared for a few days before you can trade.

Q: Does the provider offer discount for volume trades?

A: Some CFD providers may be able to offer discount for big volume or high value trades. It pays to ask your CFD provider what discount arrangements they can offer.



Q: What are the margin requirements?

A: Since the ability to trade on margin is one of the biggest attractions for you to trade CFDs, you should consider the best margin requirements that will bring you the optimum trading exposure. Current margin requirements usually range from 1% - 10% depending on the share CFD you trade.

Q: How much is the financing charge?

A: When you trade CFDs (on a margin) you are technically borrowing money from your CFD provider, therefore you will be charged what is called 'financing charge' for the total amount of your CFD holding. Most CFD providers use the current cash rate plus a possible 2% or 3% as financing charge, which is computed for as long as you're holding an open CFD position.

Q: What CFDs can I trade?

A: Another advantage of trading CFDs is that it gives you access to other markets outside Australia. Most CFD providers offer Australian and international CFDs, but there are a few that offer CFDs on Australian shares only. Make sure that your provider has a wide range of markets and instruments to trade that will give you access to bigger and more liquid markets with better trading opportunities.

Q: How small is the 'spread' that they offer?

A: Make sure your provider offers the tightest spread for your chosen trade. Spreads will vary depending on the product offered.

Q: Does the providor offer risk management tools, ie stop-loss orders?

A: As will be discussed in more details in a later part of this book, stop-loss orders are useful tools to manage your CFD trade. A stop-loss order is one effective way to minimise potential losses and to protect your profit. Make sure that your chosen CFD provider allows you to place stop-loss orders and change them as your trade progresses with little or no additional charge.

Q: Where does the provider keep client money?

A: Under existing laws governing financial services companies in Australia, CFD providers are required to keep client money in a segregated account.

Q: What happens to your money not allocated to open trades?

A: Some CFD providers pay interest on a certain amount of money on your account as long as they're not allocated to cover any open position. Some CFD providers pay interest if you have $10,000 of free equity in your account.

TYPES OF CFDS

Australian Share, Indices and Sector CFDs

As mentioned in Chapter 1 share CFDs are the most common type of CFDs. However, there are many other types of CFDs that can be traded and the list is still growing.

In Australia, most of the CFD providers offer CFDs on the top 500 listed shares. The list is continuously expanding due to demand for other share CFDs and the entry of new providers who may offer specific groups of CFDs not offered by existing providers. You should consult your CFD provider for a complete list of tradeable CFDs they offer.

The Australian stock market consists of 12 industry groups called sectors. This grouping is based on an international standard to make it easier to classify companies into their respective industries.

Here is a table of the 12 Sectors in the Australian stock market and some of the major companies under each sector. Check with your CFD provider if they offer Sector CFDs to make sure that you can trade them if you don't want to do stock specific trading.

Sector	Major components
Consumer Discretionary	PBL Ltd, TabCorp, Billabong
Consumer Staples	Woolworths, Coles Myer, Lion Nathan
Energy	Woodside Petroleum, Santos, Caltex
Financials	Perpetual, Commonwealth Bank, Macquarie Bank
Financials excluding Property Trusts	ASX, Lend Lease, QBE Insurance
Healthcare	Cochlear, CSL Ltd, Sonic Healthcare
Industrials	Wesfarmers, Toll Holdings, United Group
Information Technology	Computershare, Iress Market Technology, Baycorp Advantage
Materials	BHP Billiton, Rio Tinto, Orica
Property Trusts	Westfield Group, Centro Properties, GPT Group
Telecommunication Services	Telstra, Telecom NZ
Utilities	AGL, Alinta, Australian Pipeline Trust

12 Sectors in the Australian stock market and some of the major constituent companies

International shares and indices

Aside from Australian shares, many CFD providers also offer CFDs on international shares including US, European, UK and Asian shares. This means you can trade share CFDs on Google, Amazon, Wal-Mart, Honda, Toyota, Vodafone, BMW, Porsche and other big brands that are not available in the Australian market.

An index is a collection of stocks and the corresponding composite value of its components. In Australia, the All Ordinaries (All Ords) is the index which consists of all the publicly listed companies in the Australian Stock Exchange. The closing value of the All Ords changes everyday depending on the price movements of all the shares. Other major indices in the international financial markets include the Dow Jones Industrial Average (USA), Nasdaq (USA), FTSE 100 (UK) CAC 40 (France), DAX (Germany), Nikkei 225 (Japan), Hang Seng (Hong Kong).

Check with your CFD provider if they offer CFDs on international indices because there maybe some good trading opportunities within these indices particularly in times of big uptrends or downtrends.

Trading share CFDs on international shares, sectors and indices offers many advantages including:

- access to bigger and more liquid markets that offer more trading opportunities than what is available locally
- low brokerage fee because you don't have to pay the extra administrative charges that you pay to trade physical shares in overseas companies
- Australia's time zone makes it user friendly if you want to capture some trading action in the UK, US or Asian markets.

things to remember:

→ Choose your CFD provider like you would choose your stock broker. With many CFD providers vying for your business,
you should do your homework and choose carefully who you deal with.

→ Make sure that your CFD provider gives you access to Australian as well as other international markets that will provide maximum trading opportunities.

→ Refer to the table of comparison of the CFD providers and the list of questions to ask before you sign up with any CFD provider

03 Nuts & bolts of CFD trading

Now that you have done your research and have evaluated your shortlist of CFD providers and you have decided on which CFDs to trade, you are just about ready to trade CFDs.

Electronic trading gives you more control and instant access to market data and information which were not readily available to retail or private traders several years ago.

Today, most, if not all, CFD providers give you direct link to them through an internet based and electronic trading platform. Like electronic banking and other internet based transactions, the more familiar you become with the electronic trading platform, the better your trading experience.

After opening your CFD trading account with a provider, the first thing you need to know is how to use the trading platform of your CFD provider. Again, this will vary from one provider to another and it pays to learn the features and capabilities of the trading platform to make your trading routine as efficient and smooth as possible. Though there will be differences in the look and feel of each trading platform, your CFD trading software must have all the features and capabilities that will allow you to:

- open and close trades
- put in additional orders or trades
- amend or cancel existing orders and stops
- manage your trade from entry to exit
- preferably have quality charts for analysis
- see your daily account statement

TYPES OF TRADES

As mentioned in Chapter 1, one of the advantages of trading CFDs is that you can trade it long or short.

Going 'long'

Going 'long' means you open a CFD position by buying it with the expectation that the price will go up and then selling it at a higher price, that's when you make the money.

An example of a 'long' CFD trade

STEP 1: TO OPEN A TRADE, YOU BUY:

300 BHP share CFDs at $38.00 with a (eg) 10% margin and (eg) $10 commission
(300 share CFDs x $38 = $11,400) x 10% = $1,140 + $10 = $1,150 (margin required)

This means you will be required to have at least $1,150 in your trading account to open this BHP share CFD trade.

STEP 2: TO CLOSE A TRADE, YOU SELL:

After you bought BHP share CFDs commodity prices jumped in the international market overnight. The following day the price of BHP shares is also expected to go higher and you want to close your BHP share CFD position.

You sell 300 BHP share CFDs at $38.50 (for a 50 cents movement in each share CFD) – $10 commission = closing price

(300 share CFDs x $38.50 = $13,475) – $10 = $13,465

STEP 3: CHECKING YOUR PROFIT AND LOSS

Your profit and loss calculation will look like this:
(sell price – buy price) x number of share CFDs – commissions = profit

($38.50 – $38.00 = .50) x 300 share CFDs – $20 = $130 profit
or 8.85% return for an initial outlay of $1,150

NB: This calculation does not include the financing charge which is calculated on a daily basis for as long as you hold your CFD position open. Financing charges vary from one CFD provider to another.

Going 'short'

Going 'short' means you open a CFD position by selling it with the expectation that the price will go down and then buying it at a lower price, giving you the profit even if the CFD price goes down.

Example of a 'short' CFD trade

STEP 1: TO OPEN A TRADE, YOU SELL:

300 BHP share CFDs at $38.00 with a 10% margin and $10 commission
(300 share CFDs x $38.00 = $11,400) x 10% + $10 = $1,150

This means you will be required to have at least $1,150 in your trading account to open this BHP share CFD trade.

STEP 2: TO CLOSE THE TRADE, YOU BUY:

After you bought BHP share CFDs commodity prices dropped in the international market overnight. The following day the price of BHP shares is also expected to go lower and you want to close your BHP share CFD position.

You buy 300 BHP share CFDs at $37.50 (for a 50 cents movement in each share CFD) – $10 commission
(300 share CFDs x $37.50 = $11,250) –$10 = $11,240

STEP 3: CHECKING YOUR PROFIT AND LOSS

Your profit and loss calculation will look like this:
(sell price – buy price) x number of share CFDs – commission = profit
($38.00 – $37.50 =.50) x 300– $20 = $130 profit
or 8.65% return for an initial outlay of $11,240(margin required)

NOTE: When you have a short CFD position, you will be paid the interest on the total amount of your trade for as long as you hold the position open. This computation does not include the overnight interest you will earn. Interest payment may vary from one CFD to another. Short selling is a great opportunity for traders and money can sometimes be made faster 'shorting' due to the speed prices can retrace.

TYPES OF ORDERS

Market Order – as the name implies this is an order you place to buy or sell a CFD at the current market price. If you are a buyer, you are willing to pay the price on the Offer, and if you are a seller you are willing to accept the price on the Bid.

Limit Order – is an order where you specify the price where you want to buy or sell. A limit order is useful when trying to capture or protect your profit in a certain trade.

For example BHP is now trading at $39.00 and you are long BHP at $38.00. You want to close this position when the price goes to $39.50. You can place a limit order that says:

'Sell BHP at $39.50 on limit.'

Stop loss order – is an order that tells your CFD provider at what point you want to get out of a trade when the position turns against you. Many CFD providers will allow you to place stop loss orders automatically on the electronic trading platform. You should make sure that your provider offers stop loss orders, which is one of the most basic trade management tools. This will be discussed in more detail in Chapter 4.

Stop entry order – not all CFD providers may offer this order and this may only apply to sector and index CFDs. This order allows you to open a trade when a certain level is hit

For example, if the S&P/ASX 200 (Index) is trading at 5000 and you think that with all the volatility in the market it will be falling at about 4990, then you would like to go short when this level is hit. You can place a stop entry order that looks like this: (This will automatically open a trade for you at this level).

'Sell S&P/ASX 200 at 4990 on stop.'

Good 'til cancelled (GTC) – this is an order or instruction that you attach to a buy or sell, limit or stop order that will keep the initial order open until you decide to cancel it. This is useful and will save you time instead of reminding your CFD provider to place the order over and over again or placing the order yourself everyday.

Good for the day – similar to GTC, this is an instruction that you attach to another order that says you only want to keep this order for the day. This means that at the end of the trading day if your initial order was not executed, then it will be automatically cancelled and you may have to place another order for it the next day.

COMPONENTS OF A CFD TRADE

Commission – This is similar to the broker fee you pay to trade physical shares with your stock broker or a discount brokerage company. One advantage of trading CFDs is that commission or broker fees are relatively lower compared to what you pay your stock brokers. Some CFD providers charge as low as $10 commission for trades of up to $10,000. On the other hand, stock brokers usually charge at least $30 for each trade and much more for the few that can short sell..

Margin – A CFD is a derivative product and is traded on margin, which means you only need to put up a fraction of the total position to open a trade. The margin is the amount you need to have in your trading account, which may vary from 3% - 10% depending on the CFD you trade. Index and Sector CFDs and margin FX trades only require 1% margin.

Financing cost and benefit – As a margin traded product CFDs attract financing charges, which is similar to paying interest on a margin loan from a bank to buy shares. Technically, when you open a CFD trade on a margin, your CFD provider is lending you the money for the rest of the amount. Financing cost varies from one CFD provider to another, so it is wise to check what you will be charged.

One thing to note with financing cost is that you have to pay it if you have long CFD positions, but you will be paid an interest if you have short CFD trades. This is because technically, you are lending money to the CFD provider when you open a short trade and therefore you are to be paid interest.

FINANCE COST COMPUTATION For example, the official cash rate is 6% (interest rates are set by each country's central bank) and a CFD provider will charge an administrative premium of say 2-4%. Therefore you will be charged a minimum of 8% on the total value of your CFD trade on a daily basis for as long as you hold the trade.

BHP 'long' position financing cost
($8,400 x 8%) 360* = $1.86 per day
– this amount will be reflected in your daily account statement from your CFD provider.

*NOTE: *360/year is the industry standard for calculating financing costs.*

things to remember:

- One of the advantages of trading CFDs is it gives you the ability to trade short and therefore the opportunity to make money even if prices are falling.
- Familiarise yourself with the types of orders you can put in with your CFD provider. The better you know your trading platform the easier and more efficient your trading routine will be.
- Though most of the trading platforms will show the same or similar features for entering, amending and closing orders/ trades, there are slight differences in the actual look and feel of each trading platform.

04 Managing your CFD trade

Opening a CFD position is only one part of your trading. The next part is to manage the position to make sure that the trade is doing what you expect it to do. And if it is not doing what you expect it to do, that you can get out of it quickly.

Similar to all other financial products, CFDs have inherent risks and benefits that you have to be aware of. One of the advantages of trading CFDs is the availability of risk management tools and order combinations that will help you manage your trades.

In addition to the order types listed in Chapter 3, there are other order types that you can use to manage your CFD trades.

RISK MANAGEMENT TOOLS

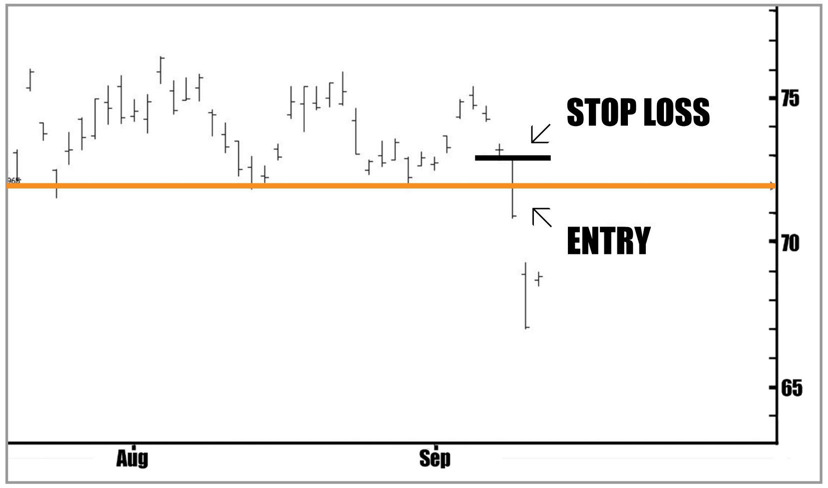
Stop-Loss Order – One of the most effective ways to manage your trade is to use a stop-loss order, which will take you out of a trade once the price of a CFD moves against you. A stop-loss point or level is a pre-determined price at which you want to get out of a trade if it goes against you. Ideally, you should place your stop-loss order using the electronic trading software as soon as you have opened a CFD position.

One thing to note and remember with stop-loss orders though is that even if you have nominated a stop-loss or exit level, there is a possibility that your position would not be closed out at exactly at that price if their is insufficient available volume against your order size or the share CFD price gaps very widely. When a stop-loss 'trigger' price is met, some providers take the order as a limit order which if the stock gaps, means your order may not get filled. other provoders take the order as a market order and will get you out wherever the volume is next available. this could be much lower than you expected but at least yoy will be out. Assess which situation best suite you.In this case, you may be taken out of the position at the next trading price. (There is another type of stop-loss order that guarantees your exit price despite price gaps, see Guaranteed Stop Loss below).

Most CFD providers offer stop-loss orders as a regular feature of their trading platform at no extra cost. Make sure that your CFD provider allows for stop-loss orders and allows you to change them frequently and that it usually can be done online or over the phone for free.

Example of Stop Loss Formula
Acct Size: $ 10,000
Risk 1 % of total Acct: $ 10,000
Equals: $100

CFD Trading (buy) at $2.20
Stop Loss exit trade at $ 1.95
The difference equals risk = 0.25 cents
$100 divide 0.25 = 400 shares (amount of share CFDs to purchase)
Total Risk $100.



Stop/Loss chart

Guaranteed Stop-Loss Order – (GSLO) – This stop-loss order comes with a small premium, because as the name suggests, it guarantees that you are taken out at a pre-set price even if the share CFD price gaps widely against you. A few CFD providers now offer GSLO, but you have to pay a small price to use it. Unlike the regular stop-loss order that can be placed electronically on the trading platform, GSLO can only be placed by calling your CFD provider on the telephone during market hours.

AN EXAMPLE OF A GSLO

You are10,000 long on XYZ share CFD and you already have made some substantial paper profit. You don't want to close the position but you have to be away on a business trip for two weeks. You decided to put a GSLO to protect your profit and to ensure any losses will be limited:

XYZ share CFD price =$10.00
Long position of 10,000
GSLO@5% of CFD price = GSLO set@$9.50
Price goes to $9.25 while you were away
GSLO would have you taken out at $9.50 even if it reached $9.25.

One Cancels (the) Other – (OCO) – This is an advanced type of order which links two orders. In this instance the execution of the first order will mean the automatic cancellation of the other order linked to it. A usual application of an OCO is to link a limit order with a stop order.

AN EXAMPLE OF AN OCO

AMP is trading at $9.00 and you have long position at $8.75. You want to take profit if the price goes up to $9.50 and you want to be taken out if the price goes down to $8.50. You can place an OCO order:

'Sell AMP @ $9.50 on limit OCO $8.50 on stop'

If Done Order – Similar to an OCO, an 'if done' order links two orders together. The difference in this type of order is that once the first order is executed the second one is automatically entered into. A usual application of this order is to set a limit entry and 'if-done' a stop-loss level.

AN EXAMPLE OF AN 'IF DONE' ORDER

AMP is trading at $9.00 and you want to buy if it goes down to $8.75, but you want to exit if the price continues to go down at $8.50. You can place an 'if done order:

'Buy AMP @ 8.75 limit; if done, sell @ $8.50 on stop'

MONEY MANAGEMENT

While the stop loss and other related orders can be used after you've already opened a trade, money management is an important tool that you can use to protect your trading capital even before you enter a trade.

When it comes to trading, money management generally refers to how much money you allocate per each trade. This is also called position sizing. As the term implies, your money management strategy should tell you how much money you should put in a trade considering the expected risk/return. For example, you may only want to put in $3,000 on

MANAGING YOUR TRADE
TRADER EXAMPLE

Christine has been trading CFDs for the past three years and she believes in going where the money leads her. This means she moves and shifts her trading capital depending on the movements of the markets she trades. Though she mostly trades Australian share CFDs, she also likes trading US and UK indices and some currencies.

On a typical day she may have two or three Australian CFD positions which may include BHP Billiton, maybe a couple of share CFDs from the finance sector or other share CFDs on the blue chip companies. When the Australian market closes, she would normally shift her attention to the UK market and may open a few contracts on the FTSE 100 and then later on to the US market, where she also trades the Dow Index or some US share CFDs.

One of the ways she manages her trade is to keep her trade sizes relatively small. This works for her perfectly because sometimes, she said, the bigger your position the more difficult it is to get out of a trade. And she doesn't want to get caught in a position where she couldn't get out whether the trade is making profit or taking a loss.

Though she doesn't have any fixed or pre-set amount for each trade Chris's trades vary from a minimum of $2,000 to $10,000. What she's found out is that depending on the instrument she trades, sometimes, she ends up having smaller lots of trades than just a few big ones.

a particular trade because you only expect a small return from it. On the other hand, you may want to allocate $8,000 to another trade because you think it will give you a higher return than the other trade.

Money management is a very important part of your trading and trading strategy. If you want to know more about money management and the strategies you can implement for your own trading, pay particular attention to the trading strategies towards the end of this book. TradingLounge is also offering a money management system as part of its trade management software (See TradingLounge and the Accounting/Data software)

TRADE MANAGEMENT TOOLS

Like any other professionals with specific tools to do their job, you will also need tools to help you do your trading properly and profitably. These are the basic tools that you need.

Market news and information – whether you want to use fundamental analysis (company valuation method) or technical analysis (share price movement method), there are various sources of trading and market information that can be helpful in your trading. Be careful and be smart in selecting which source you use so that you won't be distracted by excessive information. Also, be mindful that you don't get distracted watching news about the market that you forget about your trading. (An expanded list of these news and information sources can be found at the end of the book).

Newspapers – most of the major newspapers have business sections that carry market and company specific news. In Australia some of the newspapers with informative business sections include the Australian Financial Review, The Australian, Sydney Morning Herald, The Age, Courier Mail, The West Australian, The Advertiser and Canberra Times.

Websites – one of the advantages of trading in the Internet age is the availability of information literally at your fingertip just by clicking the computer mouse. There must be millions of websites that you can use to get market information, but again, be very selective which websites to use. Evaluate a few of them for a few weeks or a month and decide which one is the most helpful for you.

Tip sheets or newsletters – for those who don't want to do a lot or their own analysis, tip sheet services may be the place to start because many of these companies have teams of analysts monitoring the market all the time. They have much better resources in terms of researching and analysing the market than any individual or retail trader. However, it is still ideal and highly recommended that you do your own analysis of the shares/CFDs you want to trade. So while you may start with this, ultimately you will want to develop your own system. Tip sheet and newsletter services may cost you severall hundred dollars for an annual subscription. Many have monthly subscription also.

Data providers – trading data (price, volume and other relevant details) are a must if you want to keep track of your trading position. You need to be able to know the price movement and the volume of transaction on the CFDs you trade. While there are websites where you can see the daily closing prices, you need a data provider that can give you historical data as well as current and up-to-the minute information that will be critical to your trading. There are many data providers that offer information on Australian and international markets. Data providers will charge you an annual subscription fee and some have variable rates depending on the level or detail of the information you require. Scout around for the most reliable provider and do not subscribe based on price alone.

Software programs – Here are some programs I have used: *Metastock*, feature rich charting package. You can progam your own scans, create your own indicators or use the many that are uncluded. Because it has been around for quite some there are many non-official websites with codes, ideas and guides. Next is *Tradesim*: This is a tool that works with *Metastock* for advanced traders with skills in back testing. It allows you to test a method with varying parameters over a large parcel of shares and over many years to determine the results the system would have acheived.

CFD Trading education – Since CFDs are a relatively new financial product compared to shares, you will be better off getting some 'organised' CFD education. Though most CFD providers offer some form of free education, they are mostly limited to training you on how to use their platform or how to place trades. If you want to know more about trading strategies, trading on margin or the use of leverage, you have to learn from individuals or some training companies that have the expertise in trading CFDs.

things to remember:

- Like other financial instruments, CFDs have risks and rewards
- CFDs offer more risk management tools such as stop loss and guaranteed stop loss orders that are not available in shares
- Use money management wisely
- Like any other profession, you need to choose and have your trade management tools

05 On Trading Strategies

Like any career or job you pursue, your trading will be affected or influenced by your personality. If you are a methodical and logical person used to rules and step-by-step processes – it will show in the way you trade. If you are the creative type who eschew rigid rules and who get bored ticking boxes, it will also show in your trading.

Being comfortable with your trading method is very important. There are at least two types of traders (at least among traders): you are either a discretionary trader or a systems/mechanical trader.

A discretionary trader is someone who's an old hand in trading and can just read the numbers as they flow from the market. A discretionary trader can see the comings and goings and has the 'learned intuition' to judge the timing of entries and exits for each trade. This trader would have a deep understanding of all the facets of trading and there would almost be nothing new under the sun in terms of trading.

A systems/mechanical trader is one who uses a system or a set of rules on when to get in and get out of a trade. This trader would have everything spelled out in a system before putting in a trade. A system will include rules about: how much to allocate per trade, when to get in a trade, when to get out of a trade, how much to risk per trade. A mechanical trader would usually have the system backtested using historical data to test the profitability of the rules.

Whether you're a discretionary or systems/mechanical trader, there are a number of trading strategies that you can apply to enhance your trading experience.

THE TRADING LEVELS

The TradingLevels® are based on the golden ratio of .618 applied to price. with the view whole numbers as psychological levels where traders tend to enter and exit trades — we have coined the term 'Trading Levels®'.

Leonardo Fibonacci

The 13th century mathematician Leonardo Fibonacci, noticed in nature, recurring patterns that could be identified mathematically, now known as the Fibonacci sequence of numbers – 1, 2, 3, 5, 8, 13, 21, 34, 55, 89, 144 and so on. This numerical sequence is the sum of any two adjacent numbers in the sequence that forms the next higher number in the sequence : 1 plus 1 equals 2, 1 plus 2 equals 3, 2 plus 3 equals 5, 3 plus 5 equals 8 and so on.. The ratio of any two consecutive numbers in the sequence approximates 1.618 or its inverse .618, known as the golden ratio or golden mean.

This ratio is also a natural part of the Elliot Wave Theory which Robert Prechter outlines superbly in his book *The Elliott Wave Principle*, the bible on Ralph Elliott's price-behaviour theories of the 1930s. Most people find Elliott quite complicated when in fact it's quite simple, and with only three rules. Its my belief that in general traders find it difficult to follow their own trading rules let alone another's. It's a major reason why most traders donate their money to the professionals – the rich get richer! Ask any professional trader and they will happily explain to you that a little discipline towards their own trading rules goes a very long way.

What are Trading Levels?

We view the Fibonacci sequence simply as 'Price' that is, 1 becomes 1 cent, 2 becomes 2 cents, 3 becomes 3 cents and so on, 5 cents, 8 cents, 13 cents, 21 cents, 34 cents, 55 cents 89 cents…

The second aspect to understand, is that the sequence expands by the power of 10, that is,1 cent expands by the power of 10 and becomes 10 cents, 10 cents then becomes 100 cents or $1. Then $10 then $100 then 1000 and 10,000 (high numbers like this can be used with Indices such as the Dow Jones). These are our Trading Levels and are levels of support and resistance in simple terms.

The same principle applies to each number in the series eg. 2 becomes 2 cents (expand by 10) becomes 20 cents, then $2, $20, 200, 2000 and so on.

The Fibonacci sequence and the expanding by the power of 10 will start to look like this: 1, 2, 3, 5, 8, 10, 13, 20, 21, 30, 34, 50, 55, 80, 89, 100, and so on. Remembering that these numbers are now 'Trading Levels', and that any of these levels can be cents, dollars or points. The reason they work is because they have a relationship to one another and that is the golden ratio as you can see in nature itself.

Are certain levels more important than others?

Yes. More than likely 10 will have more presence over its neighbouring numbers 8 and 13 as will 20 to 21 and 30 over 34, 50 over 55 and so on.

As a guideline, if there has been a large correction at $10 – Trading Level®1 (TL1), then there will most likely be a smaller or minor correction a the next level being $13 – TL13, so the next major correction will be at $20 –TL2. You also start to notice that a five wave structure of one degree will occur between the Trading Levels®, making Elliott even easier.

I am talking about this operating in stocks that are in cents, dollars and indices.

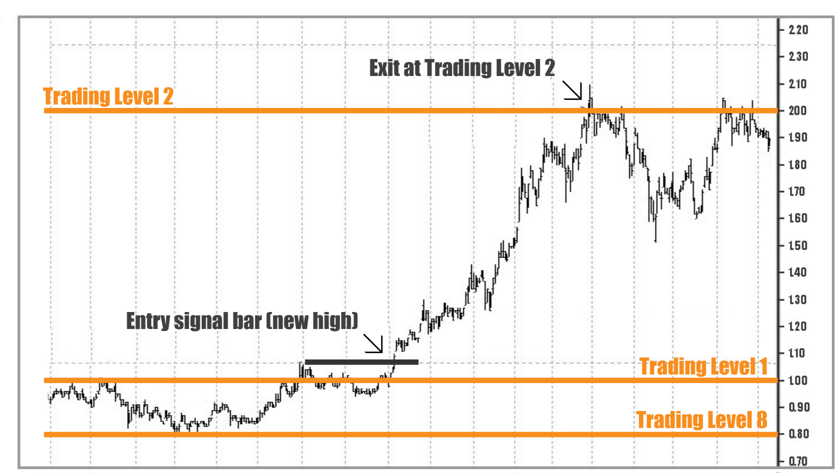
How to use them

As you can see by the sample chart (above), the market will move from one Trading Level to the next.

Corrections can occur at these Trading Levels. Corrections are where traders can lose money and caution is warranted in avoiding being trapped in a trading pattern you don't understand. Once the correction is completed – there are many ways to work this out – then the market will continue to move. I prefer to buy into new highs and sell into new lows, volume pending.

The other obvious point here, is not to buy before these levels, as you will probably be moving into a profit taking correction. You need to be patient and wait until the market has rested back above a trading level and then enter once new highs are confirmed. Also a large sideways correction at a Trading Level is a good foundation for a healthy run to the next Trading Level. The Trading Levels will become more apparent once you draw the horizontal line on your chart at the appropriate levels. You will also begin to notice that there are smaller Trading Levels between two Trading Levels – it is at the 50% level that there will be the largest minor correction. This is important to be aware of as you can move your trailing stop down under the monthly bar to ride out the storm in the tea cup.

The Trading Levels are the discovery of Peter Mathers and used in part of his TradingLounge Analysis Service on what, when and how we trade.



Trading from "Level 1" to "2"

THE ROBO METHOD OF TRADING

This is purely a mechanical method; it can be used in all time frames. The trader needs to find a suitable market and a suitable time frame.

I use it with the TradingLevels® as a trailing stop loss method between levels – usually the monthly low – until the target is reached It can also be used on the weekly bar quite successfully in most markets when its trending betweens levels. You need to learn to avoid corrections normally at whole numbers.

Intra-day trading using Robo.

Day trading is about profit ratios and money management. While there are many styles of discretionary and mechanical and mixes of both, the aim of them all is to look for low risk, high probability trades.

The Robo method is a great method to learn with for many reasons,

- the new trader entering day trading can find it quite emotional and the discipline goes out the window, but a set of rules to focus on creates detachment
- the new trader can use these rules that are simple and easy to implement the entries, trailing stops or the reversing of the position
- the new trader does not have to concern themselves with analyzing the market, but just placing orders and working in front of the market with the order placement

Sample 01: UK Mining Sector

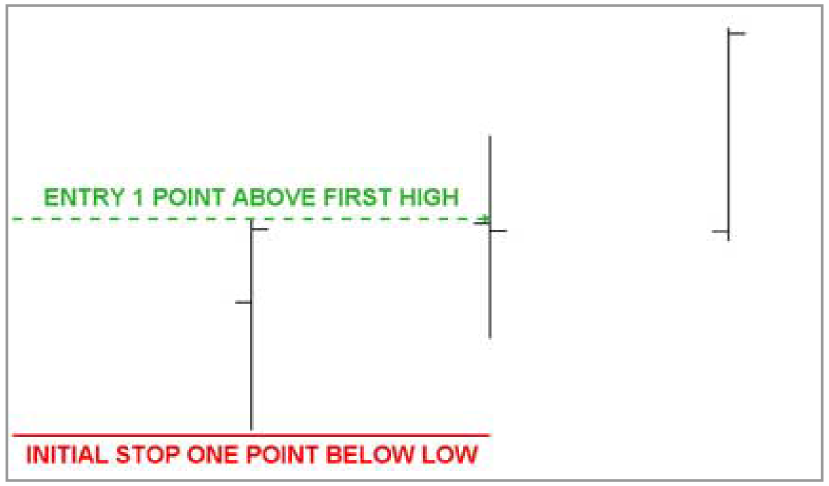
In the chart below, is the UK Mining Sector, it is a one hour bar chart. The first bar falls in place for the day. I don't care which way the market goes we are just going to follow it. If the market makes a new low then short it, placing a sell order one point below the old low. If the market makes a new high then go long, by placing a buy order one point above the old high.

In fact when the first bar is being created, the trader needs to start putting in place the orders one above and one below remembering that you need to work in front of the market. In day trading out of the five days there are going to be a few days on average that will trend nicely and a few days that will be very choppy from profit taking or the market moving around, from support and resistance levels. The day trader first needs to learn when a market is likely to run.

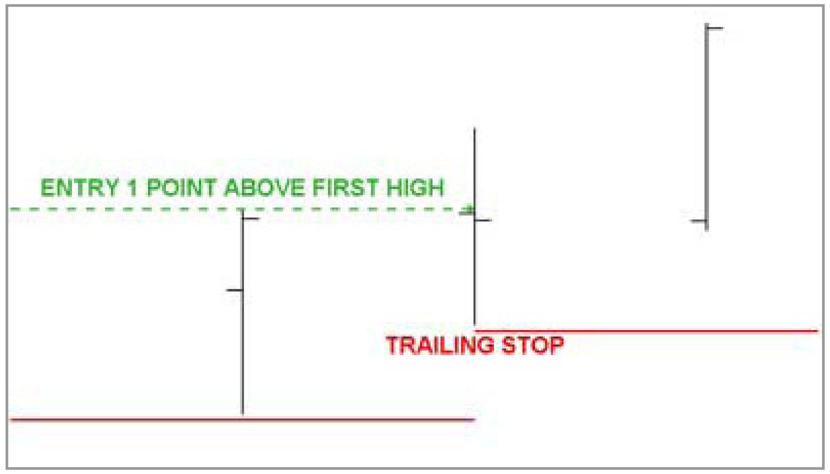
So, here I have chosen the UK Mining because it trends very smoothly. Using the Robo method has advantages in its simplicity and another benefit is that most of the time we don't know how far a market will run – the Robo method will keep the position in the trend and it will also protect profits. Mind you, it is very difficult psychologically for some traders to disregard their opinions about a market and let the system trade for them; this is an aspect you may need to crossover. When you think about it, if the market is going to make new highs or lows and you really need to be on that side so your opposite view can cost you money. As in the graph below once the first bar is in place, then it only seems logical to trade long if there is a new high being made. You're going with the highest probability of what is happening. The Robo offers all the trading rules bundled into one that is clear entry, clear stop (knowing your trading risk) and protecting profits with a clear place to put the trailing stop. And you're trading with the trend, if it is going to trend, you are going to be on it; of course we don't know if it will trend or if it does how far it will go, but you will be on it and protecting profit and letting them run, keeping the risk minimal; that is the essence of day trading in a nut shell.

Once the first bar is in place and the new high is made activating the long order, the Initial stop is placed, when the third bar starts, then lift the stop up under the next bar.

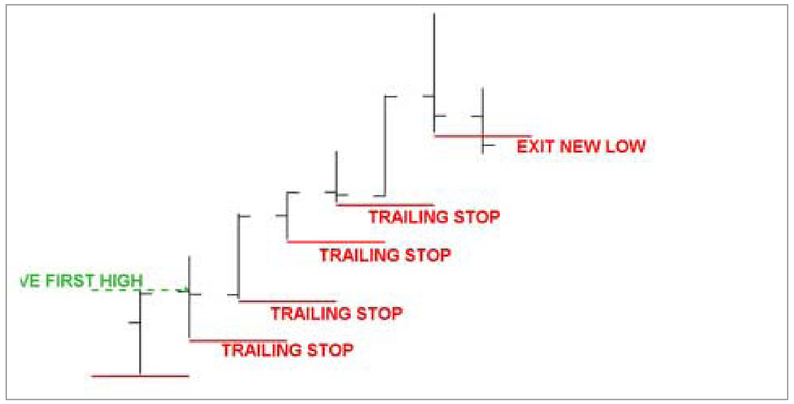
NOTE: It is handy to have two screens day trading – on one screen have the 'Offer' chart and the other the 'Bid' chart. The long orders are taken off the "Offer" chart price and the stops are taken off the 'Bid' chart, because there are no commissions charged but there is still the spread and using this market on sectors and indices the trader needs to accommodate that in setting the entries and exits at the right locations on the charts. This is important.



Lifting the stop: the stop is now a trailing stop. It is important to place the new stop in the market first, then remove the old stop, when you're using this method in shorter time frames this will become more apparent. Always work in front of the market.



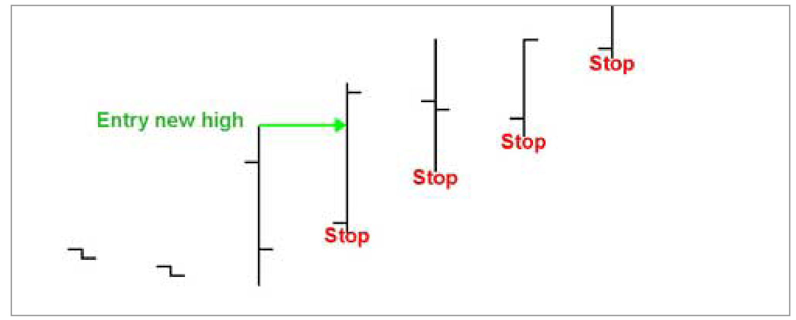
Below: This is the whole day on the UK Mining Sector still using the 1 hour bar chart. Lifting the trailing stop and at the end of the day the long position was stopped out by the market making a new low, which the stop was set one point below the previous bar.



Below: On the third bar there has been a new high and a long position activated, the initial stop in put in place, then the trailing stop is lifted into place, however because this is so early in the trading session, the trailing stop is a reverse order, that is, if the trader had one position long, then simply the trailing stop order is Sell 2, now the trader has one position short, on the new low. Now that the trader is short one position, a stop needs to be placed one point above the last high (Initial stop) then the trailing stop is lowered one point above each high.

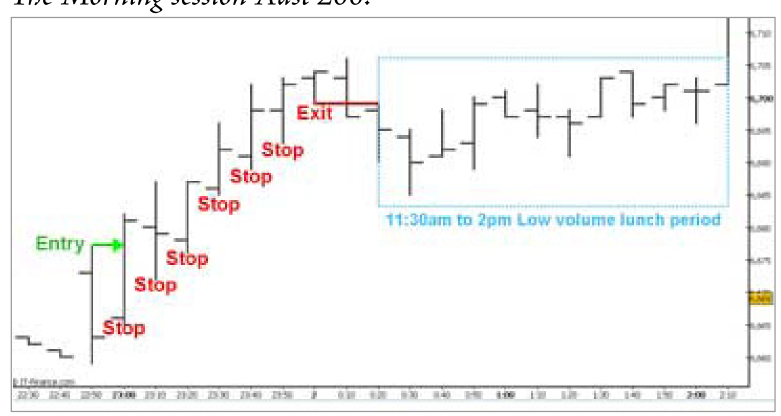
Sample 02: Aust 200

The below charts are based on the Aust 200 using a shorter time frame of 10 minute bars. Once again, waiting for the first 10 minute bar to fall into place, then Buy the high or Sell the low of that bar, the previous period bar, and placing the stop under the bar and keep lifting the trailing stop.

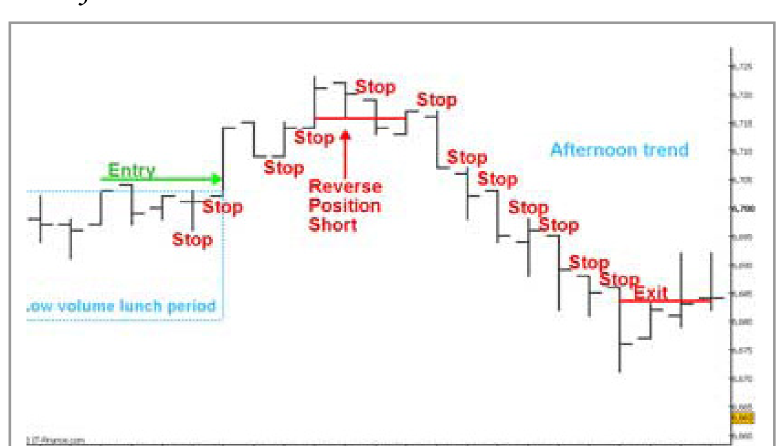


Essentially day trading the morning and afternoon sessions, leaving alone the low volume and choppy lunch time session. (11.30am – 2.30pm is a low volume time in most markets locally and internationally with most intraday traders not placing orders during this time)

The Morning session Aust 200:



The Afternoon session Aust 200:



1% RULE

This is really simple,. There is an old 1% rule, that is, only risking 1% of your total capital per trade. Some say that's too much and others say that's too little. Between 0.5 and 1% is a reasonable starting point for risk. This is only one way of managing risk and creating your trade position size, I would however stress the importance of further development.

things to remember:

importance of further development.

- Trading shorter time frames with financial leverage is very different to investing over the longer term. Watch out for the many subtle facets you will meet along the way.
- Being comfortable with your method is very important. Test your method/system along with good old fashioned back testing and money management.
- The Fibonacci sequence is the basis of the Trading Levels. Observe how they manifest in your charts.
- Robo is a simple strategy for a trending chart.

Glossary

CFD – Contract for Difference. A derivative product that mirrors the price of the actual or underlying share, index or sector it is based on.

Commission – in a CFD transaction, commission is equivalent to the broker fee that you pay to make a trade with your stock broker. The average commission is approximately $10 for up to $10,000 worth of CFD position. However, commission rate may vary from one provider to another due to the competitive nature of the industry. Some CFD providers may offer lower commission for high value trades.

Financing charge/benefit – this refers to the interest that you have to pay or that would be credited to you when you leave a CFD position open overnight. You will be charged a financing cost (interest) if you have a long CFD position and you leave it open overnight.

On the other hand, you will be credited a financing benefit if you have a short CFD position that you leave open overnight. The financing cost and benefit are calculated and charged or credited to your trading account on a daily basis. The financing charge/benefit is computed based on the total amount of your CFD position, not on the margin requirement.

Good for the day – refers to the duration or length of time a position is to be left open. A good for the day order or trading position will automatically be terminated at the end of the day if it wasn't executed during the trading hours. This order means you have to place another order the next day because the original order would have been terminated at the close of the trading session.

Good til cancelled – an order that will remain in place and for execution until it's cancelled. A good til cancelled order may remain for a few days or even weeks or until you cancel it.

Guaranteed stop loss – as the name suggests, this is the type of order that guarantees a level where you will be automatically stopped out of a position when a trade turns against you. The guaranteed level or price where you will be stopped out will be pre-arranged with your CFD provider. This is usually a few cents or a certain percentage away from the market price of the CFD you want to trade. This type of order attracts a certain premium and is usually paid the moment you place it, not when it is executed. Not all CFD providers offer guaranteed stop loss orders, so you have to check with your provider.

Hedging – this involves taking an opposite position that will offset any losses in the actual investment. Usually hedging is used to limit or minimise the risk in an investment. For example, if you have 1,000 BHP Billiton shares and you want to hold on to them for the long term. However, the short to medium-term outlook for BHP shares is down. To protect your BHP holdings you can go short 1,000 BHP share CFDs (as a hedge) which will give you profit from a fall in the share price. This means the losses from the physical shares are being offset by your gains in the short share CFD position.

Index CFD – this is a CFD issued based on a particular index, which is a collection of stocks and the corresponding composite value of its components. In Australia, the major index is the All Ordinaries which represents all the listed companies. The S&P/ASX 200 is another important index which represents the top 200 listed companies in the Australian stock market. Some of the major international indices include the Dow Jones Industrial Average (US), S&P 500 (US), Nasdaq 100 (US), FTSE 100 (UK), CAC 40 (France), DAX (Germany), Nikkei 225 (Japan),

Limit order – is an order where you specify the price where you want to buy or sell. A limit order is useful when trying to capture or protect your profit in a certain trade

Long position (going long) – To go long on any financial instrument such as shares or share CFDs means to buy them. When a trader/investor goes long it means the trader expects the price of whatever is bought to go higher and to sell it at a profit. (Opposite of going or short selling)

Margin – in a CFD trade this pertains to the amount of money required to be in your trading account for you to open a trade. Margins may vary from one provider to another and also depending on the share CFD you want to trade. For example, some providers will only require 3% margin for share CFDs in the top 20 ASX listed companies. Other CFDs outside the top 50 companies may require 10% margin.

Margin trading – is similar to taking a margin loan to buy shares or CFDs. When you trade on margin, you are technically borrowing money from the provider or broker because you are trading a much bigger position than what you would normally trade and you are only putting upfront a small portion of the total trade amount. Margin trading is considered a double-edged sword because it can magnify your profits as well as your losses. If done properly and in tandem with good money management, margin trading maybe a profitable way to trade. However, if done without regard for the risks involved, it may be disastrous to your trading.

Margin call – you will get a margin call when the amount of your position has gone lower than what you have put in. Margin calls may vary from one provider to another; however some providers give you a buffer of 5% before your position is liquidated. When you get a margin call you have two choices: you can either put in more money into your trading account to bring the balance to the required level; or you may opt to close the position.

Market order – this is an order you place to buy or sell a CFD at the current market price. If you are a buyer, you are willing to pay the price on the Offer, and if you are a seller you are willing to accept the price on the Bid.

Position sizing – this is a trading strategy that involves allocating different amounts of money per trade. As a trader your first priority is to protect your trading capital and position sizing is an effective way to do it. This means not putting all your trading capital in one trade because if the trade goes against you it may wipe out your trading account.

(CFD) Provider – a CFD provider is the other party in a CFD trade. The CFD transaction you enter into is between you and your CFD provider. This is because CFDs are over-the-counter products similar to currencies (FX). In Australia and globally some of the CFD providers include City Index, CMC Markets, IG Markets, Macquarie CFD and Man Financial. Many CFD providers originated from the United Kingdom.

Sector CFD – a CFD based on a specific industry sector such as Energy, Industrials, Materials, Consumer Discretionary, Consumer Staples, Health, Financials, Telecommunications and Utilities.

Short selling (going short) – the opposite of going long. This means selling a share CFD with the expectation that the price will fall and buying it back at that lower price with a profit. Short selling CFDs involves a much simpler and less expensive process compared to short selling the actual shares.

Spread – The difference between the bid and the ask price of a security or asset.

Stop loss – A stop loss point or level is a pre-determined price at which you want to get out of a trade if it goes against you. Ideally, you should place your stop loss order using the electronic trading software as soon as you have opened a CFD position. A stop loss level is usually a few cents or a small percentage below your entry price if you have a long CFD position or a few cents or small percentage above your entry price if you have a short CFD trade.