

Buy & Hold CFD's (Contracts For Difference)

Requirements

- Access to a CFD (Contract for Difference) Brokerage account
- Knowledge, understanding and practice in buying/selling CFD's
- Medium to Long-term market outlook

Benefits

- Using the same principles for decision-making for investment with stocks
- Purchasing CFD's requires a smaller investment to hold value of the same underlying stock position. Example; \$10,000 of stock would be approximately \$1,000 of CFD value.
- Risking smaller amount of investment capital to gain a larger percentage of profit.
- Can Buy a CFD that benefits from the markets increasing, or Sell a CFD for markets that are decreasing.

Risks

- Lack of understanding of how leverage investments affect your portfolio can cause investors to expose too much risk to the markets, resulting in Margin Calls.
- Education and practice are required to gain a thorough understanding of CFD's. This takes time and patience.
- More than 100% of the position could be lost if position is not managed correctly
- Long-term positions create a large "Interest" cost. Therefore, the position must gain sufficiently to make a profit above the cost of Interest and brokerage.

How to ...

- Decision on direction and long-term expectations for company must be established
- Buy CFD's in the stock if expecting upwards stock price activity. Sell CFD's in the stock if expecting downwards stock price activity.
- Establish exit criteria before entering into position. How long will you hold the position if it is shifting against you? At what point will you close the position for a profit? (See Trading Plan section)

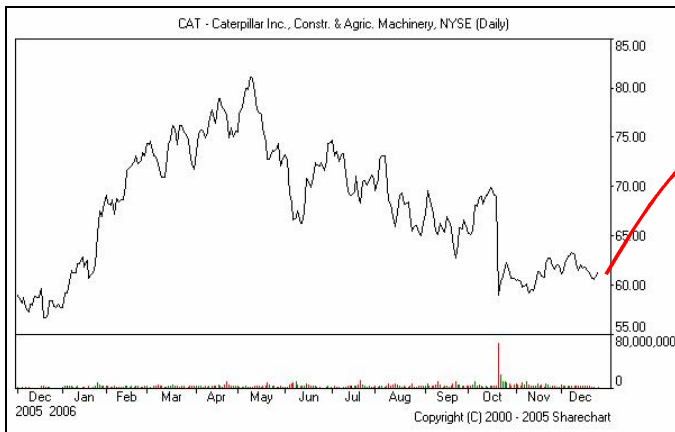
Tips & Hints

- Only purchase CFD's if you fully understand how they work, and have practiced with trading/investing in positions
- As with any investment strategy, only invest capital that you can afford to invest with.
- Establish a clear and precise plan for entry and exit, no matter the time frame expected for investment.
- Although you use less capital on the one position, do not increase the amount of money you use. Example, you may buy \$10,000 of stock, but do not buy \$10,000 of CFD's. Purchase \$1,000 of CFD's or 10% of the value you would use on the stock position.

FMR Analysts

INDEPENDENT
STRATEGY ANALYSIS

Example



Expecting share price to rise over

- CAT (Caterpillar Inc) has retraced through most of 2006.
- Investor believes that CAT is a fundamentally strong company
- For last 2 months, stock price has held above \$60 per share
- Investor believes that CAT will be worth more than \$60 over the coming year, potentially trading back to last long term high around \$80

Decision has been made to enter into a long CFD.

CFD Trade

80781/SPC000298

Place an Order

All Exchanges

CAT:nys

Search ...

CFDs: 325

Margin: 1,995

Caterpillar Inc.

Buy Sell

Type: Market

Duration: DO

Share Price: 61.35

Est. CFD Price: 61.381

Commission: 14.96

Nominal USD: 19,948.82

Interest Paid: 4.60

Place Order

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- The current stock price for CAT, according to the quote above is \$61.35 per share.
- If we were investing \$2,000 on stock, we would be able to purchase 32 shares in CAT.
- Using CFD's, we could purchase 325 CFD's with our \$2,000 - see Margin in above image.
- Because CFD's give us a 1:10 leverage (we can purchase 10 CFD's to 1 stock), we are actually controlling a position to the value of \$20,000 (325 times \$61.35)
- If the share price rises back to its last long-term high around \$80, the share position would have gained \$20 per share, or 33.33%. For the CFD, this is a 333% gain in value
- If the share price retraced, a 100% loss would be realized when the stock price traded down to \$55.21

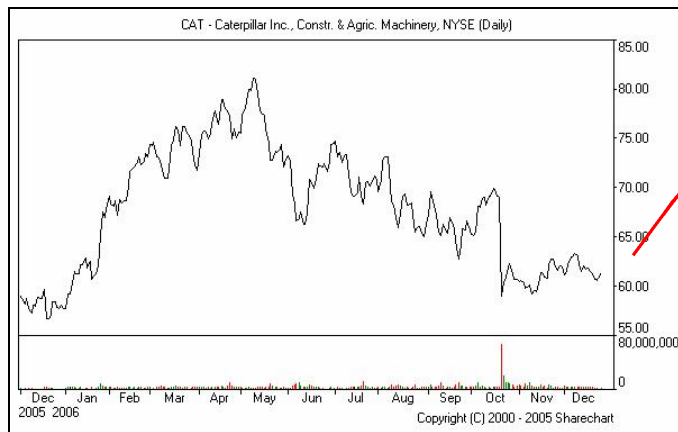
Order Placing

Buy 325 CAT

- When entering into a CFD position, the investor must be specific with their terminology.
- The first section of the order denotes what the action is - Buy or Sell.
- The next section of the order denotes the number of CFD's. Remember, we would purchase/sell 10 times the number of stock we would purchase/sell.
- Finally, the trader will need to specify how to transact the order; 1) at market value (the current price), 2) at a limit (a maximum price paid), or 3) some sort of advanced order (beyond the scope of this explanation).

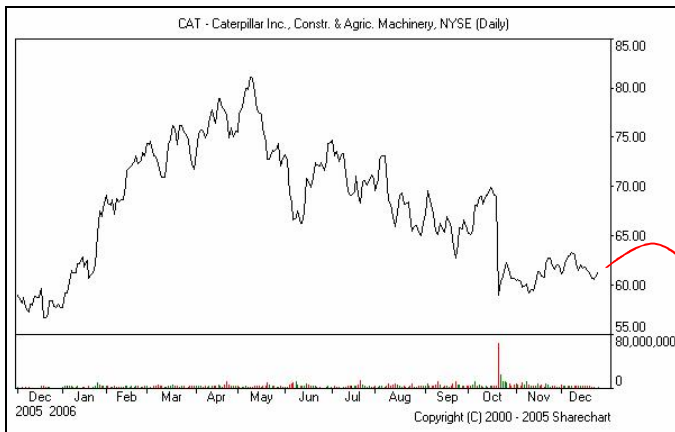
What to do if ...

If the stock price rises:



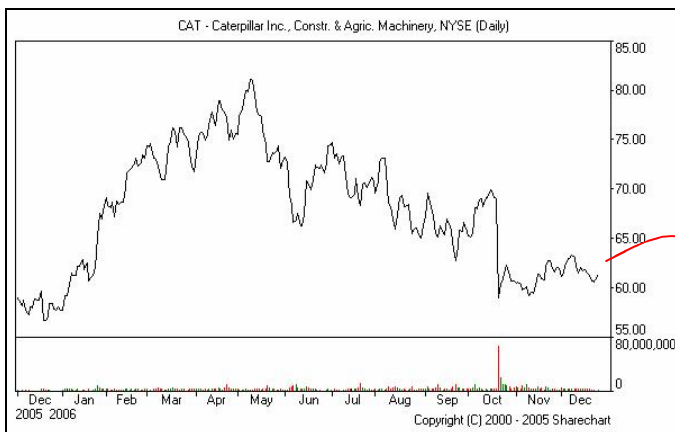
- This price movement will benefit a bought (Long) CFD position, but negatively affect a Short (Sold) CFD position.
- Use profit strategy for bought (Long) CFD's, but adopt exit strategies for short (Sold) CFD's - Keep losses short.
- Hold long CFD position as long as you believe there is reason for the stock to continue rising. Example; company remains fundamentally strong, stock price maintains an upwards trend, and/or positive sentiment remains with company
- Be aware, that there may be short-term counter-trend retracements, where the stock price falls slightly before resuming upwards trend
- Establish pre-determined points to exit, either at a monetary/percentage value or based on time.

If the stock price remains steady:



- Establish a “time frame” for exiting the position. CFD’s create an interest payment which is calculated daily. The longer the position fails to find direction, the higher the cost in interest you will be charged.
- Is there a reason for the stock price failing to find direction? Could the stock find the bullish/upwards activity you were expecting, or could it eventually find sellers?
- Rule of thumb ... the longer the stock price holds the support level, the stronger the sentiment becomes that buyers could prevail. But once that support level is broken, it is clear there are no interested buyers in the market - exit the option position.

If the stock price falls:



- This will benefit short (Sold) CFD’s, but will cause a loss in bought (Long) CFD’s.
- Adopt profit strategy for short (Sold) CFD’s, but look for an Exit strategy for bought (Long) CFD’s - Keep losses short
- In the above CAT example, the position was entered because support around \$60 had been identified, suggesting that buyers found the stock as a “good buy” at that level. If the stock price were to break the support level, then the reason for entering a long CFD position is no longer valid. The position should be closed.

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- Establish a value at which you are willing to exit the long CFD. This could be determined by a percentage fall in stock price, or maybe a dollar loss.
- Maintain discipline. When the stock price reaches your exit point, close the trade - no matter what your expectations are. If the stock price recovers, you can re-enter later. However, if the stock price continues to fall, you will realize a loss.

Defensive action ...

CFD's do not offer the same Risk management strategies that option offer. Therefore, you are unable to enter a different CFD position to limit risk in the event of the position shifting against you.

In saying this, a trader with option knowledge could be able to offset their position with the opposite option contract. That is, if a long CFD has been bought, then a Put option contract could be purchased, and vice versa for a short CFD with a Call option contract.

There are implications that need to be considered before adopting this strategy, which is beyond the scope of this article. However, a future article will be added to discuss these factors.

Presently, there is not a broker who has the facilities to accommodate a CFD and option position to offset their account. This has a major impact in the management of positions, requiring more manual transactions on behalf of the investor. Once an integrated account becomes available to the general market where the option position will be recognized as security against the CFD position, this strategy will become more readily available to all traders.

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