Equitrade Capital
Global Financial Markets

CFD Factsheet

CFD's

What is a Contract for Difference?

"A contract for differences (CFD) is an arrangement made in a futures contract whereby differences in settlement are made through cash payments, rather than by the delivery of physical goods or securities."

A CFD is an agreement between a 'buyer' and a 'seller' to exchange the difference between the current price of an underlying asset (shares, currencies, commodities, indices, etc.) and its price when the contract is closed.

CFDs are leveraged products. They offer exposure to the markets while requiring you to only outlay a small margin ('deposit') of the total value of the trade. They allow investors to take advantage of prices moving up (by taking 'long positions') or prices moving down (by taking 'short positions') on underlying assets.

When the contract is closed you will receive or pay the difference between the closing value and the opening value of the CFD and/or the underlying asset(s). If the difference is positive, the CFD provider pays you. If the difference is negative, you must pay the CFD provider.

CFDs might seem similar to mainstream investments such as shares, but they are very different as you never actually buy or own the asset underlying the CFD.

The key benefit to trading CFD's is that by only depositing a fraction of the overall value of your position in the market, you are able to free-up extra capital and magnify profits. The flip-side of this is that losses can also be magnified and may exceed the initial deposit needed to keep this position open.

Why Choose CFD's ?

One of the main reasons for choosing to trade through a CFD is access to leverage. Why? Because leverage offers a reduced margin requirement when compared to a full investment - you put in less to potentially gain more. But remember, if the market does not react in the way you expect, you can also lose more too.

Contract for Difference Example

Example & Co. are currently trading at £10 per share, you believe this fundamentally undervalues the stock, and that prices will rise. You decide to buy 4000 share CFDs (units) in Example & Co. at the current price of £10 per CFD, your total position in the market is £40,000 (4000 X £10). The allure of CFD's is that you don't need actually pay £40,000 to have that exposure in the market; instead the amount you pay depends on the margin required by the CFD provider. If the margin requirement for Example & Co. is 5% you would only need to fund £2000 (5% of £40,000) to support the position in the market. Your returns are then calculated on the difference in price between when you opened the position ("bought") and when you close the position ("sell").

If the share price of Example & Co. increases by 5% (from £10 to £10.50), and the margin requirement was 5%), you would make the total amount (100%) of your initial margin payment = +£2000.

If the share price of Example & Co. decreases by 5% (from £10 to £9.50) and the margin requirement was 5% (leveraged 20 times) you would lose the total amount (100%) of your initial margin payment = -£2000. If Example & Co. decreased by 10% (from £10 to £9), and the margin requirement was 5% (leveraged 20 times) , you would lose your initial margin payment -£2000 and would be contacted for a further £2000 (margin call) to keep your contract open. Meaning your losses may be more than your initial margin payment.

"An investment in knowledge, always pays the best interest.
- Benjamin Franklin"

CFD Long Example

You go long when you open a position to profit as the asset increases in value.

You go long on (purchase) 4000 Example & Co. shares at £10, There is a 5% margin requirement , resulting in an initial payment of £2000 and resulting in a market position of £40,000.

Buy (Long) 4000
Example Co. Shares
5% Margin requirement = £2000 deposit
Total exposure =£40,000
Market value = £40,000
Equitrade open commission = £100 (0.25% of total exposure)

Market Value
£40,000
Required Deposit £2000

Profit Scenario

After 4 days, shares increase in value by 5% to £10.50 and you decide to close (sell) your position.

Sell (Close) 4000
Example Co. Shares
Equitrade Close commission = -£105
(0.25% of market value)
4 Day holding fee = -£13.20
(2.5% + interbank rate, annualised)

Market Value
£42,000
Required Margin £2100

Profit is calculated on your total position in the market (£40,000) and therefore you are left with £2000 gross profit.

After accounting for costs
You are left with £1781.80 net profit.
(£2000 - £100 - £105 - £13.20) = **£ 1781.80**

Loss Scenario

After 4 days, shares decrease in value by 5% to £9.50 and you decide to close (sell) your position.

Sell (Close) 4000
Example Co. Shares
Equitrade Close commission = -£95
(0.25% of market value)
4 Day holding fee = -£13.20
(2.5% + interbank rate, annualised)

Market Value
£38,000
Required Margin £1900

Loss is calculated on your total position in the market (£38,000) and therefore before costs you are left with a -£2000 loss.

After accounting for costs
You are left with =£2208.20 loss.
(-£2000 - £100 - £95 - £13.20) = **£ 2208.20**

CFD Short Example

You go short when you open a position to profit as the asset decreases in value.

You go short on (sell without owning) 4000 Example & Co. shares at £10, There is a 5% margin requirement , resulting in an initial payment of £2000 and resulting in a market position of £40,000.

Sell (Short) 4000
Example Co. Shares
5% Margin requirement = £2000 deposit
Total exposure = £ Unlimited
Market value = -£40,000
Equitrade open commission = £100 (0.25% of total exposure)

Market Value
-£40,000
Required Deposit £2000

Profit Scenario

After 4 days, shares decrease in value by 5% to £9.50 and you decide to close (buy) your position.

Buy (Close) 4000
Example Co. Shares
Equitrade Close commission = -£95
(0.25% of market value)
4 Day holding fee = -£8.79
(Interbank rate - 2.5%, annualised)

Market Value
-£38,000
Required Margin £1900

Profit is calculated on your total position in the market (-£38,000) and therefore you are left with £2000 gross profit.

After accounting for costs
You are left with £1796.21 net profit.
(£2000 - £100 - £95 - £8.79) = **£ 1796.21**

Loss Scenario

After 4 days, shares decrease in value by 5% to £9.50 and you decide to close (sell) your position.

Buy (Close) 4000
Example Co. Shares
Equitrade Close commission = -£105
(0.25% of market value)
4 Day holding fee = -£8.79
(Interbank rate - 2.5%, annualised)

Market Value
-£42,000
Required Margin £2100

Loss is calculated on your total position in the market (-£42,000) and therefore before costs you are left with a -£2000 loss.

After accounting for costs
You are left with =£2208.20 loss.
(-£2000 - £100 - £105 - £8.79) = **£ 1786.21**

Costs

In addition to any profits or losses, there are different types of costs linked to transactions in CFDs. Costs will impact the effective return. Examples of costs include commission on each trade (i.e. on opening and closing a contract), daily and overnight financing costs (Interbank rate + 2.5% for long positions, dependant on provider) and (Interbank rate - 2.5% for short positions, dependant on provider).

What are the main risks of investing in CFDs?

CFDs, especially when highly leveraged (the higher the leverage of the CFD, the more risky it becomes), carry a very high level of risk. They are not standardised products. Therefore, generally, they are not suitable for most retail investors. You should only consider trading in CFDs if you wish to speculate, especially on a very short-term basis, or if you wish to hedge against an exposure in your existing portfolio, and if you have extensive experience in trading, in particular during volatile markets, and can afford any losses. CFDs are not suitable for 'buy and hold' trading. The volatility of the stock market and other financial markets, together with the extra leverage on your investment, can result in rapid changes to your overall investment position. Immediate action may be required to manage your risk exposure, or to post additional margin.

What can you do to try and protect yourself?

Discuss and agree a trading strategy with your Personal Broker which matches your appetite for risk and investment goals. Be clear on what you are prepared to risk and keep your Broker informed of any changes to your financial circumstances.

Stop Losses - Knowing your limit

To limit losses there is the opportunity to choose 'stop loss' limits. This automatically closes your position when it reaches a price limit of your choice. Although there are some circumstances in which a 'stop loss' limit is ineffective - for example, where there are rapid price movements, or market closure. Stop loss limits cannot therefore always protect you from losses. The market is constantly influenced by news, opinions, trends and political decisions which can result in unexpected volatility a smartly placed stop loss can help, but there is no 'golden rule' for all traders or trades. For each trade, you need to select the appropriate stop loss limit. Your Broker will help guide you by considering the trade's time frame (remember - the longer a trade is open, the more volatile it will probably be), the target price, the account size and current balance, other open positions, general market sentiment (e.g. volatile, nervous, awaiting news or other external factors) and how long will the market stay open (e.g. is the weekend coming soon or is the market closed overnight)?

Limiting your Leverage

The higher the leverage, the faster you gain profit or loss. If you lose, it may be because of over leveraging - meaning you chose a leverage level with a risk too high to reasonably manage. While trading with smaller investments is an attractive option for avoiding over-leveraging, it also reduces your potential profit. You should carefully select your leverage according to your account volume, appetite for risk and financial circumstances. It's important to calculate your order sizes with enough trade capital available to outlast unexpected market movements.

Hedging with CFDs

As CFDs allow you to short sell and therefore profit from falling market prices, they are often used as a 'hedging' tool by investors as 'insurance' to offset losses made in their portfolios. For example, if you have a long-term portfolio you wish to keep, but feel that there is a short-term risk to the value of your investments, you could use CFDs to mitigate a short term loss by 'hedging' your position. This way, if the value of your portfolio does fall, the profit in the CFDs would help you offset these losses, thus enabling you to retain your portfolio without incurring any significant loss to its overall value. Whether hedging is a suitable strategy for your portfolio will depend on your personal circumstances.

> "Equitrade Capital employs a range of risk management techniques during the life-cycle of a trade to help protect your position"