Diary of a trader

I log in to start my month-long CFD trial...

How should a novice approach contracts for difference? For speculation or hedging? Fast gains or safety? What are the pitfalls? For answers, **Chris Wright** trialled a CFD platform during the most volatile month since the GFC. He shares his experiences.

Mon	Tue	Wed	Thu	Fri	Sat	Su
			1	2	3	4
5	6	7	8	9	10	11
12	13	14	15	16	17	18
19	20	21	22	23	24	25
26	27	28	29	30		

MONDAY September 5

It's been a characteristically miserable day in the markets: the S&P/ASX 200 is down 2.2 per cent at lunchtime and the Asian markets are faring worse. The market chat is about miserable US economic data, while the fate of European sovereign debt lurks in the background like a hangover. It's against this backdrop that I key in my password and log in for a month-long trial on a popular contracts for difference platform. I have $20,000 of mock capital (regrettably, it's not real) and I'll paper trade until I think I've figured it all out.

As I log in, my first impression is of a data-heavy page with some regular flashing red and blue lights. Closer inspection shows the flashing is next to buy and sell prices on $A/$US foreign exchange rates, the spot gold price, the FTSE 100 (it's late in the day and London is in session) and crude oil. I look at the various menus and within seconds realise I need some training.

I also have access to the platform's training modules and I've decided my job for the first few days will be to get through the six-part series before trying even a paper trade. The modules, in PDF form on this platform, are well ordered and filled with examples. The early emphasis tends to be on unfamiliar things such as short positions, which makes sense because most people coming here will have bought shares in the traditional manner beforehand.

In real life, I'd also be making a decision now on whether to pay extra for live data – which depends on just how closely you want to follow the market.

THURSDAY September 8

I've gone through the six training modules. A lot of it is about risk management and I like the bluntness of some of the advice: "Do not trade for fun. Do not trade because you are bored. Do not trade because you are scared of missing out." And, "Leave your ego at the door and admit when you are wrong."

The CFD trading process seems straightforward. There's a lot of explanation around stop-losses and I've decided I'll use them (or a limit order) on every trade I make.

In the time I've been going through the modules, the world has gone through yet more tortuous ructions: the Swiss central bank has set a ceiling (or floor, depending on which way you look at it) for the Swiss franc against the euro and the fear in world markets now is of a currency war. It doesn't look good.

For various reasons tedious and unfortunate, I own a tonne of bank stocks that are a mile underwater. Had I had a CFD account earlier I could have taken a short position against banks to hedge them. It's too late to insulate those losses but, frankly, it looks like things will get worse before they get better, so I decide to short Macquarie Bank (MBL) as a hedge.

The way I see it, if I'm wrong then at least my other bank shares will be rising. Part of me can't help but feel that this is cutting off my nose to spite my face and that I should just have the courage of my convictions; the other half thinks it's prudent risk management and if I'd done this ages ago I'd be living in a larger house.

Conducting a trade is simple: type in the stock code, do any research you want to do in another window (charts, Reuters information etc), set the size of your trade, put a stop-loss on if you want to, and press buy or sell. I decide to sell 100 Macquarie shares, worth $2380 or roughly 10 per cent of my opening account.

But I've forgotten just how powerful leverage is in a CFD platform. You need only put down a fairly modest amount to effect a major exposure. So having made what, to a usually long-only investor, appears a reasonably significant trade, I notice that I still have $19,992 of funds left and have spent just $87.49.

My initial reaction is: Oh, I should make it a much bigger trade. And then I realise I've learned my first lesson about CFDs. The power of leverage is great, amplifying good and bad calls equally, and just because you have the ability to use it doesn't mean you should.

...Europe plunges, my $20,000 of equity stands at $36,240. Clearly I'm a genius...

CHYNA ROSE WRIGHT

I leave Macquarie as it is but also decide to short the European market. Nothing in recent weeks has made me think anyone has the faintest idea how to fix the European sovereign debt problems and that things are going to get worse before they get better.

Again, there's a logical hedge here. While I don't own many European stocks I do have lots of stocks that fall when there are global macro-economic worries – indeed, it's hard to think of any that don't. So I find, without really thinking about it, that I'm using CFDs as a hedging tool rather than a money-grabbing exercise.

I go to the indices panel and pick the EU 50. I take a bigger position here, and now I've used a total of $2000 of margin. Once again I've used a stop-loss, so if I've understood the system correctly, the trade will close out at a point where my maximum losses are about $4000. While I wouldn't want to lose that in real life, I comfort myself with the fact that if it happens, then probably my other shares (the ones I really own in this bitter reality) have been going up.

Within seconds, I'm down about $500. I log off and get some work done.

FRIDAY September 9

Next day, I find myself up about $2000. Suitably galvanised, I decide it's time to try foreign exchange, otherwise known as FX.

Having traded only shares in the past, it takes me a little while to work out which way I ought to be betting (let's be honest, with forex, it's all betting)to express my view. I have a theory, you see, and want to try it out: Switzerland's pegging of the Swiss franc, to support its exporters, is another bit of news that's not great for the euro. Also, people will be looking for another safe-haven currency if the Swiss franc can't move. Everyone's talking about the Singapore dollar, but why not the Aussie? What could be safer and more supported than our very own dollar?

So I take a long position on the Aussie-euro cross rate. I notice that just one lot requires more than $1000 of margin, a reflection of the leverage involved in CFDs. I decide to put my stop-loss in 30 pips below the trade, which means the trade will close if the exchange rate falls from the 76.30¢ where I've bought in to less than 76¢. On reflection,

No Material

No Material