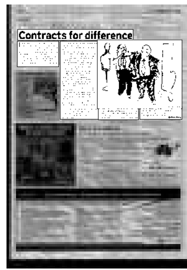
MEDIA MONITORS
INCISIVE INSIGHT



Age
Wednesday 4/5/2005
Page: 6
Section: Supplements
Region: Melbourne Circulation: 196,250
Type: Capital City Daily
Size: 265.38 sq.cms.
Published: MTWTFS-

Brief: CURRENCY

Contracts for difference

Investors who dare to be different have products tailor-made for them. Contracts for difference (CFDs) are relatively new to Australia and allow investors to punt on the difference between the price of shares today and their price at some specified time in the future.

Unlike other derivatives such as warrants and options that hold the same promise, CFDs are relatively simple to understand because price movements are worked out on a simple one-for-one basis.

Hence, if the underlying share price rises by 25 cents, so do your CFDs.

Like other derivatives, CFD holders don't own the underlying asset but they do receive all dividend payments.

A CFD is a contract between you and one of a growing number of licensed providers. Increasingly, they can be traded online.

CFDs can be bought on local and international stocks, indices or foreign exchange for an upfront payment, which is typically 5 to 10 per cent of the value of shares or 1 per cent for indices.

This is what the professionals call leverage; that is, the ability to extract more profit per dollar outlay. But CFDs also have the potential to maximise losses.

For example, if you pay $1000 for $10,000 worth of shares and the share price falls 10 per cent, you will lose your entire outlay. If losses exceed your initial outlay, you must top up your investment to restore the original loan-to-valuation ratio (LVR).

To reduce potential losses investors can increase their outlay as a percentage of underlying equity. Alternatively, they can use a stop loss.

For example, if you buy a stock at $10 and set a stop loss at $9.50, your potential loss is limited to half your capital on a 10 per cent LVR.

Unlike warrants and options, CFDs have no set expiry date, although in practice most people hold them for weeks rather than months. In other words, they are best left to dedicated traders.

One of the main reasons for the quick turnaround is the fact that interest owed to the provider is charged daily. However, when you short sell, that is, sell shares you don't own, the provider pays you interest, albeit at a lower rate Interest rates are generally 2.5per cent above the cash rate when you buy and below when you short-sell. Transaction costs are lower than brokerage on ordinary shares.

Barbara Drury

Illustration: Michael Fitzjames

Copyright Agency Limited (CAL) licenced copy

Ref: 16329733