

CFDs: OVERVIEW AND TRADING ONLINE



In this module we look at the basics: what CFDs are and how they work. We look at some worked examples, as well as how to place a trade online and other basic features of our dealing platform. We also discuss why this form of trading has become so popular in the last few years and the advantages that our service offers over other forms of trading.

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WHAT IS A CFD?

CFD stands for Contract for Difference. A CFD is a type of derivative, meaning the price of a CFD is derived from the value of some other asset such as a share or currency pair, but it can effectively relate to any financial instrument.

Rather than trade or exchange the asset itself, a CFD is a deal whereby two parties agree to exchange money according to the change in value of the underlying asset between the point at which the deal is opened and when it is closed. One party will be a buyer (of the value of the asset), and one will be a seller. The buyer will make money (from the seller) if the asset value increases and will lose money (to the seller) if it decreases. Conversely, the seller will lose money as the price of the asset rises and make money as it falls.

Put simply, CFDs are a means to gain exposure to the change in value of a financial instrument without actually being in possession of that instrument.

When you trade with us we act as a CFD provider, meaning that when you choose to place a deal, giving you access to the pricing of the underlying instrument. You choose whether you are buying or selling, and this defines us as being either the seller or the buyer in the contract.

How this works will become clearer if we look at an example of using a CFD to trade a share.

EXAMPLE 1

BUYING VODACOM GROUP LTD

When trading shares using CFDs, the procedure and terminology are similar to normal share dealing (and in many cases exactly the same).

Vodacom is trading on the Johannesburg Stock Exchange at **16518/16529c**

Having watched Vodacom's share price over the last month, you feel that the stock is undervalued and you think that now might be the time to take an exposure.

You decide to buy 1000 shares as a CFD with us. Rather than physically taking ownership of the shares, you are instead opening a contract with us that gives you the same financial exposure as if you had gone out and actually purchased the same number of shares.

The price that we quote for shares is always the same as the price that is trading on the stock exchange. You therefore open your deal at 16529c, the offer price of the shares.

Just as with a regular share transaction, we charge a commission.

Our standard commission for SA shares is 0.2%.

This means that your opening commission is:

$0.2/100 \times 1000 \text{ shares} \times 16529\text{c} = \text{R}330.58$

MARGIN

A fundamental difference between trading a CFD and physically buying and selling shares in the conventional manner is that when trading a CFD you only need to initially deposit a small portion of the value of the stock that you are commanding. This is known as margin (and is discussed in depth in Module 4).

The amount of margin required varies according to the liquidity and volatility of the underlying instrument. For SA shares the margin requirements begin from as low as 5% of the underlying value, but can be larger, depending on which share you are dealing.

Only having to put down a fraction of the value of the stock that you are commanding obviously makes trading easier and more convenient. It means that you do not have to tie up as much of your funds with a trade as would normally be the case.

Should the share price move adversely, however, you need to be able to send further ongoing margin.

In this case, Vodacom is margined at 10%

You are dealing in 1000 shares at a price of 16529c. This means that the underlying values of the shares in which you are dealing is
 $1000 \times 16529c = R165290$

The margin of 10% is therefore just R16529.

*We operate a tiered system of margining whereby very large positions in a given stock may result in a higher margin rate beyond a certain threshold. More details are given in Module 4, which discusses leverage and margin.

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FUNDING

One of the key concepts of CFDs is funding. In this example, you are buying R165290 worth of equity (as a CFD) but you do not need to pay for the full value of the shares. Instead, you initially only have to hand over 10% and you are effectively borrowing the value of the shares.

As a result, you are charged a financing cost on the value of the underlying asset.

The cost of borrowing is based on a lending rate for the relevant territory or country. In the case of Vodacom, as with all SA shares, the rate is based on a SA lending rate (specifically, we use the 1 month SABOR rate).

For a long position (that is, a deal where you have bought and want the underlying to rise in value) you might pay 2.5% above that rate. Let's say that the underlying rate is 7%. You will therefore pay 9.5%. This is an annual rate, but the financing is calculated on a daily basis using the following equation:

Daily interest adjustment = No. of shares x current share price x $i/365$
Where i = the applicable annual interest rate

For each day that you hold the position, therefore, you accrue a financing cost. This is calculated and debited from your account on a daily basis.

In the equation above, the daily funding is calculated by dividing the annual interest on the whole underlying value by 365, which is the divisor used for SA shares; for shares from certain territories we use 360, however.

With our example, let's say that Vodacom closes at 16600 on the first day. The first daily interest adjustment is calculated as follows:

Adjustment = 1000 shares x 16600c x 0.095/365
= R43.21

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FUNDING

DIVIDENDS

Net dividends are credited to long positions held at the close of business on the day before the ex-dividend date.

At the time of Vodacom's ex-dividend date, your position is still open. The net dividend is 165c per share and this is credited to your account balance as shown:

$$1000 \text{ shares} \times \text{R}1.65/\text{share} = \text{R}1650$$

SHAREHOLDER RIGHTS

As you do not own any actual shares, you are not entitled to any shareholder rights, such as voting on corporate actions.

Over the next few weeks, Vodacom makes steady gains and 22 days after you opened the deal the share price is trading at 17110/17125c. You decide to take your profit.

You sell 1000 shares at 17710c, the market bid price, and close your deal entirely.

Your closing commission is 0.2%:

$$0.2/100 \times 1000 \text{ shares} \times 17110 = \text{R}342.20$$

Closing level: 17110c

Opening level: 16529c

Profit per share: 581c

Profit on trade: 581c x 1000 shares = R5810

CONTINUED ▼

FUNDING

We also have to take into account the commission that you have paid and the adjustments made for interest and any dividends.

You hold the position for 22 days. Using an annual financing rate of 9.5% this might amount to a total financing cost over the period of about R950.62. Over the 22 days during which you hold the position, the shares go ex-dividend, paying a net dividend of 165c per share. An adjustment was made to your account of **R1650**.

The overall profit is calculated thus:

Profit on trade:	R5810
Opening commission:	-R330.58
Closing commission:	-R342.20
Interest adjustment:	R950.62
Dividend adjustment:	R1650
<hr/>	
Overall profit:	R5836.60

GOING SHORT

The trade detailed above is an example of going long of a share price (ie buying a share and wanting the price to rise). With CFDs it is just as easy to go short of a share.

That is, you can sell shares first with the hopes of buying them back later at a lower price. In effect you owe the stock by doing this. With such a transaction, the CFD provider acts as the buyer and you as the seller. The advantage of being able to go short is that it is possible to make money even when share prices are not rising (which, of course, they can't do all the time).

As going short is the opposite of going long, the net dividend adjustments described in the example above work in reverse.

That is, when you take a short position, net dividends are debited from your account if a position is held at the close of business on the day before the ex-dividend date.

Interest differs slightly in that it can be either credited or debited to your account depending on the lending rate of the relevant territory at the time.

EXAMPLE 2

SELLING TELKOM

After monitoring a recent bounce in the share price of Telkom, you remain unconvinced that it will be able to sustain such levels given continuing problems in the general economy.

Telkom is trading in the market at 6140/6150c and, judging some kind of correction to be likely in the coming weeks, you sell 1000 shares as a CFD. You deal at 6140c, the market bid.

Your opening commission is 0.2% of the underlying value. In other words, the opening commission is $0.2/100 \times 6140c \times 3000 = R122.80$.

This amount is automatically debited from your trading account as soon as you place the trade.

MARGIN

In this case, Telkom is margined at 20%.

The underlying value of the stock that you are commanding is 1000 shares x 6140c per share = R61400.

20% of this is **R12280** and this is the amount that you deposit as initial margin.

FUNDING SHORT POSITIONS

Funding for short positions works slightly differently to long positions in that interest can be either credited or debited from your account depending on the interbank lending rate at the time.

For example, if LIBOR is greater than your financing fee, you will receive interest for being short as the fee is subtracted from, rather than added to, the interbank rate. If the financing fee is greater than the lending rate, this will appear as a debit to your balance.

In the same way that rates on loans are generally higher than savings rates, the amount you may receive for being short is not as much as the amount that you pay for being long.

Let's say the rate happens to be 6.9%. For a short position you might receive 2.5% below that rate. You will therefore receive 4.4%. This is an annual rate, but the financing is calculated and credited daily to your account.

With our example, let's say that Telkom closes at 6105c on the first day. The first daily interest adjustment is calculated as follows:

$$\begin{aligned}\text{Adjustment} &= 1000 \times 6105c \times 0.044/365 \\ &= R7.36\end{aligned}$$

DIVIDENDS

By selling shares you are foregoing any dividends after the time of your sale. For that reason, net dividends are debited from short positions held at the close of business on the day before the ex-dividend date.

It's important to note that not all stocks can be shorted. Although we offer this facility on the vast majority of shares for which we have CFD dealing, there are some stocks for which the necessary mechanisms (such as institutional lending of the stock) are not available in the underlying market to allow us to hedge short-positions satisfactorily. Such stocks are 'unshortable' (also referred to as 'unborrowable'). Moreover, there may be stocks with 'tight borrowing' whereby you are able to take a short position, but will receive less than the normal daily funding (or none, as the case may be). Such conditions are subject to change: a stock may be unborrowable one week, but not the next. Our dealers will always be able to inform you of the latest condition for a specific stock. There are also some stocks that cannot be shorted owing to regulatory restrictions.

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FUNDING SHORT POSITIONS

Your prognosis regarding the share price proves to be correct over the next few weeks, as Telkom gradually drops in price. Nineteen days after you opened the trade, the price is 5980/5990c and you decide to take your profit. You buy back 1000 shares at the market offer of 5990c in order to close your position.

Your closing commission is 0.2%:

$$0.2/100 \times 1000 \text{ shares} \times 5990\text{c} = \text{R}119.80$$

Your profit on the trade, before taking into account commission and adjustments for interest and dividends, is calculated as follows:

Opening level: R61.40

Closing level: R59.90

Profit per share: R1.50

Profit on trade: R1.50 x 1000 shares = R1500

To arrive at the actual profit on the trade, we also have to consider the commission that you have paid and the adjustments made for interest and dividends.

You hold the position for 19 days. Using an annual rate of 4.4% this might amount to a total credit over the period of R139.84.

Over the 19 days during which you hold the position, the shares do not go ex-dividend. There is therefore no adjustment to be made on account of dividends.

The overall profit is calculated thus:

Profit on trade:	R1500
Opening commission:	-R122.80
Closing commission:	-R119.80
Interest adjustment:	R139.84
Dividend adjustment:	-R0
Overall profit:	R1397.24

OUR ONLINE DEALING PLATFORM

Our CFD trading service is available over the telephone via our dealers, from our range of mobile apps, or on our dealing platform.

Dealing online can provide significant benefits, including near-instant execution of trades, thousands of streaming prices, integrated news and analysis and a selection of advanced dealing tools.

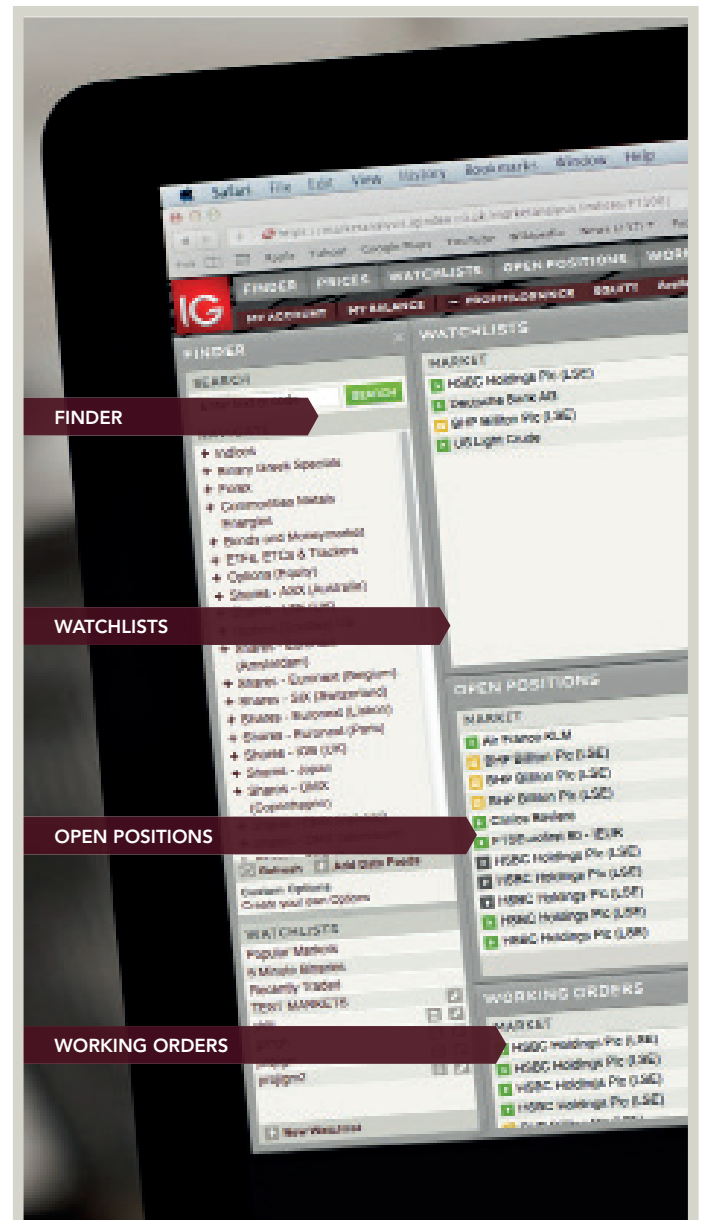
When you log in to our dealing platform, the screen is split into four specific areas, as shown.

All windows can be toggled on or off by using the buttons that appear at the top of the screen. 'Finder', 'Watchlists', 'Open Positions' and 'Working Orders' are selected as a default, but there are other options that can be selected to offer you further functionality.

For example, selecting the 'Tools' button launches a window which contains links to a variety of trading tools including charts and news.

The 'Watchlists' pane at the top shows a list of our more popular markets. The 'Finder' pane on the left is used to navigate to any of our thousands of markets, which can then be displayed as streaming live prices in a 'Prices' pane. From any live price that you are looking at you can open a deal ticket (with which you can place a trade). You can also choose to add your favourite markets to your own personal watchlists (you can set up a maximum of five watchlists).

Let's look at an example of placing a trade online.



EXAMPLE 3

SELLING VODACOM

1 It is early October and you think a fall in the SA share price of Vodacom is likely. Selling the shares as a CFD will allow you to profit if such a fall occurs. You decide to go online and check what prices we are making on Vodacom.

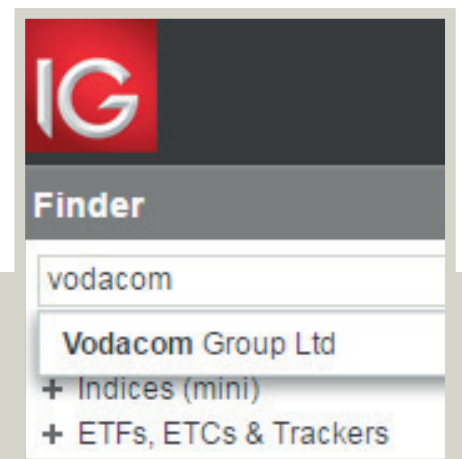
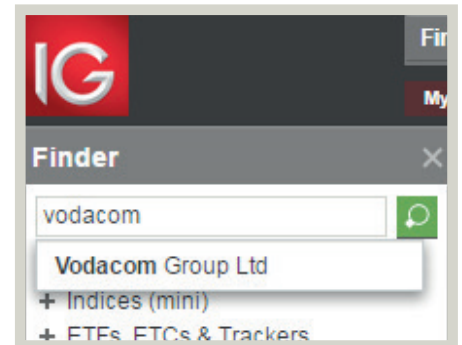
To do so, you first need to access the live price for Vodacom. There are two ways to do so from within the 'Finder' section: you can choose to use the navigation tree or use the 'Search' function.

Using the 'Search' function is as simple as typing in part or all of the instrument's name. As you type in letters, a dropdown automatically displays markets that match; the more letters you type in, the narrower the results that are displayed.

Selecting the market of your choice and then clicking 'Search' imports the results of your search into the 'Prices' section.

2 You can also search through our markets using the navigation tree. As Vodacom is listed in SA, you expand the 'Shares – SA' directory. You then expand the directory that corresponds to the letter with which the share begins.

3 You then expand the directory that corresponds to the letter with which the share begins. In this case, it is V that you want.



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EXAMPLE 3

SELLING VODACOM

4 Scrolling down to Vodacom and clicking on the directory name, displays all available markets on Vodacom in the 'Prices' section.

				CHANGE	SEL
				-0.85	158.2

5 The current bid and offer prices are displayed (underneath 'Sell' and 'Buy' respectively), along with other useful pieces of information, such as the net change on the day and the day's highest and lowest prices for the share. The 'Period' is marked as '-'. This absence of a dated period means you can hold a position as long as you want (CFDs on some products have expiry dates which mean that if you hold your position to that date it will automatically close or 'expire'). You click the green button next to 'Vodacom Group Ltd' which launches the deal ticket (clicking on the market name does the same thing).

6 This deal ticket is populated with the current price and allows you to enter the details of the trade that you would like to place.

The bid (17058) and offer (17068) of the current price appear in the 'Sell' and 'Buy' boxes, respectively.

The price constantly updates in both the 'Prices' section and the deal ticket, so that you can sit with the price in the deal ticket, waiting for the right price, if you so wish.

TICKET

Vodafone Group Plc

DEAL

ORDER TO OPEN

Size 10

(Min: 1 Shares)

Currency GBP

☐ Market Order

☐ Force Open

Sell

161

Buy

161.1

STOPS AND LIMITS

Stop

pips away (Min: 0.01)

☐ Guaranteed Stop

☐ Trailing Stop

Limit

pips away

REQUIREMENTS

Margin Required GBP 0.79

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EXAMPLE 3

SELLING VODACOM

To place a trade, you first need to specify the deal size (in this case, the number of shares). To do this you enter a quantity in the box entitled 'Shares'. Below this box there is a 'Currency' box that indicates in which currency you will be realising profit or loss. In this case, as we are dealing in a SA share that is priced in pounds sterling, the currency is indicated as 'SR' (rands).

You choose to sell 1000 shares: you enter 1000 in the 'Shares' box. The bottom half of the deal ticket is an optional section offering the ability to attach further dealing instructions; this is covered in detail in Module 3. Making up your mind that you are happy to deal at the price that is showing, you click on 'Sell'.

TICKET	
<input checked="" type="checkbox"/> Confirmed	
Market	Vodafone Group Plc
Period	-
Level	161
Size	Sell 10000.00 Shares
Ref	DIAAAAFESWL6AK
Status	Open
<input type="button" value="CLOSE"/>	

7 You receive an acceptance message that confirms the trade you have placed (please note that it is possible for deals to be rejected. The vast majority of trades – over 90% – are accepted, however). The acceptance message includes the details of your trade, along with a reference number; you should always check that all the information about your deal is correct and make a note of the reference number.

8 As soon as your trade has been accepted, your position appears in the 'Open Positions' window.

You hold onto your position for the better part of two months. The whole time that your position is open, it is possible to check the profit/loss of the position by looking at the valuation in the 'Open Positions' screen. The share price never really drops in the way that you had anticipated, and eventually starts to make some gains. 42 days after you opened the trade, you decide to cut your losses.

Checking the price online, you see that Vodafone is now trading at **17235/17245**.

You decide to close your position.

CONTINUED ▼

EXAMPLE 3

SELLING VODACOM

9 To close your position, you need to deal in the opposite direction to your open position. If you deal in the same size as your open position, you will close the whole trade.

If you deal in a size that is less than your open position it is possible to close part of a deal. You want to close your entire position, however. The quickest way to do so is to open a 'Close Position' screen. This is a special type of deal ticket that ensures you are dealing in the direction that is required to close an open position and also pre-populates the correct transaction size in order to achieve a complete close. The 'Close Position' screen is opened by clicking on the green button (or the market name) of a position in the 'Open Positions' screen.

To help you, your running profit/loss for the position in question is displayed in the 'Close Position' screen (which updates with the changing price).

You click on **'Buy'**.

You receive another confirmation back telling you that you have bought 1000 shares to close at 17245.

Your loss, before taking into account commissions and adjustments for interest and dividends, is calculated as follows:

Closing level:	17058c
Opening level:	17245c
<hr/>	
Loss per share:	187c
Loss on trade:	187c x 1000 shares = R1870

To arrive at the overall loss on the trade, we also have to consider the commission that you have paid and the adjustments made for interest and dividends.

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EXAMPLE 3

SELLING VODAFONE

Our standard commission on SA shares is 0.2%.

Opening commission = $0.2\% \times 1000 \text{ shares} \times 17058c = R341.16$

Closing commission = $0.2\% \times 1000 \text{ shares} \times 17245c = R344.90$

For being short of a SA share you might receive an annual rate of 4.4%, yielding an overall interest credit over the 42-day period of R873.12 for interest.

Over the 42 days during which you held the position, the shares went ex-dividend, paying a net dividend of R0.80 per share. A dividend adjustment was therefore made to your account: this was a debit of $1000 \text{ shares} \times R0.80/\text{share} = R800$.

Loss on trade:	R1870
Opening commission:	R341.16
Closing commission:	R344.90
Interest adjustment:	+R800
Dividend adjustment:	R800
<hr/>	
Overall loss:	R2482.94

ONE-CLICK DEALING

We also offer an alternative way of viewing prices. In the previous example, the prices were viewed as a list. There is another mode in which you can view prices as 'pairs', as shown.

Clicking anywhere on a 'Sell' or 'Buy' price launches a deal ticket. As well as giving you the choice of how price information is displayed visually, the pairs mode offers another benefit. It is possible to set your account to 'One-click Dealing', which allows you to deal on markets directly from prices in the pairs view, without needing to open a deal ticket.

To enable 'One-click Dealing' you need to go to the 'My Account' section, which can be accessed by clicking on 'My Account' in the top left-hand of the screen.

Once you have launched the 'My Account' window, you need to click on 'Preferences' within the 'Settings' section and then switch 'One-click Dealing' to 'Enable', before finally clicking on 'Set Preferences'.

Market	Sell Price	Buy Price	Low	High
Vodafone Group Plc	157.80	157.85	157.05	159.65
HSBC Holdings Plc (LSE)	622.00	622.10	617.10	623.00
Spot Gold	1731.13	1731.63	1728.10	1732.79
Wall Street	12864.8	12866.8	12823.3	12872.8

MY ACCOUNT

- HISTORY
- DATA FEEDS
- ADD SPREAD BETTING
- PAYMENTS
- SETTINGS**
 - Preferences
 - Username/Password
 - Personal Details
 - Cookies
- REFER A FRIEND
- CONTACT US

ONE-CLICK DEALING

One-click dealing lets you enter a deal size directly into the price box for a market, a single click on either the Buy or the Sell price not be presented with an intermediate screen and you will not be asked to confirm the deal.

☒ Allow One-click Dealing

☐ Don't Allow One-click Dealing

DIRECT MARKET ACCESS (DMA) EQUITIES

DMA Equities allow you to interact directly with the order book immediately. Therefore please ensure that you understand the risks involved before using this service.

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ONE-CLICK DEALING

Now when you look at prices in the pairs mode there is a field where you can specify the size of the deal ('Contracts' in the images shown).

If you enter a deal size in this field, the 'Sell' and 'Buy' buttons become dealing-operational as shown.

Now if you click either 'Sell' or 'Buy' you will directly initiate a deal.

'One-click Dealing' makes it even quicker and easier to place a trade than normal, especially if you pre-fill in the number of contracts or shares in which you intend to deal, but you should take care if this setting is enabled. With the intermediate step of the deal ticket removed, you should be cautious not to accidentally place a trade.

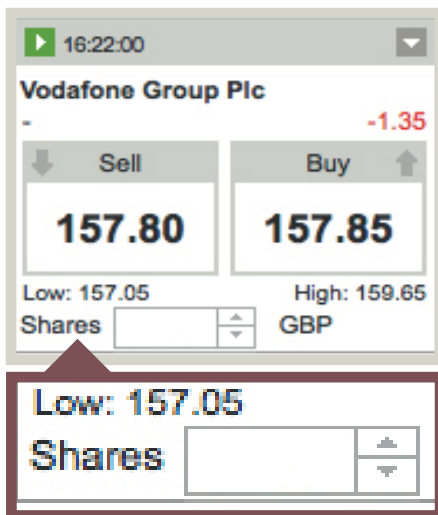


Figure 1

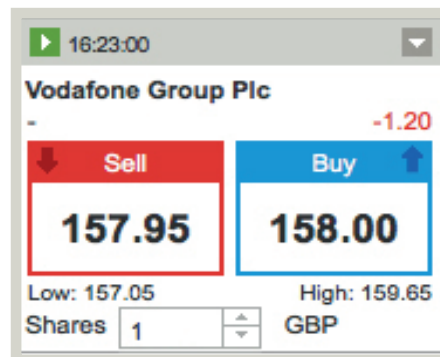


Figure 2

ADVANTAGES OF USING OUR CFD TRADING SERVICE

CFDs have quickly grown in popularity over recent years for a variety of reasons. Some of this is due to changes in trading attitudes: as private investors have become more sophisticated, they have sought more sophisticated methods of trading.

The simple long-term buy-and-hold strategy offered by investment in conventional shares no longer has the same appeal amongst the retail market that it once did. At the same time, small investors have started to become less risk-averse in their approach.

Further to this, CFDs offer a number of excellent benefits that are not normally available through normal share trading:

LOW COMMISSIONS AND SMALL MINIMUM TICKETS

Our standard commission rate for SA share CFDs is a competitive 0.2%, with a minimum charge of just R100. Furthermore, as a new client on our introduction programme you'll benefit from even smaller minimum charges for the first two weeks, which allows you to try out our service and practice trading CFDs with minimal risk.

LOW MARGIN RATES

Maximise your trading power by taking advantage of the small margin requirements for CFDs. You can deal on shares by putting down as little as 5% of the underlying value.

For example, taking a position equivalent to R100,000 worth of equity in a stock that is margined at 5% would require a deposit of only R5000, offering you the convenience of only having to send further funds in the eventuality of the position moving against you.

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ADVANTAGES OF USING OUR CFD TRADING SERVICE

ABILITY TO GO SHORT

Buying shares is usually done as a result of the view that the share price will go higher and that there will be the opportunity to sell the holding for a greater amount at some point in the future.

As we all know, however, share prices don't always go up, and the ability to profit from falling as well as rising markets can be very useful, therefore. Because no shares are physically changing hands when you trade CFDs, selling to open a new position is just as easy as buying, giving you trading opportunities that are not readily available with conventional share dealing.

SPEED OF TRADING

Whether you are dealing over the telephone or via the internet, transactions are executed very quickly, with internet deals typically transacted in just fractions of a second.

GUARANTEED STOPS

We offer the ability to restrict the potential loss on a trade to a fixed amount, specified by you at the opening of the transaction.

Stop-losses are dealing instructions that can be used to close out a position in the event of the market moving a certain amount against you (there is detailed information on Stops in Module 3: Using Orders to Trade). Normal Stops will not always provide complete protection against particularly fast-moving prices (for example, after a profit warning). We offer special Guaranteed Stops (for a small extra charge) that will always be executed at exactly the price you have set and thereby provide total protection against any unforeseen adverse movements.

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ADVANTAGES OF USING OUR CFD TRADING SERVICE

FLEXIBILITY AND CONVENIENCE

CFDs are not just limited to shares: we also offer a wide range of different financial instruments (this topic is discussed in depth in Module 2: Financial Markets). Stock index levels, commodity prices and FX rates are just some of these many different markets, and they can all be accessed quickly and efficiently from your single CFD trading account.

24-HOUR TRADING

Although shares trading is constrained to stock exchange hours, many of our financial products, such as leading stock indices and FX, can be traded 24 hours a day. This means you can open and close positions even when the underlying financial markets are shut.

SUMMARY

By now you should:

- Understand what CFDs are and how they work
- Understand how the commission on a share trade is calculated
- Have an understanding of the effect of interest and dividend adjustments on a CFD position
- Be familiar with the advantages that CFDs offer
- Know how to search for prices online
- Be able to open and close a trade online

CFDs are leveraged products. CFD trading may not be suitable for everyone and can result in losses that exceed your initial deposit, so please ensure that you fully understand the risks involved.

Please note that although the material contained within our introduction programme is updated regularly to ensure accuracy, the information given is subject to change, often without notice, and therefore may not reflect our most current offering. Our examples are for illustrative purposes only and do not reflect events in the markets. The information is for guidance only and we accept no liability for its accuracy or otherwise.

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