TRADING INSIGHT

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Speed fails to impress long-term investors

Full steam ahead: a cable laying vessel at work. Hibernia Atlantic, the submarine communications system, has carried out a survey for a high-speed connection from the US, due to go live in 2013
Global Marine

A $300m cable under the Atlantic will improve trading times but many UK spread betters prefer to trade at a slower pace, says **Matthew Vincent**

Professional traders are set to gain an extra six milliseconds in which to open and close ultra short-term positions on currencies, equities and bonds – thanks to a ship currently off the east coast of the US, which is surveying a superfast communications cable linking Wall Street to the City of London.

But a significant number of UK spread betters seem to prefer the trading equivalent of a slow boat to China, so they can ride out choppy conditions longer.

Last month, Hibernia Atlantic, the transatlantic submarine communications cable system, received widespread coverage of its seabed survey work on a 3,741-mile transatlantic fibre-optic cable.

When completed, the $300m cable will be the first undersea link to be laid since the 1990s.

Although it will only cut the time it takes to execute US trades by up to six milliseconds, analysts say a one millisecond advantage could be worth up to $100m a year to the profits, or losses, of a big hedge fund.

News of the link came as sustained volatility in equity and currency markets highlighted the risk of not closing trades quickly enough. In August, the FTSE 100 moved in a range of more than 100 points on 18 out of 22 trading days, a degree of price movement seen only three or four times a month in average trading conditions.

Lacking the computer-driven algorithms that drive high-frequency trading for hedge and quant funds, most UK spread betters manually increased the frequency, and cut the duration, of their positions.

Spreadex reported a 28 per cent "surge" in betting volumes in August. Andy MacKenzie, the firm's marketing communications manager, says: "The incredible volatility experienced by global indices, equities and commodities sparked furious short-term trading activity and meant other investors were forced to address longer-term positions."

Similarly, IG Index saw a "surge in account openings" during the month, and said clients placed more spread bets than ever before. David Jones, chief market strategist at the firm, noted: "As a direct result of the volatility, the number of orders placed by clients jumped significantly, with the PureDeal platform processing almost 900,000 transactions on August 9 alone."

In a typical month, IG says its platform handles some 6m transactions, suggesting daily volumes were up 230 per cent at the height of the trading.

Most spread betters were seeking short-term profits, says Angus Campbell, head of sales at Capital Spreads. "During times of extreme volatility, we tend to see trade numbers spike. In these periods, clients will often trade more frantically in an attempt to take advantage of the sharp movements in markets so they can make a quick buck."

Some adjust their time frames to match up with the markets. "As volatility increases, we tend to find clients reduce their holding period and trade more frequently," observes Manoj Ladwa, senior trader at ETX Capital.

"Traders initially reduce their exposure and trim positions but, as volatility continues to rise, they get back into the market. But subsequent positions tend to be smaller and shorter-term, as traders look to exploit and profit from the exaggerated moves."

However, for some clients, this short-term trading is neither preferable nor intentional. "Most clients classify themselves as short-term traders, or onger-term traders," says Tim O'Sullivan, global head of trading at Gain Capital's Forex.com. "But the volatility hastens the movement for both sets." It also throws longer-term traders out of positions prematurely.

Mr Mackenzie says: "Often, the short duration of a bet is not through choice. The problem can be that violent and exaggerated market swings can see prices see-saw through stop-loss levels, therefore closing traders out of their positions. There have been many examples of this recently." He says many longer-term investors found themselves "stopped out" of a trade, only to see the price then move in their favour, meaning they missed out on the longer-term profit opportunity they had identified.

Data from IG Index indicates one in five spread betters would prefer to be longer-term traders, as they no longer use daily bets.

A random sample in August revealed longer-term bets accounted for 21.9 per cent of trades in gold, and 19.2 per cent of trades on Barclays shares. "There's a definite move to a longer-term 'buy and hold' mindset with gold and Barclays," says Mr Jones. "People are appreciating they don't have to be short-term, but could run trades for two or more months. It's not buy, buy, buy."

> 'People appreciate they could run trades for two or more months. It's not buy, buy, buy'

Capital Spreads has seen a similar trend in individual share bets. "Equities tend to attract clients with a longer-term view," says Mr Campbell. "Equity traders can have longer investment horizons, which could be as much as weeks, months or, in the minority of cases, years."

At CMC Markets, clients like to play longer-term trends in currencies. "We found that clients focused on currencies rather than equities because of the yo-yo in equity markets. There was no clear direction," says Michael Hewson, CMC market analyst. "You can make a more rational decision on where a currency pair is going, as euro-dollar. You've got people talking about a break-up of the eurozone – that's a definite possibility."

Spreadex clients tend to take longer-term bets on bonds or interest rates. "There is less of the 'instant' return that can be experienced from trading indices, equities or foreign exchange," says Mr Mackenzie. "But if you have a successful long-term strategy and plenty of patience, the rewards can be just as good if not better."

But as they are margin-traded derivatives, which require traders to pay financing charges for holding positions open overnight, spread bets have traditionally been an expensive way to exploit such strategies.

Craig Inglis, CMC's head of product development, says there used to be several cost disadvantages: financing, if trading any underlying on margin; the interest rate differential between currencies, which clients must pay on certain currency pairs; and the holding cost associated with certain commodities, such as natural gas.

Now, spread betting firms are beginning to address many of these barriers to longer-term trading. CMC has started offering "continuous cash commodities" bets based on spot prices with no expiry dates, no need to roll bets over and pay financing charges, and greater transparency over holding costs. "One of biggest criticisms of our old marketmaker platform was that there was no way to display continuous commodity contracts, only three-month durations," says Mr Inglis. "Now there's no rollover, just one price, traded like a spot currency."

Spreadex offers a range of exchange traded fund bets that allow clients to take positions over a basket of stocks, commodities or bonds – with prices based on an expiry that is months or years ahead. "These can smooth out the short-term volatility experienced when trading on a daily future, or close quarterly, expiry date," says Mackenzie

Alternatively, ETX Capital gives spread betting clients online access to the options market, which allows them to take longer-term positions, with limited exposure. But Spreadex also provides evidence that the most lucrative holding period for a bet is neither six milliseconds nor six months. Judging by recent results, it is 90 minutes.

On August 28, the firm suffered one of the worst trading days in its history.

Not because of UK equity market volatility, nor US economic data. It was simply because of what happened at Old Trafford, Manchester. Its sports betting arm lost close to £250,000 when Manchester United beat Arsenal 8-2.

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Traders take short-term view as eurozone's volatility increases

Sovereign debt

Uncertainty creates opportunities, writes **Alice Ross**

The European Union is hardly the model of stability. Concern over Irish, Greek and Italian debt, and the health of French banks, has led to much market volatility. However, spread betting firms say this creates opportunities for traders.

The market volatility in August sent the Euro Stoxx 50 index, which covers stocks in 12 countries, down by more than 11 per cent. Since the start of the year, it has lost about a quarter of its value.

Investors have fretted over whether Greece will be able to pay back its debt, whether Germany will offer enough support to troubled fellow eurozone members, and what will happen to French banks, two of which were downgraded in September by Moody's, the rating agency, over concerns about Greek debt exposure.

Traders have been shorting the euro against the dollar AFP

This uncertainty in the eurozone has led spread betters and traders to try to profit from the swings in the market by placing short-term trades on indices, according to Joshua Raymond, of City Index.

"We have seen the typical length of time that spread betters leave their trades open shorten sharply, as the high volatility means that profit or loss targets are reached quicker than usual," he explains.

"Spread betters have also been picking up on smaller movements in prices, when, in calmer times, they may have waited for a longer and bigger move."

At IG Index, meanwhile, clients are getting exposure to the volatility in Europe through stock indices and in particular currency trades.

Many have been shorting the euro against the US dollar, for example. Others have been trading German Bunds, which have attracted some investors due to the relative strength of Germany's economy.

> 'The debt is unlikely to go away soon, so jittery markets are here for the foreseeable future'

But market watchers agree it is difficult for amateur traders to work out what is happening in the eurozone, with speculation causing wild daily swings.

Yusuf Heusen, sales trader at IG Index, says: "Markets are being buffeted by rumours on a daily basis, so without any solid facts, there is a corresponding lack of conviction in any direction [particularly up]."

But he adds: "This volatility is still proving inviting to short-term traders.

"The European debt problem is unlikely to go away soon, so it seems likely that jittery markets are here to stay for the foreseeable future.

"As we have seen, markets tend to fall much quicker than rise, and there are plenty of spread bet clients only willing to sell into the rallies."

Europe's problems are also affecting the UK market, but the volatility has highlighted how difficult it can be to predict swings and make money.

Traders at Capital Spreads had been selling high positions and buying low ones on the FTSE 100 in the run-up to the August crash, as the index was moving back and forth between about 500 points relatively frequently.

Angus Campbell, head of sales, says that many lost money.

"The sharp breakout to the downside was unforeseen by many clients who had bought into the weakness of the FTSE towards the end of July, expecting the previous support to hold firm. But this time it didn't, and many of them paid the price," he says.

By September, some clients had returned to their strategy of buying on the lows, when the FTSE neared the 5,000 mark. Mr Campbell said he expected they would start to sell again when it neared 5,400.

Amid all the chaos, some betters have been forking out a little extra on their trades for protection.

City Index says that guaranteed stop-losses, which protect traders against violent swings by automatically closing their positions at certain levels, have increased in popularity.

A guaranteed stop-loss ensures that positions are closed at the price the customer wants.

Unlike basic stop-losses, a guaranteed stop loss avoids the problem of "gapping" – whereby the market may be moving down so fast that there is no time to close a position at the level the customer had asked for.

As such, a guaranteed stop-loss comes at a price – about 1 per cent of a trade.

Mr Raymond says that the increasing use of these stop-losses is "the right thing to do" when markets are extremely volatile. Their adoption shows that betters have learnt their lesson following the collapse of Lehman Brothers and the huge slides in markets of 2008.

But traders should be aware that paying for this protection can crystallise any losses they make. If the markets move up again after their position has been closed out, they miss out on the gains.

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Poor harvests boost trader appetite

Soft commodities

August's weather woes highlight the sector's potential, reports **Alice Ross**

Failed harvests in sugar, wheat and corn this year have prompted traders to speculate on the movement of soft commodities, with trading showing a particular spike in August.

Floods and weather disasters have taken their toll on crops, and shorter supplies of food have caused prices to rise sharply.

In August, the combination of a heatwave and a drought in the US led the government to cut its forecast for the country's crops, including corn and soya beans. Contracts for the foodstuffs leapt in price as a result.

Sugar prices also hit a three-decade high recently, after new research suggested the cost of producing the crop in Brazil, the world's largest exporter, would surge 85 per cent in the next 20 years.

By contrast, wheat markets could be set for an increase in supply, which would push prices down, after Russia and Ukraine lifted export bans they had imposed in 2010.

Commodity prices overall have trebled in the past 10 years, according to the Lloyds TSB Private Banking Commodities Monitor, published in September – mainly because of strong demand from emerging markets and a weaker US dollar.

The report found prices rose 232 per cent between 2001 and the end of August this year – equivalent to an average annual return of 13 per cent or three times the average annual return from UK equities over the same period.

The S&P GSCI Agricultural index rose 43 per cent in the year to the end of August. Strongly performing soft commodities over the same period included coffee, which rose 64 per cent; corn, up 93 per cent; and sugar, which rose 49 per cent.

Traders have been trying to capitalise on the movements in prices as a result.

Commodities were one of the top two drivers, along with indices, behind a spike in total trade numbers in August at Capital Spreads.

Angus Campbell, its head of sales, says commodity trades during August rose 165 per cent on the previous month, and 122 per cent on the monthly average for the year.

Joshua Raymond at City Index says spread betters have started to take an interest in how the impact of soft commodities such as wheat and cotton is being used to monitor the performance of certain stocks.

Companies whose business depends in part on how expensive it is to buy foodstuffs, such as Associated British Foods, may find their costs escalate as the prices of commodities fluctuate.

"Spread betters are looking at how the performances of certain commodities are applying yet more pressure on the profit margins of certain companies and are using this as part of a more rigorous and fundamental approach to stocks," explains Mr Raymond.

IG Index says trading in soft commodities has become more popular with its clients in recent years.

Many are looking at corn, whose price per bushel has doubled in the past year from $3.80 to $7.50, with some traders predicting further inflation ahead.

"It's now a regular occurrence that price spikes in something like cocoa, wheat or cotton hit the mainstream media, so combine this with the sheer depth of information available on the internet and you have the ability to develop some trading models based very much on the fundamentals," says Ben Critchley, sales trader at IG Index.

He recommends traders interested in profiting from soft commodities should look out for drivers of price and supply, such as overplanting, freak weather conditions, or political or distribution problems.

Cocoa prices rose 14 per cent in a couple of months earlier this year following a disputed presidential election in Côte d'Ivoire, the main producer of the crop. IG Index says it has seen more interest in cocoa this year than it has "for some time" as a result.

Commodity prices have surged

Traders should also look at which crops are affected by the weather in certain key producing countries – for example, coffee production in Brazil or cotton in Pakistan – if they want to trade on the back of weather forecasts, says Mr Critchley.

He also suggests traders check official output data, such as the US Department of Agriculture's monthly World Agriculture Supply and Demand Estimates, which give a snapshot of production and consumption across the globe.

"News events in this sector have been producing some protracted movements in price, offering clients a great opportunity to place longer-term trades," he adds.

However, some say spread betters are being distracted by the high volatility of European stocks and indices at present, leading to lower trading volumes in soft commodities than might have been expected.

"Normally, one would see a recycling of funds to the typical asset classes and sectors that are seeing increased volatility from areas of low volatility, which spread betters attempt to take advantage of," says Mr Raymond.

"Today, the high volatility in stock markets triggered by news of the sovereign debt crisis is limiting the amount of interest spread betters may otherwise have shown in soft commodities such as sugar or wheat."

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Ireland's shock victory turns World Cup upside down

Rugby

Markets positive as draw heads for north versus south showdown, writes **Huw Richards**

Ireland beating Australia 15-6 in the Rugby World Cup last Saturday did not merely enthuse fans waiting for the tournament's first bona fide shock result. It also moved markets.

Andrew Sinfield, rugby trader at spread betting specialists Sporting Index, explains: "It turned the draw for the later stages upside down.

"It means Australia are now likely to be in the same half of the draw as New Zealand and South Africa, while the other half will be all Six Nations teams."

The impact could be seen fully on SI's tournament-long index, offering 100 points for the eventual winner, 80 points for the losing finalist, 60 and 50 points for third and fourth place respectively and 25 for reaching the quarter-final.

Until last Saturday, Australia were clear second favourites. Now, they are barely ahead of a clutch of contenders quoted in the 40s and low 50s.

Mr Sinfield explains: "All of the main Six Nations contenders were marked up because their half of the draw suddenly looks easier. Ireland came up 13 points, while South Africa dropped a few points because they will now probably play Australia in the quarter final."

What remained strikingly unchanged was host New Zealand's status as hot favourites – trading consistently above 80 points. The result also pleased the spread companies.

Preference for favourites losing is not as marked as among fixed-odds bookies, since spreads allow punters to bet against as well as for outcomes, but Mr Sinfield's pre-tournament view was: "Our least favourite outcome would be a New Zealand v Australia final and we'll do much better if one of the Six Nations makes it, particularly Ireland."

Rugby's complexities offer serious possibilities for the spread punter.

As Mr Sinfield says: "You can do a huge amount of research into a single aspect of the game – drop goals, cards or something else – and become a real expert. We have to cover the whole range of markets, so we're there to be picked off."

Both SI and rival Spreadex, which also offers fixed odds and binary betting, report decent business on the tournament so far.

Shaun Howells, assistant sports team manager and rugby trader at Spreadex, says: "Having England playing at breakfast time on weekends is working very well for us."

> 'Our least favourite outcome would be a New Zealand v Australia final'

Match timings have emerged as a significant factor. Mr Sinfield says: "I would never have expected USA v Russia at breakfast time on a Thursday morning, broadcast on ITV4, to have generated as much business – 600-700 bets – as it did. But the early-morning games have been very quiet. Wales v Samoa, one of the key games of the pool stage, attracted fewer than 400 bets."

The outstanding trend of the opening stages – that most matches have been closer than expected without many shocks – has also worked in favour of spread betting's facility for wagering on the detail of outcomes. Mr Howells reports that only two winners from the opening 12 contests covered their handicaps in those markets.

As Mr Sinfield points out, spread punters like to buy – allowing them to cheer a team on as it piles up points. But he and Mr Howells both note the effects of the poor weather that has accompanied many matches. Mr Howells says: "When it rains, punters start selling – which makes sense. Games such as the US v Russia and Scotland v Georgia produced very low scores, in part because the weather made it so difficult to play."

Walloping for the Wallabies: Australia could find themselves in the same half of the draw as their southern hemisphere rivals Reuters

That mix of stronger performances by developing rugby nations and hostile weather has squeezed most points-based markets.

Mr Sinfield says: "Our spread for total tournament points started above 2,400 but is now below 2,300, while total tries have dropped from more than 280 to below 260."

Both companies offer a market on the highest-scoring match in the tournament, which opened on Spreadex at 109 to 112 but has now fallen to about 100, with the 90 points from New Zealand v Japan representing the current peak.

Both Mr Sinfield and Mr Howells point to Australia v Russia, with the World Cup newcomers possibly exhausted in playing their fourth match in little more than a fortnight, as potentially affecting this market, but Mr Sinfield says: "The days of 100-point massacres are pretty much over."

Also on the way down is the market on tournament yellow cards. It was running in the 30s when the tournament began – not least on the basis of 30 and 35 cards in the past two World Cups – but has now receded into the lower 20s, with only five cards issued in the first 19 matches.

Mr Howells says: "You get talk before every big tournament, rugby or football, that there is going to be a refereeing crackdown with a lot more cards issued. It drives the markets up but rarely seems to come to much."

One market that has shown an upward trend, though, is for the total number of drop goals.

Closer matches mean more are attempted and the three struck by Namibia's Theuns Kotze against Fiji, followed by two from Ander Monro of Canada as they battled against France, have helped to generate a total of eight from the first 19 matches and a spread shifting upwards from an opening 15.5-16.5 to 17.5-19 on Sporting Index at the time of going to press.

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Fernando Alonso and Jenson Button will be vying for second place in the Formula One world drivers' championship after Sebastian Vettel's Monza win all but guaranteed him first place AP

Racing certainty piques interest

Motor racing

F1 is almost dead for fixed-odds but not for spread traders, writes Huw Richards

Sensible sports fans always keep in mind the saying of New York baseball legend Yogi Berra that "it ain't over, till it's over". But if ever an event did look finished before its time, then the 2011 Formula One world drivers' championship is it.

Five races, a little over a quarter of the season, are left, starting this weekend in Singapore. That means 125 points remain to be claimed by the five race winners. However, the reigning champion, Sebastian Vettel of Germany, driving for Red Bull, leads by 112 points.

Even were his closest pursuer, former champion Fernando Alonso of Spain, to win all five remaining races, Mr Vettel taking single third place in any of them, or an accumulation of more minor placings, would be sufficient to give him his second title.

Just before Mr Vettel extended his lead by winning at Monza on September 11, Chris Loud, F1 trader with Spreadex, which offers fixed odds, binary and spread markets, reported: "Vettel is 50 to 1 on and Red Bull 200 to 1 on for the constructors title."

But if the event is more or less dead as far as the fixed-odds market is concerned, the same is certainly not the case for spreads.

Aidan Nutbrown, F1 trader for dedicated spread providers Sporting Index, says this as exactly the sort of event which illustrates the potential of spread betting.

He says: "While we're pretty sure who'll be coming first on our 60 point drivers' championship index, numbers two, three, four and five are much up for grabs."

Only 14 championship points cover Mr Alonso, Mr Vettel's Red Bull teammate Mark Webber, and the two British former champions, Jenson Button and Lewis Hamilton. With 40 points on the SI index for second place, 30 for third, 20 for fourth and 10 for fifth, all four were being quoted in the mid to upper-20s last week.

Still more relevant, however, is the season-long driver point index, on which every single mark can make a difference.

Mr Nutbrown says: "We're very happy to see Vettel go on winning, as it would suit us in business terms. However, there is always the possibility of a driver getting injured, or that, having sealed the title, he'll start settling for lower placings from positions when he might previously have pushed hard for a victory."

F1 is a challenging sport on which to trade, particularly given its propensity to respond to innovations by constructors with mid-season rule changes: "That can be a nightmare," says Mr Nutbrown.

> 'There is always the possibility of a driver getting injured, or of him settling for lower placings'

However, in common with all spread markets, it thrives on uncertainty and large numbers. Rule changes before last season increased the number of points for a win from 10 to 25, as well as improving conditions for competitive racing with more overtaking.

As Mr Loud says: "The first year was edgy, with nobody quite sure how it was going to work, but it was clear that our clients like the extra volatility."

Mr Nutbrown, an F1 trader for the past decade, says: "We did not see much of a shift in the betting patterns of our clients, but extra volatility is always good news."

Certainly, the sport is much more attractive to punters than it was a few years ago, when Michael Schumacher was completely dominant, says Mr Nutbrown, who adds: "In any case, there was a much narrower range of markets in those days, but you'd end up offering Schumacher against the field on a 10.3 index – and he always seemed to win. You could see punters and television viewers sliding away."

The years since have seen a sharp reversal of that trend – and the return of Mr Schumacher as a battling veteran rather than an oppressive overlord – has been welcomed by spread traders as adding an intriguing element to the F1 scene.

But Mr Nutbrown is concerned that the much-publicised proposed shift of television coverage from BBC to Sky will be damaging.

"I think the BBC coverage is excellent," he says. "And of course, you've got the loss of viewing numbers involved. I'd expect that most people who bet with us have got Sky, but there are still a lot of people who are very unhappy about it."

But whoever is broadcasting there are always nuances to look for in each race. Certain events will always pull in more punters, Mr Loud says. "The British Grand Prix is always a big event for us, as is Monaco because of its heritage, traditions and the track."

Individual tracks matter, so, as Mr Nutbrown points out, new venues for three of the five remaining races in Korea, Japan and India will be a challenge for traders. "In general, you expect Red Bull to do well on tracks with sweeping corners, and MacLaren on tight tracks, with Ferrari somewhere in between."

Some other sports, notably football, are marked by the patriotic punter, so spread firms always regard English success at World Cups with decidedly mixed feelings.

But F1 punters appear to be a little bit more hardheaded, with backing for Mr Button and Mr Hamilton generally related to their performance rather than flag-flying. Backing for Mr Button, in particular on in-running markets, often relates to the conditions: "Punters know he is exceptionally good on drying tracks," says Mr Nutbrown.

Betters aim to profit from sovereign debt crisis

Rating agencies

Speculators should be cautious about relying on rumours, says Tanya Powley

President Barack Obama averted a debt default and US treasuries rallied despite the S&P downgrade Getty

Credit rating agencies have started to create big price movements in both the bond and equity markets, as traders increasingly look to them for an indication of the seriousness of sovereign debt problems in the eurozone and the US.

In recent months, agencies have downgraded Greece and Portugal several times, while in August one agency, Standard & Poor's, even downgraded the US. Italy was also downgraded by S&P in September.

"Rating agencies are regularly watched by investors, but more so now," says Joshua Raymond, chief market strategist at City Index, a spread betting provider.

Experts say that, while agencies have always affected price movements, their changes in ratings have become more of a focus because they are concentrating on the status of eurozone and US sovereign debt.

"What is different this time around is that instead of emerging or restructuring economies, it is some of the world's largest and most developed economies that have come under the microscope," explains Colin Cieszynski, market analyst at CMC Markets.

Simon Denham, head of Capital Spreads, says that in the past, rating agencies tended to react to market events, while now they are trying to pre-empt economic events.

Many believe this is because agencies are attempting to re-establish their credibility after the credit crisis, during which the top rating agencies failed to spot the liquidity problems facing big banks across the world.

"I think the rating agencies are so chastened by having dropped the ball so conspicuously on subprime debt that they are doing their best to look hungry and more aggressive," says Alastair McCaig, market analyst at WorldSpreads.

As changes in credit ratings, and even changes in an agency's outlook, can instantly influence price movements, analysts say spread traders can take advantage of these announcements and profit from them.

Tim Hughes, managing director of IG Index, says the bulk of high-profile price action tends to be around financial institutions and their exposure to sovereign debt.

"The recent sovereign downgrades haven't had a primary impact on the euro or the equity markets of eurozone countries. Obviously the fact that the eurozone is far bigger than the nations who have been hit with downgrades has something of a dilution effect. Meanwhile, questions are being asked over the credibility of S&P's cut on the US," explains Mr Hughes.

He points out that it has been specific bondholders who lose when there is a downgrade.

"So understanding who owns what, in terms of government debt, is critical. If you know that bank X is holding a large amount of debt issued by entities that are facing an imminent downgrade – or upgrade – you may want to take a position accordingly."

> 'Rating agencies have been chastened by having dropped the subprime ball so conspicuously'

Government debt can also be seriously affected by changes in ratings, though this is not always the case. Analysts point out that the S&P downgrade of US debt had the opposite effect, and saw treasuries rally.

"US treasuries actually rallied strongly and the equity market fell," says Mr Denham. "Normally a falling rating would mean higher yields not lower."

Mr Hughes believes this rally raised question marks over whether the US downgrade was justified and says the fact other large agencies failed to follow suit has reinforced this view. Some spread betting providers offer investors the ability to trade European sovereign debt. In July, IG Index started quoting Italian sovereign debt and has seen large demand from clients, who are attracted to the volatility and political decisions that continue to drive its price.

However, experts say traders need to be cautious when trading on the back of a change in ratings. Rating decisions may already have been priced in by the market, and therefore create no movement. In addition, agencies may disagree in their ratings of a country, as happened with the US.

Mr Denham says one of the problems with trying to capitalise on rating decisions is that they do not generally have a timetable. He says: "Unlike economic data releases which come out at an exact date and time, investors will not know when an agency will announce a re-rating."

Analysts also say traders should be careful trading on rumours of a downgrade. Mr Raymond says: "Trading on rumours of downgrades is risky and at times of high volatility when many rumours flood the markets, with traders reacting to any rumour, data or news item, it can be hard to distinguish between fact and fiction mixed with rumours that were quashed some minutes or hours later."

He adds that if spread betters do want to trade on rumours, they should protect themselves with a guaranteed stop loss.

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Investors who missed gold rush look for silver lining

Traders have begun betting on silver as gold has started to look increasingly expensive Reuters

Precious metals

Recent strength suggests the bulls are back, says **Lucy Warwick-Ching**

Investors are turning to precious metals again, as concerns have grown over eurozone sovereign debt, widespread economic uncertainty and currency volatility.

But with the gold price rocketing to all-time highs, some traders and spread betters have shifted their attention to silver.

The spot price has historically tended to follow gold, so the thinking is that as the gold price rises, so will that of silver.

"Silver has been something of a poor relation compared with gold, but has still risen by about 30 per cent this year," says David Jones, chief market strategist at IG Group.

He adds: "The massive volatility experienced earlier this year scared away plenty of investors and traders. But recent strength has suggested the bulls are back."

In April, the silver price reached a record high of $48.58 per ounce before an aggressive sell-off when the price fell to $32 an ounce in a matter of weeks.

Some experts say those traders who missed the recent gold rush may jump into silver in coming weeks in anticipation of the precious metal rising in value.

The reasons why silver could catch up with gold are pretty clear, says Brenda Kelly, market strategist at CMC Markets. "It serves an industrial purpose whereas gold does not," she says.

"Silver's high electrical and thermal conductivity means it is used for such things as power generation, so there is global demand and recovery play, just as for other industrial metals such as platinum and palladium."

She also notes there is higher demand for silver from investors, notably in the Middle East and east Asia. This is where gold has started to look increasingly expensive and could start to drive the smaller investor to gravitate towards silver, she says.

Traders can bet on silver either through spread betting or via contracts for difference (CFDs) using spot and future bets. Spot bets reflect the cash price and are typically used for short-term views. Futures are more suited to trade longer-term views.

Whichever you do, the mechanics are the same. For example, investors can bet on each cent movement, so if silver is trading at $25 an ounce, investors can bet £1 a point and win or lose £1 for every cent that the price changes.

However, experts warn that the price of silver can be more volatile than that of gold and there will be plenty of traders haunted by unhappy memories of the big falls in the price of silver seen this year.

"Gold and silver are very different beasts," says Kathleen Brooks, research director at Forex.com. "Gold has surged to record highs in recent weeks, because it is a haven and it is a good store of value in times of economic uncertainty. By contrast, silver has industrial uses, so is much more closely connected to the global economic cycle."

She says the threat of another recession has weighed heavily on the price of silver: "The grey metal's uptrend in 2010 and part of 2011 was fuelled by expectations of a strong global recovery and also by weakness in the dollar."

"While the dollar remains weak, the growth outlook has deteriorated markedly. Unless expectations for the global economy change or the US Federal Reserve embarks on more policy stimulus, then silver may be in the doldrums for some time."

Others agree. "While a repeat of the Bunker Hunt event of the 1970s [when brothers of that name failed to corner the world market in the metal, but temporarily pushed up prices] cannot be discounted, silver looks pretty highly valued on a real demand basis," says Simon Denham, head of Capital Spreads. "If gold continues to rally, silver will probably tag along, but it would take quite an event to challenge the current price ceiling – unless there is a sudden sell-off in gold and global markets regain a sense of equilibrium and certainty."

Traders at Capital Spreads currently hold six times as many long positions in gold as in silver, which would seem to suggest more people believe the gold price will rise than silver. At other spread betting firms, such as City Index, traders appear to be expecting the ratio between gold and silver to narrow over the next year, resulting in a more realistic price for both metals.

Alastair McCaig, market analyst at World Spreads, says there is a strong possibility gold will continue to rise.

"As well as the prospect of [more quantitative easing] devaluing the dollar even further, and the likelihood that fear will return to the market, there is the added pressure on cash that has been sitting on the sidelines since the market troughs of late, losing value through high inflation and low interest."

Inflationary pressures Wide spreads in global price movements prove attractive

One of the main concerns for investors and savers in the UK has been the pace of inflation increases, which have steadily eaten away at the value of their assets.

Some investors have also been watching world news, keeping an eye on the monetary policies of other countries, and hoping to benefit from the global rise in inflation.

The consumer price index in the UK rose 5.3 per cent in the first quarter, but this was eclipsed by a rise of 5.4 per cent in China over the same period, a 32-month high.

Food and energy price pressures have also forced up inflation in India, which has responded by raising interest rates 12 times since March 2010.

Investors who wish to speculate on market reactions to inflation data may be interested in currencies. If countries raise interest rates in reaction to high inflation, their currencies may become more attractive to investors, who will buy to take advantage of the spread between interest rates in each country.

Angus Campbell, head of sales at London Capital Group, says that examples of this have been seen in recent weeks with the announcement of US inflation data.

The Federal Reserve stated this year that base interest rates will not be increased until 2013, due to the poor outlook for growth. But the release of higher than expected inflation data gave the dollar/yen currency pair a boost. Japan's low interest rate makes it a popular pair with countries that may experience an interest rate rise, thus increasing the spread between the two.

For example, in mid-September the dollar/yen pair rose from 76.60 to 77.30 in half an hour, possibly as a result of inflation data, meaning traders who bought £10 per point at 76.60 and sold at 77.30 in a spread bet would have made £700 in 30 minutes.

Michael Derks, chief strategist at FxPro, says that traders, as opposed to investors, tend to be more interested in short-term capital gain rather than how inflation will affect the value of their investment.

This means they can benefit from the impact that inflation has on bonds and equities, as well as currency pairs.

"The general rule of thumb is that if interest rates are due to rise, then bonds will fall," said Mr Campbell. "So spread betters can take advantage of moves in these products." Markets can also be dented by news interest rates may rise, as this fuels fear of a constriction in growth. Spread betters can take advantage of short-term equity changes by taking up sell positions.

But the reaction of world governments to inflation data is not necessarily an easy bet, nor do inflationary movements always lead to appreciation in the currency.

China's wage inflation is even higher than its consumer price index, rising by as much as 25 per cent a year in cities.

Kathleen Brooks, research director at Forex.com, points out that high wage inflation is to be expected in fast-growing emerging markets. "Higher incomes are the consequence of rising living standards and rising growth rates," she says.

However, she cautions investors to be aware that although there are measures that may be employed by governments to tackle inflation, these tend to be unpopular with emerging market leaders. "One way to quash inflation pressure is to increase the value of your currency, something China and other emerging markets seem loath to do, so expect only a gradual appreciation of the renminbi at least for a year," she says.

Retail traders interested in betting on the Chinese stock market or the renminbi, but unable to get a foothold, can opt for an alternative.

Some are using the Australian dollar as a renminbi proxy and, as the country is highly dependent on China's demand for its exports, the currencies' fates are closely tied.

Elaine Moore

Rates come into focus as MPC hawks turn dovish

UK economy

Short-term increase unlikely, says **Lucy Warwick-Ching**

Homeowners are benefiting from low interest payments on their mortgages, and now traders are also making money on falling rates – through spread bets and contracts for difference.

UK interest rates are set in relation to the Bank of England's prevailing base rate, which is at the lowest it has been in history at 0.5 per cent, and has remained at this level for more than two years.

Some economists had expected rates to start moving up this autumn, but minutes from the latest monetary policy committee meeting, which sets the base rate, suggested that the possibility of a rise in interest rates in the near term had fallen.

For traders, interest rates are a market like any other, but one advantage in betting on interest rates – rather than, say, foreign exchange or commodities – is that the downside risk to spread bets is more fixed.

Moves in the interest rate tend to be made in 0.25 percentage point amounts. As such, investors usually know the extent of how far the market can move against them in the short term.

But before traders can bet, they need to predict which way rates will go. At the beginning of the year, analysts predicted rates would rise in September, but it now seems likely that rates could remain on hold until at least mid-2012.

"It's funny how quickly things can change," says Neil Looker, chief foreign exchange dealer at City Index. "With UK growth remaining slow at best, there is less pressure now on the MPC to raise rates in the near term."

Others agree. Michael Hewson, analyst at CMC Markets, predicts that UK interest rates will remain low until early 2013.

He says the change of position by Spencer Dale and Martin Weale, previously policy hawks, at August's MPC meeting signalled a significant change in the committee's dynamics.

"This suggested that the Bank had more or less given up on inflation, despite the likelihood that CPI [the consumer price index, the Bank's preferred method of measuring inflation] will hit 5 per cent by the autumn because of the energy price rises," Mr Hewson says.

"The fact that these two hawks pulled in their claws suggests that the committee is more concerned about growth than rising prices."

So, how do you profit from an interest rate decision? Whatever your view, there are several ways that investors can trade on the direction of interest rates.

The most widely used trading instruments for betting on interest rates are short sterling contracts. Prices for these are calculated at 100 minus the interest rate. Therefore, the price will move inversely to the change in interest rates; this means that if interest rates rise, the price of short sterling falls, and vice versa.

IG Index currently offers a bet on where the interest rate will be on December 30 2011. In May of this year, a spread of 24-34 was being quoted for the rate to be at 0.5 per cent or lower.

That meant, if you thought the rate would be 0.5 per cent or lower by the year end, you could buy the binary at 34.

Assuming the rate remains at 0.5 per cent, or lower, the bet will expire at 100 and your profit would be 100-34 times your stake. Should the rate be above 0.5 per cent, the bet will expire at zero and your loss would be 34 times your stake.

As the summer has progressed and the risk of an interest rate rise has diminished, the binary price has risen.

By early August it was 76-86 and at the time of writing it was a heady 85-95. Those who had bought at 34 earlier in the year could sell now at 85, making a profit of 51 times the stake, regardless of what happens to interest rates between now and the year end.

Tim Hughes, managing director at IG Index, says: "The advantage of a bet like this is you are simply forecasting what will happen to the underlying rate,".

> 'With UK growth remaining slow, there is less pressure on the MPC to raise rates'

There are other ways to bet on interest rate movements, he says, such as movements in exchange rates. If the Bank of England's base rate is going to rise but the ECB's rate is set to stay unchanged, the theory is that investors would move euro deposits into sterling to benefit from the higher interest rate.

"The laws of supply and demand therefore mean that the pound will appreciate relative to the euro as a result of news like this," says Mr Hughes.

Another option is to look at government bonds, as the prices here will reflect the underlying interest rate. As rates rise, bond prices fall, as investors demand a higher yield.

"Again, however, the risk of default that is building in many economies is distorting the international bond markets, so although this may technically be a suitable way of trading interest rates, it's not without flaws.

Any suggestions the UK's credit rating is at risk could result in far bigger movements in these assets than talk of a quarter point rate rise," he says.

Rate changer: Spencer Dale has altered his position on an imminent interest rate rise

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