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How to Make Consistent Profits Trading Futures Part III

A lot of traders are trading the stock indexes like the FTSE, the DAX, the S&Ps, NASDAQ and the DOW, but rather than use futures they are using spread betting firms. The reasons for using these firms is that they require very small amounts of capital to get started, a trader can trade very small amounts (like £1 a point on FTSE as opposed to £10 for FTSE futures) and these firms make opening an account so easy. I understand the lure of being able to open an account with very little money and trading small amounts, but I have some serious considerations about using spread betting as a realistic vehicle for professional trading.

The two biggest selling points are no commissions and no capital gains tax. There are many different costs to trading, commissions are one and the spread is another (especially when you have to trade at the market as you do with spread betting, with futures you have the choice of joining the bid or the offer). Commissions are important for an active trader and as an active trader you can get them very low, but lets assume they are £8 per round turn for futures and lets assume that the spread in FTSE futures is an average of 2 points. If the spread with a spread betting firm for FTSE is 6 points and assume that we are trading £10 a point we can compare the two trading vehicles.

Last week (written Nov 2001) I made an average of 2.42 points per contract traded and I traded 48 times. That is, for each contract I bought and sold I made £24.20 before commissions, assuming my commission rate is £8, I made a profit of £16.20 per contract traded, which is £777.60 net profit if my average size per trade is one contract.

Had I had the same success trading with a spread-betting firm, with a 6-point spread, I would have lost £1718.40! Now I would rather pay tax on a profit than no tax on a loss.

There is one other very important reason for trading the futures market rather than a non-exchange traded market such as those offered by spread betting firms. The futures markets are exchange traded and this means that they are fully transparent, i.e. everything is visible and above the table, I can see every single trade that happens. Imagine the trading pit, as it used to be when traders stood physically in a ring trading with each other.

When a trade is entered, the order goes into the pit and is represented there, free to be taken by any other market participant. We can all see what is happening, we trade with the same information and with the same advantages/disadvantages. Now assume you are a trader who can only trade with one broker in the pit, you can trade as much as you like, any size you like, but he sets the spread he is willing to offer you and you have to trade at market (i.e. buy at his offer and sell at his bid). This broker doesn't want to lose money, naturally, so he always makes his spread wider than the real market spread, he also, naturally, puts his interests before yours, so he won't always be willing to trade when the market is moving fast and he is uncertain.

Remember whenever you make money he loses, so he is very careful to maintain his advantage at all times. Who wouldn't want to be in this broker's position (he isn't really a broker, though he claims to be)? When you trade with a real futures broker, all the broker does is facilitate your trade; he gives you the ability to have your orders represented in the pit. A real broker's concern is that they execute your order as efficiently as possible, that is their job, they do not take positions and they do not take the opposite side to you.

They naturally want you to make money because by making money you become a client who will continue to pay them commissions. Trading with a spread betting firm is absurdly costly, spread betting firms are like amusement arcades, they can be fun, but to imagine you are going to make your living from slot machines is illusory.

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