CFDS AND STOCKS EBOOK

Introducing CFDs

CFD, or Contract for Difference, gives you a unique possibility to earn money without owning any real asset. Rather, you earn your profit through the price movement of it. From the assets' entry into the trade to its exit, the CFD takes into consideration only the changes of its price.
The underlying value of the asset is not a factor and does not have an effect when you trade with CFD.

The Meaning of the Word

CFD stands for Contract for Difference, and it is a contract like any other, at least form-wise.

Namely, it is a document that regulates the relationship between two parties that engage in speculations about the price movement of an asset. This contract, however, is unlike any other in trading.
It allows the parties to speculate in this matter without owning the asset in question.

CFD Trading 101

CFD trading has walked quite an interesting path before becoming what it is today. It was first introduced to retail traders in the late 1990s. From then on, many UK companies took this innovative way of trading under their wing. They created top-notch trading platforms, which showed the price movements in real time.

With the beginning of the new millennium, the CFD way of trading expanded from London Stock Exchange by including commodities, assets, indices, currencies, and bonds.Today, you can trade CFDs in 2 ways, through a long and a short position. When you decide to open a long position, you have bought or "acquired" a position which will bring you profit from the increase of a price of an asset. Meaning, you will use a sell order when you want to close your position.On the other hand, when you open short position means that you will get a profit only if the price of a certain asset decreases. Accordingly, you will use a buy order when closing your position.When trading CFDs, you are buying a contract that will track the price movement of the asset on the market. But how is it different from shares, for example? Well for starters, with CFDs, you trade with much fewer expenses. Also, there are fewer fees that come with this kind of commitment.

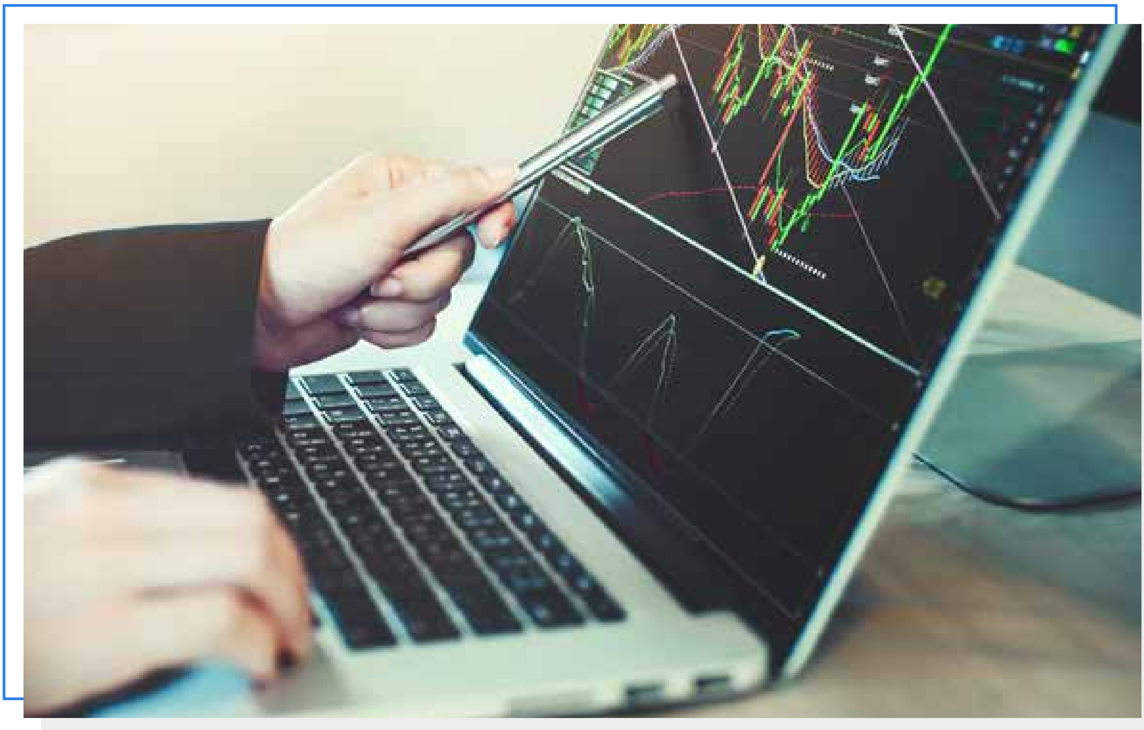
Advantages of CFDs

By giving you not one but two ways to open a position and begin your trading, the CFDs have made a big move that makes them stand out. This way, you can observe the market from both ends, and make a move accordingly to the current events on it.

Next, CFDs have higher leverage. What does it mean for you? Well, standard leverage is subject to regulation. On the other hand, its absence is a two-way street. While it means more freedom each step of your trading experience, it also makes it somewhat harder to find a broker you will trust. A solid relationship with your broker is imperative. However, do not be discouraged by this, since brokers who mistreat their clients do not survive on the market for long, anyway.
And finally, it is important to emphasize that CFDs give you a unique opportunity to trade anything and everything, as long it is available on the market, of course. You don't have to set up multiple accounts on different platforms, have a different broker for each one, and so on. CFDs make trading easier by giving you access to all the biggest markets in the world, conveniently and efficiently.

Understanding Stocks

If you ever had even the slightest encounter with the trading market, you surely came across the term "stock" at some point. In its definition, a stock is a "share in the ownership of a company". And though it may seem simple, this explanation can be a bit misleading. We will cover all the terms and characteristics of a share in the following passages.



What Are Stocks/Shares?

A stock or a share is a unit of ownership of a company. In other words, a stock is a claim on the company's earnings and assets. By being a stock or a shareholder, you can have many perks regarding the company of your choosing, from dividends to even voting rights, in some cases.

Ownership

When it comes to ownership, it can be the most confusing part when it comes to stocks. When I own a stock, does it mean I own a part of the company, too?

This is a common misconception. You don't own a company, but a right to a part of their assets and profits. Understanding this distinction is quite important for various reasons, one of them being the liability. In other words, your liability as a shareholder is separate from the liability of the company.
What does this mean for you? For example, if a company goes bankrupt for any reason, your assets are not at risk. Not even a judge can force you to sell those shares if you don't want to do so. However, keep in mind that their value will immediately decrease, following the demise of the company itself.

To conclude, instead of taking part in the ownership of the company, you take participation in the company's growth.

Advantages of Stocks

With higher risks comes a bigger reward. You've heard it so many times, and it is completely true in this case, too. Though stocks have greater risks than bonds, for example, their return is also bigger.

Furthermore, owning a stock or a share of the company brings you an income from dividends. The amount you will receive can be affected by many things, and the main one is the company's current position on the market. This, however, can change in a heartbeat for better or worse, proving the shares' riskiness once again.

In addition, when investing in stocks, you don't have to limit yourself to a certain type of stock or just one company. Instead, you can invest in as many stocks and companies in the countries they originate from. This way, you increase your profit immensely, as well as experience other opportunities for the growth of your portfolio.

What Are Indices?

The term of indices is typically the one that inexperienced traders have a somewhat harder time figuring out. Is it the same as an index? Can I invest in indices?

The term "indices" is closely connected to both the stock and bond market, and it is also an essential part of any financial market. In addition, you may have heard about two of the most common indexes.
One of them is the S&P 500 index in the American stock market, while the other is the US Aggregate Bond Index, for the bond market.

What is an Index?

In its simplest form, an index is an indicator or a measure of something. It is also important in the area of finance, where it serves as a statistical measure of the change in the securities market.

When it comes to stock and bond markets, an index is calculated a little bit differently, in accordance with the rules and customs of the market itself. The imperative is to remember that when it comes to indices, its relative change is often more important than the numeric value of what it stands for. In other words, indexes are used for comparison, to check how a certain value has changed from the previous day, for example. The value itself, however, is shown by other indicators.

How are Indexes Calculated?

An index is also a measurement of the value of one section of the market. It is used to describe the market and its characteristics, as well as a way of understanding how the market is performing. It is calculated by computing the prices of assets, stocks or any other value that the market holds.

Most commonly, indices are indicators of the nation's performance on the market. In this case, the national indices you’ve certainly heard of are the American S&P 500, the British FTSE 100, or the Japanese Nikkei 225.

Downsides to CFDs and Stocks Trading

Trading with CFDs has its perks, such as access to all the world's biggest markets in one place and less fees, to name a few. However, each time you engage with some part of the market, you are agreeing to some risks, as well. We've reviewed the biggest ones in the following passages, so you won't have to.

Leverage

As we've mentioned before, the leverage is one of the key features on which traders base their choice of CFDs. Namely, the leverage here is above standard, so it can create a greater divide between the gain and the loss. In other words, sure, getting a bigger return is great.
But, what about the losses?

When trading CFDs, it is much more difficult to create that balance, so the leverage itself is automatically not a leverage per se since it is not in your favor. The key here is to keep it slow and steady, so you can try to minimize those risks. Of course, this way the options for gain are also decreased since everything on the market is connected.

Higher Risk

Accordingly to the previous point, with higher leverage comes higher risk. With CFDs, you always need to make up for a certain funded portion. For example, if the market drops a couple of points, the leverage still needs to be fulfilled. In addition to the funding costs and possible capital damage from the trade, your investment becomes that much riskier.

Speaking of risks, the biggest one the stockholders endure is the market volatility. This fluctuation in the price of a single stock is affected by many different events – such as geopolitical and economic. For that reason, trading stocks can be quite risky, too.

Lack of Ownership

The main distinctive feature of a CFD is that you do not own the asset in question. You just debate on its value and make your moves on the trading market accordingly. Unlike the stocks, you do not have any dividends or other rights that come with the ownership. The only value that is essential here is the current market price of an asset, whatever that may be.

Overnight Financial Costs

The market moves quite fast, so you need to keep up. Especially with CFDs, speed is essential, suitably to the higher leverage. When you open a position, you can decide to keep it that way for weeks or even months.

Meaning, you need to pay for it to stay open even after the day on the market ends. These costs can pile up quite fast, so the traders rather choose to open a long position, instead.

Margin Requirements

Unlike most other forms of trading, CFDs trading comes with the margins that are firmly set by the broker. Furthermore, they can vary from one broker to another, as well across the market.
Overall, this can be quite limiting to your freedom of investment.