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CONTRACTS FOR DIFFERENCE

Strategic profit

By JENNY DILLON

MANY people find it hard to get their heads around the notion of contracts for difference, or CFDs as they're called by those in the know.

These contracts allow traders to speculate on the direction of shares, or other commodities such as gold or oil, without needing full ownership of the commodity being traded.

And while the trader actually owns only a small percentage of the commodity, he takes all of the profit — or the loss.

Typically, trading is swift and frequent, with many CFDs held for only a day, the trader pocketing the difference between its opening and closing price.

CFDs have grown spectacularly since they were introduced by CMC Markets in 2002.

The second annual 2007 CFD report by Investment Trends said the number of CFD traders doubled in the year to April 2007 and 96 per cent of traders intended to increase (66 per cent) or maintain (30 per cent) their level of trading, with just 4 per cent deciding to stop altogether.

CFDs are a highly aggressive way of trading shares, using other people's money, Man Financial head of institutional sales Anthony Anderson said.

Before CFDs, a trader wanting to buy shares would be lent a maximum of 65 per cent of the value. Now, some borrowers wanting to trade in CFDs can get up to 97 per cent.

"The experience at Man is exactly the same as buying a share on the ASX, except you're using our money and we charge you for that privilege," he said.

What makes them exciting to traders, he said, is that because the trade is leveraged, the profits are magnified significantly.

But so are the losses.

For example, say you had $5000 to buy some shares. If the bottom fell out of the market and the value of the shares fell to zero, the most you could lose was $5000, he said.

But if you decided to buy up to $100,000 worth of shares with that $5000 (the remaining $95,000 would be borrowed), you could theoretically lose $100,000 if the shares fell to zero.

"You've got to play within your limits and comfort zone," Mr Anderson said. "Sure, a lot of people have made a lot of money, but a lot of people have also lost a lot of money. Shares don't go in a straight line."

A person who understands exactly that is David Limburg, a 27-year-old from Maroubra.

As an account holder with CMC Markets, he was entitled to enter a CFD contest run by the company and last week he emerged as the winner, with a return on his investment of a spectacular 441.8 per cent.

With his own money, he made slightly more than $100,000 during the competition. Then because he was the most successful trader, CMC gave him the $100,000 prize, meaning he made just over $200,000.

Lucky or skilful? "Somewhere in between," he conceded.

Trading in CFDs has been his full-time job now for slightly more than a year.

After living like a pauper at university, when he started earning money he wanted to invest it to secure his future.

"It was typical mum and dad investments, Telstra, BHP, but I got ordinary returns and started to look for a more efficient way to trade the market."

He learned by reading a lot of books and losing a lot of money.

"I was treading water for five years, until about two years ago. Now I've just started to work it out," he said.

In the game his strategy was just as he'd normally trade — to start each day looking for breakouts on daily charts.

"The daily chart is a graph of the trading ranges over, say, three months or some other time period," he said.

"I'd look for patterns in the charts and try to predict where moves would come from."

On average, he'd hold a position for two or three days, although sometimes it might be only a few minutes.

Importantly, he didn't worry about losing the lot.

"I always have good risk management systems in place, and I never risk too much in each trade. I think I've worked out how to be more efficient, taking less risk on my losing trades and letting my winning trades run."

His advice for would-be players is to read a lot before you start putting money in, "and don't take other people's advice, for example tipsters or brokers who have a vested interests".

Success . . . David Limburg says he's started to work out CFDs after seven years. Picture: JOHN GRAINGER