



# Contracts for Difference Guide (CFD)

Cave & Sons

Stockbroking & Investments Since 1906

STOCKBROKING

FINANCIAL PLANNING

WEALTH MANAGEMENT

# Contracts for Difference (CFD)

## Introduction

For more experienced and sophisticated investors, our Contracts for Difference (CFD) service provides access to a much more dynamic form of trading.

A comparatively recent development, CFDs offer significant advantages to the active trader and those looking to protect the value of their underlying investment portfolio, or mitigate the capital gains tax consequences of particular transactions.

At Cave & Sons, we have been offering dealing and advisory services in CFDs for several years now and enjoy strong links with one of the country's leading CFD providers. This ensures that our clients benefit from efficient administration and prompt access to all of the major investment markets at competitive dealing spreads.

Our service is not only competitively priced, but it also includes the essential elements for successful trading; quality advice and access to reliable information, as well as speed and efficiency in executing transactions.

## What is a CFD?

A CFD is simply a contract to exchange the difference in value of a particular share between the time when a contract is opened and when it is closed, i.e. the profit or loss of a particular trade.

Trading in CFDs is very similar to trading in normal shares. You receive the dividends and the benefit (or loss) of share price movements but you don't actually own the underlying share. This is because a CFD is a derivative.

## Initial Margin

When you open a position, you deposit an initial margin, often just 5%\* of the value of the position. This allows you to open a bigger value position that you might otherwise be able to afford.

## Variation Margin

If, however, your position moves against you will need to make further deposits. This is because you must meet the running losses as well as maintaining the initial margin.

## Interest & Dividends

As you are only putting down a small proportion of the value of the shares, you are effectively borrowing money to trade. As a result you will incur interest to finance your trade if you go long (buy a share CFD) but you will receive interest if you go short (sell a share CFD).

Dividends are treated in the normal way, and will be credited to your account if you go long (buy a share CFD) but will be debited if you go short (sell a share CFD).

\* Margin may vary between 5% and 25% depending on the capitalisation of the company.

## Example – Buying Barclays equity CFDs

### Opening the position

You feel that the prospects for Barclays are promising and decide to buy (go long of) 1,500 shares at 610p.

Instead of paying the full value, you put down initial margin of 5% of the value of the shares or £457.50 to open the trade. Commission on the transaction is 0.5% plus £15 so you pay £60.75, but you do not have to pay Stamp Duty so you save £45.75.

While you hold the shares and the position remains open, your account is debited to reflect interest adjustments and credited to reflect any dividends paid.

### Interest Adjustments

Interest is calculated daily by applying the appropriate interest rate (2.5% + LIBOR\*) to the daily value of your position. In this example the applicable interest rate may be 7% and the closing value of your position, say £9,200. Thus, the interest for this position on this particular day is £1.76 (i.e. £9,200 x 7%/365). Each day's interest calculation will be different and will be posted to your account on a weekly basis.

### Closing the position

Shares in Barclays have risen, and you decide to take your profit, selling at 680p. Commission on the transaction is 0.5% plus £15 so you pay £66.00

Your profit on the trade is calculated as follows:

Closing position	680p
Opening position	610p
Profit	70p

Profit on trade = 70p x 1,500 shares = £1,050

### Calculating the overall result

To calculate the net profit on the transactions you also have to take into account commission, interest adjustments and dividend payments. In this example you may have held the position for 20 days, at a total interest cost of say £37.00 and no dividend payments were made during this time. Your total profit is thus:

Gross profit on the trade	£1,050
Less Commission	(£126.75)
Less interest adjustment	(£37.00)
Add dividends received	£0
Net Profit	£886.25

\*LIBOR is the London InterBank Offered Rate and tends to trade near to the UK Bank of England base rate though it can move both above and below.

## Benefits of Trading in CFDs

### Lower Commission Charges

As we do not incur the Stock Exchange or settlement costs of acquiring or disposing of shares we are able to offer cheaper dealing charges. Commission charges start at just 0.5% plus a £15 contract charge though cheaper rates are available for frequent dealers.

### Pay NO Stamp Duty

Under current legislation Stamp Duty is only payable on the transfer of an asset and, as you are only exchanging the difference in its value, none is payable. This saves 0.5% on all UK share transactions.

### Gearing

You can open a position without having to pay the full value of the underlying asset. Instead you put up an initial margin from 5% to 25% of the contract value. This allows you to open much bigger positions than would otherwise be possible, allowing potentially greater proportionate profits but with greater risk!

In the Barclays example shown, an 1½ % rise in the share price has resulted in a 230% gross profit (actual figures would be reduced by commission and interest adjustments less any dividends).

### Go 'Short' as well as 'Long'

As well as opening a long contract to benefit from any upside potential in a share price, you can also just as easily open a short contract to benefit from any downside potential. This allows you to profit from both rising and falling markets.

## Drawbacks of trading in CFDs

### Gearing

The effects of gearing work both ways and it is quite possible for you to lose all (or more) of your investment. In our Barclays example above, a 5% or 30.5p fall in the share price would have wiped out your initial investment, whilst an 1½ % fall would require you to provide further 'variation' margin, taking your loss up to £1,052.25 or 230% of the initial investment (plus commission and interest adjustments, less any dividends).

### Interest Expenses

Interest adjustments on long positions can easily add up, making CFDs unsuitable for a traditional buy and hold strategy. Most investors use CFDs for short-term trading, speculation or hedging.

Our service is not only competitively priced, but it also includes the essential elements for successful trading; quality advice and access to reliable information.

If you would like to discuss CFDs in more detail, or for information regarding our charges please contact one of our advisors.

## IMPORTANT INFORMATION

Trading in CFDs carries a high degree of risk to your capital and it is possible to lose more than your initial investment. Only speculate with money you can afford to lose. These products may not be suitable for all investors, and if you are in any doubt please speak to one of our advisors for further advice.

more than  
**100 YEARS**  
of service



[www.caves.co.uk](http://www.caves.co.uk)

**Cave&Sons**

Stockbroking & Investments Since 1906

**Northampton Office**

Lockgates House	<b>T</b> 01604 621421
Rushmills	<b>F</b> 01604 234335
Bedford Road	<b>E</b> <a href="mailto:info@caves.co.uk">info@caves.co.uk</a>
Northampton NN4 7YB	<b>W</b> <a href="http://www.caves.co.uk">www.caves.co.uk</a>

**Stratford Office**

Suite 4a, Arden Court	<b>T</b> 01789 209137
Arden Street	<b>F</b> 01789 209138
Stratford-Upon-Avon	<b>E</b> <a href="mailto:stratford@caves.co.uk">stratford@caves.co.uk</a>
Warwickshire CV37 6NT	<b>W</b> <a href="http://www.caves.co.uk">www.caves.co.uk</a>