TRADING INSIGHT

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Spread betting numbers are on the up

Demand has remained buoyant but investors shy away from short selling **Page 2**

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Contributors

Matthew Vincent
Personal Finance Editor
Lucy Warwick-Ching
Online Money Editor
Sean Smith
FT Reporter
Tanya Powley
Money, Mortgage and Property Reporter
Huw Richards
FT Contributor

Adam Jezard
Commissioning Editor

Steven Bird
Designer

Andy Mears
Picture Editor

For advertising details, contact:
Rachel Padhiar on:
+44 (0) 20 7873 3564;
email:
rachel.padhia@ft.com
or your usual representative

Investors prefer to bank on the long game

While more people are turning to spread betting and contracts for difference, they will not short sell, says **Matthew Vincent**

Nearly 100,000 UK investors have made use of financial spreads bets or contracts for difference (CFDs) in the past year. However, in spite of being presented with, or attracted by, greater opportunities to profit from falling markets, most remain uncomfortable with taking short positions in equities via these retail derivatives.

According to the 2011 UK Financial Spread Betting and CFD Report, published last month by Investment Trends, a research firm, another 7,000 people opened accounts and placed their first trades in the 12 months to July.

Spread betting customer numbers reached 88,000, up from the 83,000 recorded in October 2010, while 26,000 were trading CFDs, up from 25,000. Allowing for approximately 8,000 people who now trade both, the total number of active traders is estimated to have grown from 91,000 to 98,000 over the nine-month period.

Based on a survey of investors' intentions, and conversion rates from previous studies, Investment Trends now forecasts another 16,000-20,000 people will start spread betting within the next 12 months, and 10,000 will try trading CFDs.

This gain in popularity – trader numbers had been largely flat between September 2009 and October 2010 – has coincided with a marked increase in market volatility and, with it, the scope to use spread bets and CFDs to short sell individual shares and indices.

Data from ShareScope, a trading software provider, shows that the FTSE 100 index has suffered intraday falls of 2 per cent or more 16 times so far this year. On two of those days, it closed the trading session more than 4 per cent down. Many of the falls have come on consecutive days. At the end of last month, the index closed down for nine sessions in a row – the longest losing streak since 2003.

Some of the index's constituent companies have offered even more potential to bet on price falls. As many as 63 have seen their share prices fall by 10 per cent or more in the space of a week. Two companies have had this happen five times since January: Lloyds Banking Group and Royal Bank of Scotland (RBS). Another six have fallen by this amount on four occasions, including Barclays.

However, the vast majority of spread betting clients at IG Index – the firm used by 41 per cent of UK traders, according to Investment Trends – have held long-only positions in all three of these shares. A snapshot of traders' positions in mid-November showed that "buys" accounted for 98 per cent of bets in Lloyds, 97 per cent of bets in RBS, and 94 per cent of bets in Barclays.

And according to IG's chief market strategist, David Jones, traders were no more willing to bet on price falls during the market sell-off in August.

He says: "There is still a reluctance to sell short – clients are either long or not in the market," he says. "We see this bias among equity traders: they are almost exclusively long – and in banks, on average, they are 95 per cent long."

At City Index, traders have exhibited a similar nervousness about shorting individual shares. Although chief market strategist, Joshua Raymond, reports "a move to the bearish front", the overwhelming instinct is still to go long – even with prices in a downtrend.

"Historically, equity trades typically attract a high majority of buy spread bets," Mr Raymond notes. "This is no surprise given the psychological tendencies to buy a market than sell it, as well as the fact that most spread betters have experience in trading shares physically, which means they already had buyer tendencies." Only a few have overcome the tendency: the ratio of buy to sell trades at City Index was 74:26 in October, having stood at 82:18 in August.

Traders of equity index bets have been more confident in shorting. Gain Capital's global head of trading, Tim O'Sullivan, has seen more clients taking short index positions in recent months – mainly in the S&P 500 – in response to negative newsflow. "Through the abundance of information available about the current geopolitical situation, we have seen traders look with disdain on all equity markets and position themselves for a decline in equity value," he says.

But, at ETX Capital, even those who previously sold index bets to hedge existing shareholdings have become more reticent. "We are seeing an altogether different trend in index trading," says Manoj Ladwa, senior trader.

"Traditionally, clients would be net-short the index to offset their long stock positions. But with the increased volatility, clients are roughly split 50:50 between long and short index trades. This is a marked change from usual 25:75 long/short positions."

Short selling indices is not much more popular at City Index. In August, 55 per cent of all new index trades were clients going long, as traders preferred to bet on a bounce. Two months later, the proportion of short positions had risen to its highest level in more than a year – but the buy-to-sell ratio was still only 46:54.

At CMC Markets, sentiment has also shifted in favour of shorting index bets. Again, the ratio has not gone beyond 40:60.

Those traders who have gone short have tended to do so only for a limited period.

"Regarding indices, the clients have always been as bearish as bullish – but the real switch we are seeing is their current changeability," says Simon Denham, head of Capital Spreads.

"Usually, clients build up long or short positions and then hold them for days or weeks at a time, but over the last couple of months we have seen our net client positions veering from long to short several times in the course of a single session."

Andy Mackenzie, marketing communications manager at Spreadex, sees this as a product of volatility. "Many of the more popular stocks, such as banks or miners, have experienced sharp movements and this makes it more likely for traders either to cut out of positions earlier to take profits or, alternatively, to cut losses because of stops being hit."

CMC's market analyst, Brenda Kelly, believes short sellers worry about brief rallies driven by just a few bullish buyers.

"Low volume in the underlying market can drive the index higher quite quickly," she warns. "When coupled with a shortlived 'risk-on' attitude, this can cause a bounce to the upside that can be damaging to the short position holder."

Having seen this happen more than once this summer, traders have lost faith in their ability to short, claims Mr Denham. "Trading in single stocks has plummeted over the course of the summer," he says. "It is not that clients are more willing to go short of stocks, it is more that they seem to be losing confidence in trading in them at all."

But Alastair McCaig, market analyst at World-Spreads, thinks those eschewing shorting are simply being logical and looking at charts. "Fundamentally, the disposition of the vast majority of UK spread betting clients is to be long rather than short," he says.

"The pattern you see in any product – equities or currencies – is a series of long upward moves punctuated by short, sharp, corrective adjustments. As such, it is easier for spread betters to buy a position and see it go in one direction than try to call the top. If a client is not already short before his markets adjust, he's too late – a pattern we see repeatedly." He says August's events showed the difficulty a short seller has in calling the top of a market. At one point, the FTSE 100 index swung between 4991 and 5377, immediately, followed by a fall back to 4929.

"Many clients prefer to call the bottom," adds Mr McCaig. "It's ingrained in psychology that most people buy, not sell . . . and that has not changed over the past few months."

It has been ingrained – or enshrined – in regulation, too. "A further brake on shorting, making traders nervous, is talk from Angela Merkel, the German chancellor, about banning short selling in European financial stocks," adds Mr McCaig. "Further, potential shorting targets such as Greek stocks are very difficult to engage in."

Any ban, by its very nature, adds to the difficulty. Mr Ladwa at ETX says: "The universe of stocks clients can short has shrunk since the short selling ban on European financial institutions."

Investment Trends' report suggests three further explanations. First, the influx of new customers is concealing more widespread short selling by seasoned traders. While only 28 per cent of the next wave of spread betters said they would be comfortable taking a short position if they anticipated a decline in the price of an asset, the proportion jumps to 70 per cent among established clients.

Second, economic patriotism is preventing traders from betting against domestic companies.

In Australia, for example, the proportion of traders opening short positions fell to 31 per cent this year, and three quarters said their last trade in Australian shares was long. By contrast, only 43 per cent were long on overseas indices.

Third, all traders are suffering from a cognitive bias towards optimism.

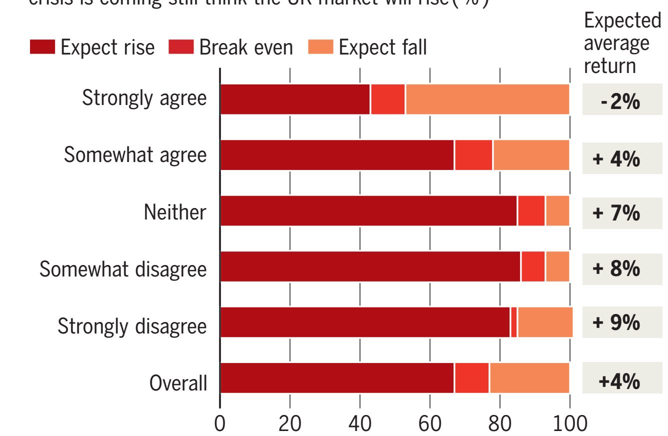
What else can explain why 78 per cent of spread betters who believe a second wave of the global financial crisis is imminent also expect the UK stock market to rise in the next 12 months?

Safe investment?: equity traders in banks are 95 per cent long, research suggests Bloomberg

'Clients have always been as bearish as bullish but the switch we are seeing is their changeability'

Traders see no need to short sell equities

Spread betters who agree or disagree that a second financial crisis is coming still think the UK market will rise (%)



Source: Investment Trends Pty Ltd (July 2011)

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Trading Insight

Caution urged over volatile Europe

Financial crisis

Tanya Powley looks at the risks in trading debt markets

The sovereign debt problems in the eurozone have dominated headlines for the past year, and been the biggest event driving stock market volatility.

"It has been the only news story in town when it comes to what has been moving markets," says David Jones, chief market strategist at IG Index.

While debt has traditionally been one of the least popular markets to trade in because of its stability, the recent volatility and divergence in yields have led to a rise in its popularity.

Joshua Raymond, chief market strategist at City Index, says: "Spread betters are naturally very opportunistic traders, so when volatility surrounds a particular market, as it has with bonds of late, this would normally attract a greater amount of spread betting activity, with clients attempting to profit from quick moves in a short space of time."

Most firms typically provide spread betting markets on UK gilts, German bunds, US treasuries and Japanese government bonds. However, in August, IG Index capitalised on betters' growing interest in bonds and began offering the option to trade the BTP Italian bond contract.

The firm saw a near five-fold increase in Italian bond trading in November, a month when Italian bond yields rose to critical levels and a new Italian prime minister took office.

The German bund has seen a lot of trading activity because of its haven status, say experts. Trading eurozone debt can provide significant profits for spread betters because of the big price moves.

The German bund has risen almost 2,000 points since its April lows and rose 600 points in just three weeks in November. "This can be traded from £1 a point, so significant profits are possible," says IG's Mr Jones.

Similarly, over the same period, the Italian BTP has seen a 1,000 point decline, providing traders with short selling opportunities.

However, as with other asset classes, there are risks with trading debt markets, warn providers.

Kathleen Brooks, research director at Forex.com, says a big problem is the speed of some of the moves in the markets. "Investors who traditionally trade on stocks and foreign exchange need to be clued up as to political risk, which has been a large mover of eurozone debt in recent months," she says.

In addition, one of the problems with eurozone debt is that many of the political decisions are being made over the weekends, says Simon Denham, chief executive of Capital Spreads.

"There is an increased chance, over other markets, of substantial gapping from Friday close to Monday opening," he warns. Because of this, it is crucial traders deploy a sensible margining policy.

Mr Raymond believes investors who have not traded bond markets before should be cautious. He says the volatility of both Italian and Spanish bond yields, and the role of the European Central Bank in influencing yields in their effort to contain the crisis, make it difficult for even seasoned traders.

"For spread betters to try to trade bonds now for the first time, this can be quite dangerous," he warns.

Mr Denham agrees. "Traders have tried quite a few strategies, but it has to be said that the actual 'moves' have generally come at surprising moments, leaving dealers unsure as to whether to make a play or sit on their hands," he says.

"I would always advise people to stay away from volatile markets, as you generally only have to get it wrong once to be damaged."

But for those keen to cash in on price movements, there are a number of strategies for trading eurozone debt.

Mr Jones says some traders choose to follow a trend, assuming it will continue, such as weakness in Italy or strength in Germany.

Others take a contrary view that market pessimism or optimism is overdone. Ms Brooks says that she prefers the yield spread trade: going long on German debt and short on Italian or Spanish debt as this yield spread tends to surge at times of market stress.

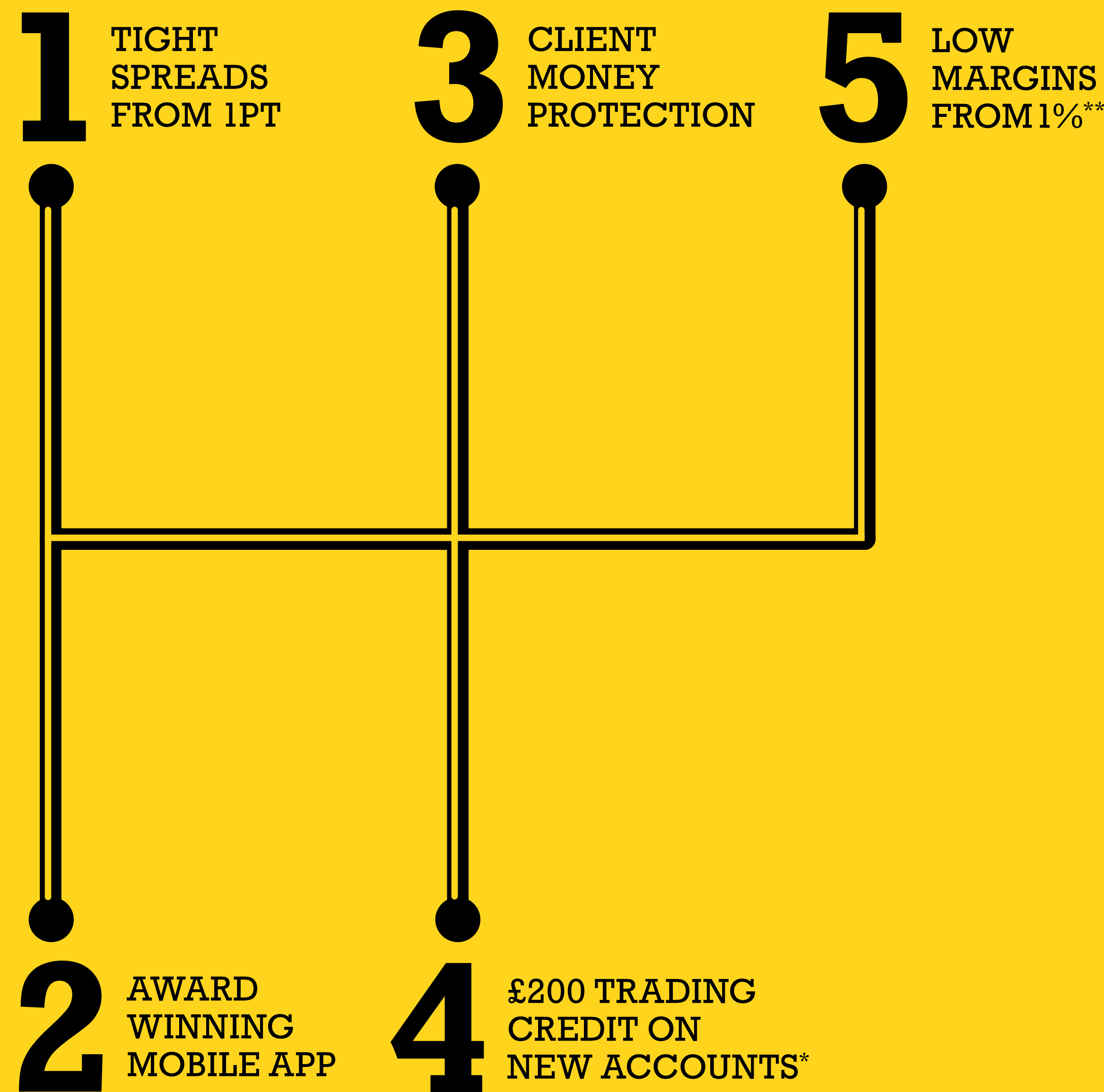
> 'Stay away from volatile markets as you only have to get it wrong once to be damaged'

There are also other ways to capitalise on the euro-zone debt crisis without betting on the debt of the affected countries. One of the most obvious is to take a position on the euro.

"This has seen some very big moves in short periods all the way through the crisis, but it seems to be holding up relatively well, confounding some who are calling for its death," notes Mr Jones.

Meanwhile, from January, investors with WorldSpreads have been able to take a position on how many days they believe the euro will survive in its current guise. WorldSpreads' "Euro Break-Up price" is quoted as a number representing the predicted number of days, from and including January 2011, until the date the euro breaks up.

David Jones: The euro has seen some big moves



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Trading Insight

Fervour for ITV's X-Factor puts BBC's Strictly in shade

Novelty betting

The talent show may be losing the ratings war but **Sean Smith** finds punters still adore it

Just as the popularity of ITV's *The X-Factor* has started to fall with the viewing public, it has won the favour of spread betters.

For a long time it was the queen of television talent contests, consistently beating *Strictly Come Dancing*, its BBC rival, in the ratings war, but rarely impinged on the consciousness of traders seeking a profit.

But in a year in which the quality of the singing talent on the TV show has been sketchy at best, and which has seen it unceremoniously overhauled in the ratings by its cheaper BBC counterpart, *The X-Factor* has finally found its mark in the novelty betting markets.

According to Aidan Nutbrown, head of general sports at Sporting Index: "This year, *The X-Factor* has been pretty amazing for us – the best ever. With *The X-Factor*, it has been the openness of the competition. Any one of six or seven could have been seen as winners."

Alex Bake, responsible for reality TV shows at Betfair, agrees: "*The X-Factor* is by far the most liquid market and the most is traded on it. *The X-Factor* betting has really taken off this year and has left *Strictly* in its wake. We have had almost five times the amount traded on *The X-Factor* than *Strictly*."

One of the reasons for spread betting firms' success in persuading punters to trade in what is, at first sight, an insecure and unpredictable market, is that it is relatively straightforward once you understand the formula, according to professional novelty trader Daniel Gould.

"A lot of people believe, quite rightly, that it is a better market to trade in, because there is a way to get an edge that they might not be able to get elsewhere," says Mr Gould, who runs betting blog Sofabet.com.

"In many betting markets – such as horseracing or financial markets – the variable is in the event itself, which makes it difficult to predict.

"In *The X-Factor*, the variable is after the event – in the voting – which makes it much easier to calculate."

Despite a chaotic series, in which one contestant was kicked off for alleged drug taking, another left to continue his studies and a third was parachuted in halfway through the competition, the key to trading is understanding those that pick the winners: the public and the producers of the show.

This variable has meant that a product that is struggling to attract viewers – the BBC's *Strictly Come Dancing* topped the weekly viewing figures for the first time this year – has seen a huge rise in the number of people trading on the result.

Mr Nutbrown adds: "This year, we saw a really big tail-off in *Big Brother* betting, which has been a staple, because traders just did not engage with it, and *Strictly* has failed to capture the imagination.

"But *The X-Factor* is very successful: the quality of the singers in this year's competition is not as good as previous years, which is bad for the show, but good for us."

Above, from left: 'X-Factor' hopefuls Mischa B, who was voted off last week, Marcus Collins, Amelia Lily and girl group Little Mix.
Left: Bruce Forsyth and Tess Daly, hosts of 'Strictly Come Dancing' PA

The changes in betting technology since the 2010 show, including the take-up of smartphones, are another important reason for *The X-Factor*'s success.

The ITV show's live Sunday results have proved a huge success with traders, and hampered trading in *Strictly Come Dancing*, which records the Sunday results show the night before. "Because they record the results on Saturday night, we can't trade in-running on *Strictly*," Mr Nutbrown says.

"So you don't see anything like the business you do on *The X-Factor*, where we have big fluctuations up to the final sing-off and result."

Mr Gould says: "In-running, a lot of money goes down in the 10 minutes of the final sing-off [at the end of the show]. I've made some very good money out of those 10 minutes."

The reinstatement of a contestant has also added to the attraction, with spreads in the outright market for Amelia Lily, the 16-year-old who was voted back on to the show after Frankie Cocozza was asked to leave, rising sharply from 0-1pt (50 points for the winner) to as much as 28-30 points.

But for experts, the key to trading on the outcome of *The X-Factor* is to know what the producers are thinking. Often, there are clues during the show to suggest which contestants the producers are trying to nurture and which ones they want to leave.

"There are lots of ways to tell that the producers have made up their minds: the running order, dodgy lighting, the judges' comments," Mr Gould says.

> 'A lot of money goes down in the 10 minutes of the final sing-off. I've made some very good money out of those 10 minutes'

Perhaps the biggest concern for the growing markets is the show's possible demise. Last year, *The X-Factor*'s quarter final drew a peak audience of 14.5m, while the face-off for a place in this year's semi-final was widely reported to have attracted 3m fewer.

Nonetheless, traders as ever have a fallback position. "[Ending the series] would be slightly disastrous," admits Mr Gould. "But at least there is always the Eurovision Song Contest."

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Yellow metal was a surprise casualty

Gold prices

The shiny stuff is not a one-way bet, says **Lucy Warwick-Ching**

The gold price is often seen as a barometer of investor sentiment: the worse the outlook, the higher the gold price, as investors seek havens for their money.

In keeping with tradition, traders piled into gold in the first nine months of this year, sending the price soaring, as fears over the eurozone debt crisis and slower economic growth in the US led many to seek shelter from volatility.

But gold became the surprise victim of the market in September, when investors around the world dumped both equities and commodities because of fears of a global economic slowdown. The precious metal lost nearly 9 per cent of its value in one week – the biggest percentage fall since 1980.

Although a drop in the price of gold negatively affects those who have invested directly in the physical metal, these unpredictable swings have presented spread betters with an opportunity.

"Gold remains a popular trade for clients and probably one of the most profitable ones for them too," says Angus Campbell, head of sales at Capital Spreads.

"There's something about it that gives it an allure for private investors. Almost everyone wants to own a bar of gold, which nowadays is incredibly expensive, but you can expose yourself to the price of gold via a simple spread bet without having to put up a huge amount of capital."

City Index also reports that trading on gold is the most popular bet on commodities for clients. Sandy Jadeja, chief technical analyst at City Index, says: "Next year is probably going to see an increase in gold trading, until we see a long-term resolution to the eurozone debt crisis and a return of faith in the US dollar and other major currencies."

Alex Orban, chief executive of XTB, agrees. "Should the euro collapse and retreat to a small core, cutting a number of southern eastern members adrift, there is a possibility that gold could soar as high as $4,000 in the ensuing panic," he says.

There are various ways in which investors can gain exposure to the metal: gold funds; exchange traded funds; physical gold; spread betting; contracts for difference; mining shares; futures; options – with the key being whether or not the investor wishes to inject leverage or not.

Typically, long-term investors choose gold funds, mining shares, exchange-traded funds and physical gold, with active traders focusing on futures, options, spread betting and contracts for difference, because of their shorter trading horizons and their desire to make use of leverage to amplify the movement for their trading positions as they seek rapid gains.

One benefit of spread betting on gold is the ability to deal at just about any time of day, as it is a 24-hour market. Many spread betting firms calculate gold trades at 0.1 basis points per US dollar, which means that for every dollar movement, you would either make or lose 10 times your stake. So if you buy £5 worth of points and gold moves up $2, you would make £100 (£5 x 2 x 10).

With gold, most firms permit gearing of up to 20 times the initial stake. The flipside of leverage is that potential losses are also not limited to your stake.

The big concern for traders is the future performance of the precious metal.

Brenda Kelly, market analyst at CMC Markets, believes gold could continue upwards. "These days the lack of a gold standard coupled with a willingness to print money on demand through quantitative easing means you have the basis for quite a bullish outlook," she says.

Others are not so sure. Kathleen Brooks, research director at Forex.com, says that pressure in Europe could thwart gold's attempts to breach the £2,000 per ounce threshold. At any rate, "it may not do this until conditions in the markets settle down".

So it seems the gold price should not be seen as a one-way bet, either up or down. "The big sell-off that occurred in late September suggests that the recent rally phase has ended and a consolidation phase has commenced," says Colin Cieszynski, market analyst at CMC.

"These times favour taking advantage of swings in the gold market in both directions over viewing gold as a one-way trade."

Others, such as Chris Beauchamp, market analyst at IG Index, recommend managing risk using stop losses. However, he says: be careful where you place this stop loss. "Because of the volatility – October saw a $150 dollar range for gold – it is a market – similar to foreign exchange – that should be given room to move to cut the risk of getting 'stopped out' in the day to day 'noise' [volatility]."

One thing experts generally agree on is that gold tends to keep its underlying value in spite of anything going on in the world.

Alastair McCaig, market analyst at WorldSpreads, says: "In the dim and distant past, when it was worth threepence ha'penny, an ounce of gold would buy you the finest suit on Savile Row.

"Today, an ounce of gold will [still] buy you the finest suit on Savile Row.

"Gold is an excellent store of wealth, regardless of what price action has done to its value in the intervening years."

All that glistens: you do not have to own gold to benefit from its price swings Reuters

> 'When gold was threepence ha'penny an ounce, that would buy you the finest suit on Savile Row. An ounce still will'

On FT.com

American football With the National Football League now just below rugby union in viewing figures on Sky Sports, the game is again popular with punters.

Cricket The pitch will be worrying betters when England take the field against Pakistan in the United Arab Emirates in January.

Inflation Savers, pensioners and cash-strapped households have been hit by the rising Consumer Price Index but there are ways to make money on soaring inflation.

Diversifying assets is not as easy as it was

Risk reduction

It is still sensible for clients to broaden their short-term bets, reports **Elaine Moore**

Having a spread of investments has long been the approach favoured to minimise risk, but the rise in volatility across asset classes previously considered havens is causing confusion.

The theory that adding asset classes to a portfolio will reduce the impact of large movements in one particular area, and so improve overall returns, is creaking under the strain of volatility across multiple markets, including those traditionally considered less risky.

"When markets panic, any asset that has the slightest hint of risk gets heavily hit," says David Jones, chief market strategist at IG Index. "Shares, indices and currencies have all moved, meaning that what looked like a sensibly diverse approach can quickly crumble."

Once, asset diversification was an easy way to minimise risk. But as Tim O'Sullivan, global head of trading at Gain Capital, says: "That was then and this is now."

In the years since 2008, relationships that had previously existed between markets moved from the known to the unknown, he claims, citing the example of US 10 year Treasury bonds and the euro/US dollar currency pair. Since 2008 this combination has experienced huge correlation fluctuations at both extremes, he explains.

Mr Jones points at the relationship between the same currency pair and gold. "If a client had bought euro/dollar and bought gold, this isn't really that diversified," he says.

Dollar weakness is associated with both an increase in the euro/dollar pairing and to a rise in gold. "So, really, it's just a large bet on the dollar going down," Mr Jones says.

Brenda Kelly, market analyst at CMC Markets, says that while global political action, or even inaction, has added to the volatility of most global markets, it has been felt particularly acutely by foreign exchange (forex) traders.

"Trading a forex pair means taking a position on two global economies with the expectation that one economy will outpace the other," she says.

Negative headlines, which indicate that the economic situation of one country will go against that bet, can drive up the risk of loss.

The debt crisis within the euro zone, coupled with the traditional haven status of the US dollar, has driven investors to seek dollars during times of uncertainty and high volatility in the equity markets.

In recent weeks the euro/dollar currency pair went from trading at 1.38 down towards 1.34.

Those traders who did not employ tools to limit their losses on long euro trades would have seen their investment severely dented, Ms Kelly says.

Brokers point out that during periods of turmoil, trading activity increases, as clients rush to limit their losses and others act to take advantage of quick market movements.

Angus Campbell, head of sales at London Capital Group, confirms this experience: "As volatility spikes, so does the number of trades we take and vice versa."

Those investors interested in profiting from volatility can consider taking a position on the Chicago Board Options Exchange Market Volatility Index, also known as the VIX or "fear" index, which tracks expectations of volatility in the S&P 500 index.

The higher the number, the greater the turmoil predicted. Anything above 30 is generally considered to be a prediction of erratic market movement to come; after 11 September 2001 the index hit 41.

IG Index allows investors to gain exposure to the VIX index with a minimum bet size of £50 per index point.

If investors think the market has risen too quickly they can go long, and can use this as a way to hedge against long positions on the stock market.

The beauty of spread betting and contracts for difference trading is that they offer investors the chance to diversify across multiple asset classes from a single trading account, says Mr Campbell. But, no matter the position taken, any trade requires preparation and planning.

Acknowledging the right risk appetite is the basis for any investment, say brokers. Although leveraged trading can magnify profits, it can also exacerbate losses and the only way to minimise this is by planning an exit point.

Employing tools such as stop losses means investors can make decisions about how much they are willing to lose. CMC Markets suggests a risk/reward ratio of at least 1:2, meaning that to gain £200 an investor is willing to lose up to £100.

"Any trader who doesn't have a plan in place is going to face problems, because volatility can be fast and furious," says Ms Kelly. "The speed at which your losses can stack up can be overwhelming."

Diversification may no longer be as simple as picking more than one asset class, but it is still sensible to use it to broaden out short-term bets, says Mr Jones, so long as traders opt for investments that are really diverse.

Alternatively, he suggests focusing on a smaller range of markets and adjusting trade size accordingly.

"If you're unsure where the market is heading and want to reduce stress and potential losses, it may make sense to dial down the size of your trades," he says.

Dollar weakness is associated with an increase in the euro/dollar pairing

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Currencies Interest in forex increases

Foreign exchange (forex) trading has surged in popularity in recent years, increasingly rivalling indices, as spread betters take advantage of fast-moving currency markets.

"Forex trading is probably the hot market of recent years, very close on the heels of the ever-popular indices such as the Dow and the FTSE," says Chris Beauchamp, market analyst at IG Index.

Interest has been sparked by currency movements making front-page news, ranging from the eurozone debt crisis to interventions by central banks to control currencies. But such stories have also highlighted the risks of forex trades.

Angus Campbell, head of sales at Capital Spreads, says: "Currency trading is fraught with risks because of volatility, examples of which can be seen as a result of recent intervention from the Swiss and Japanese central banks.

"On the other hand, this can serve as a lure for would-be foreign exchange traders."

On August 15, the Swiss franc dropped sharply on speculation that the country's national bank was preparing to peg the currency to the euro to prevent inflows from investors seeking its haven status and making its exchange rate uncompetitive.

This saw some traders make unexpected profits, but others will have made big losses.

Joshua Raymond of City Index says: "The move by the Swiss National Bank to peg the Swiss franc against the euro and the ensuring sharp 9 per cent move that came off the back of it was an unbelievable event that was unforeseen by even the best of traders."

Volatility remains the biggest risk.

Even in a quiet market, the various forex pairs can trade in 50 to 100 point ranges and end the day broadly unchanged.

Mr Beauchamp says that traders should ensure they have a stop loss in place when trading these instruments, but not so tight the trade is closed out on short-term volatility.

The most popular currency pairs to trade remain the euro/dollar and sterling/dollar, although most agree that the former is seeing the most interest from spread betters.

"Euro/dollar is still the most traded currency pair," says Kathleen Brooks, research director at Forex.com.

Ms Brooks says that, while most people expected the single currency to collapse, it has been buoyant this year.

This is mainly because the more that the eurozone crisis threatens global growth and US growth, the greater the chance of further quantitative easing (QE) from the Federal Reserve.

"QE tends to weaken the dollar, so whenever there is a possibility of this, then you tend to see investors avoiding the dollar like the plague," adds Ms Brooks.

Alex Orban, chief executive officer of XTB, says the firm has seen one investor achieve a 2,582 per cent return in a month trading the euro/dollar pair, executing more than 200 trades, with about 90 per cent of the trading positions delivering a gain.

Mr Orban says: "The trading strategy often shorted the euro, using automated trading techniques applied by the investor, which ensured both speed of execution as well as the application of stringent trading 'rules' to minimise any loss while maximising gains."

Because of the tight spreads on offer, many traders will dip in and out of the markets quickly to try to take advantage of small movements. This is particularly the case after the publication of key economic data, says Mr Campbell.

The biggest market mover remains the US non-farm payroll, nicknamed "non-farm Friday" due to the fact the US Bureau of Labor Statistics publishes the data on the first Friday of each month.

According to Mr Campbell, in November the data were a little below expectations and as a result traders fled from risky currencies back into the dollar straight after the release of the data.

"The euro/dollar currency pair fell 40 points in a very short period from about 1.3765 to roughly 1.3725, so if you had sold £10 a point at 1.3765 (if our spread was 1.3765-1.3766) and then bought back at 1.3725 (if our spread was 1.3724-1.3725) you would have made £400 (1.3765 – 1.3725 x £10)," he explains.

Tanya Powley

Eyes turn to Iowa as presidential race begins

US elections

A good Republican contest is crucial for business, writes **Huw Richards**

Spread betting and prediction firms are obliged by their nature to be politically non-committal, but there is one thing on which they would readily agree with Barack Obama, the US president: they would all like nothing better than for next year's US election to be a rerun of 2008.

Mr Obama had every reason to be pleased with the result that swept him into the White House on a genuine wave of enthusiasm for the change he appeared to represent.

The election in 2008 was "the perfect storm", says Carl Wolfenden, politics marketmaker for the Ireland-based predictions firm Intrade.

"It had just about everything you could want to create excitement, and therefore business.

"You had the first election in ages without an incumbent, two long and exciting nomination races, and a Democrat race that was going to give you either the first black presidential nominee for one of the main parties, or the first woman."

Given that most experts recognised it as a once-in-a-lifetime election, people whose working lives depend on analysing the probability of such events have little difficulty in recognising that it may be asking too much to hope for a repeat performance.

Certainly, it seems likely that there will be an incumbent in the race. Mr Obama may face electoral difficulties, but not on a scale likely to bring serious Democratic challengers for the nomination.

So far, however, interest among potential traders on Intrade's markets – in which a successful prediction scores 100 points and an unsuccessful one scores nil – has been, says Mr Wolfenden "pretty much at the same level as in 2008".

Barack Obama, the US president, along with many spread betters, would like a rerun of the 2008 election PA

Maintaining anything like that level of attention and the business that it brings with it, pretty clearly depends on the race for the Republican nomination, now getting seriously into its stride ahead of the first formal event, the Iowa caucus on January 3.

Mr Wolfenden points out that Iowa has been determined to keep its influential place at the head of the queue of states holding nomination events. "It began to look possible we would get a primary or caucus before the end of the year," he says.

But the indications so far are that the Republicans may deny Intrade and others the epic battle they desire.

A series of potential contenders has risen and fallen over the past year, with money placed on the possibilities of Tim Pawlenty, Sarah Palin, Donald Trump, Rick Perry, Herman Cain and others who have had periods of prominence and apparent potential.

None of those now trades at more than 3 per cent.

The constant in markets on the Republican nomination since they were first offered has been Mitt Romney, the former governor of Massachusetts, who was runner-up to the eventual 2008 nominee John McCain.

Mr Romney was trading at more than 70 per cent in early November.

Mr Wolfenden says this does not make him a certainty.

"Hillary Clinton was trading at similar levels four years ago," he says. However, he adds: "I don't see any of the other Republicans having the same potential as Obama."

There are, he says, good reasons why Mr Romney has been showing so strongly: "He has been running for the job since 2006 and he's now a pretty polished and credible candidate.

"If there was any scandal about him, we'd almost certainly know it by now, and I certainly think he's got the best chance of any of the Republicans of beating Obama."

At the same time, it is clear that Mr Romney is disliked by many hardcore Republicans.

"As a governor, he raised taxes and introduced universal healthcare – and being a Mormon doesn't help. As a businessman, he put quite a lot of people out of work – not that conservative Republicans mind that."

The strongest anyone-but-Romney contender so far looks to be Newt Gingrich, the former House of Representatives majority leader. He was up in the past month from single figures to 34.4 per cent.

"He's a smart guy, but isn't liked by a lot of people," says Mr Wolfenden.

Next up are Ron Paul, who commands the unshaking allegiance of a hardcore of libertarians, and former ambassador Jon Huntsman, both on 6.5 per cent.

One possibility, acknowledged by Intrade's introduction in mid-November of a market on the possibility of Mr Romney winning the first five events of the Republican race, starting with Iowa, is that it could be finished quickly. "If he does that, it will be all over," says Mr Wolfenden.

A convincing Romney win in Iowa might be enough almost by itself.

"He isn't a natural for Iowa, which is conservative territory. But winning it would make him hard to stop," says Mr Wolfenden.

At the time of writing Intrade's market on Iowa suggested that Mr Romney would fall short, trailing in third place on 14 per cent behind Mr Gingrich (58.3 per cent) and Mr Paul (20 per cent)

From a business point of view, Mr Wolfenden would like to see a sustained challenge to Mr Romney.

If it does not materialise, interest would shift to the Republican vice-presidential nomination.

Beyond that is the national election itself, in which Mr Obama has so far been hanging on to marginal favouritism.

Software subtracts the passion

Black-box systems

Stripping out emotions can cut losses, says **Lucy Warwick-Ching**

Spread betters are all too often ruled by emotion, with many moving carefully placed stop losses at the last minute only to lose that day's profits when the bet goes against them.

Rather than being ruled by their gut feelings, some traders are now turning to high-frequency trading systems. These so-called "black-box" systems use statistical algorithms to place trades in seconds to exploit small price differentials.

"Algo-derived trading can be an efficient, low-maintenance form of trading that requires less and less trader interaction," says Joshua Raymond, chief market strategist at City Index.

"What's more, part of the difficulty facing retail spread betters is that being able to master one's trading psychology is an important and potentially crucial part of determining whether a spread better is profitable or not."

The idea is that algorithmic trading removes psychology from trading by employing trades in accordance with strict rules. If spread betters stick to these rules and interact less with their trading strategies, this can lessen the chances that they place irrational trades driven by emotion.

Experts say the automated trading community has grown in leaps and bounds over the past few years with, computer-driven services now accounting for about half of the average trading volume on US equity markets, and a third of the volume on European markets, according to US consultancy Tabb Group.

"What's interesting is that we're seeing all levels of traders participate in this dynamic," says Tim O'Sullivan, global head of trading at Gain Capital.

"From the new retail trader to the expert fund manager, all members of the foreign exchange trading community are utilising advancements in technology to their benefit.

"These programs mean retail traders no longer need to commit research time to macroeconomic trends."

But these systems can be hard for professionals to understand, let alone retail spread betters.

Mr Raymond says: "I suggest beginners stay clear of algo-trading solutions until they have gained experience of trading the markets first hand."

He adds that one of the advantages of the programs – stripping away emotion – can also be a disadvantage to some individuals.

"Trading the markets can be a huge buzz," says Mr Raymond, "particularly if you call the market direction right and have real capital at stake.

"If you replace interactive trading with an algorithmic trading model, this can remove part of the buzz in trading and leave you with a less fulfilled trading experience."

There is also the question of cost. At the low end, it would not be unreasonable for a total trading system to be available for less than £200. At the upper end, the sky is the limit.

Betters should also be aware that some trading sites, including IG Index, will not let clients use such systems.

"The IG Index trading platform has an enviable record for its stability and ability to withstand surges in demand during events such as the non-farm payrolls, where we typically handle a lot of transactions in the minute after the numbers are released," says Tim Hughes, IG's managing director.

Tim O'Sullivan: software can reduce traders' research time

"However, if we were to have thousands of clients attempting to run the same black-box trading systems simultaneously, then factors such as response times and stability would potentially become something of an issue, in turn impacting all our clients."

Alastair McCaig, market analyst at WorldSpreads, says such trading is attracting interest from financial regulators seeking to clamp down on the practice to avoid "flash crashes" – quick falls and recoveries in share prices.

Angus Campbell, head of sales at Capital Spreads, makes the point that human beings are lazy and says: "If there's something we can't do very well or don't understand, and someone else claims they can do it better, then we will happily trust them with our cash and hope it will make us richer.

"This is especially the case when past performance shows outstanding returns, but unfortunately, as with anything in this world, past performance is no guarantee that the black-box strategy will be able to repeat it."

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