Contracts for Difference

A measure of Risk Management and Strategic Awareness

Mikael Ghebrehiwet
Abstract

The introduction of contracts for difference, CFDs, in the Nordic market has meant a tremendous freedom for both large investors and small investors. CFDs, like many other financial derivatives, allow speculation on price movements in virtually all global markets with easy access to leverage, which is the same as borrowed capital. CFDs carry high risk and hence should only be used by qualified traders.

Swedish CFD providers have been criticized for mass marketing their services with lack of regard for the industry’s sustainability. The legal requirements placed on CFD providers for customer’s creditworthiness and knowledge are also said to be weak, given the products complexity and high risk. Thus, the purpose with this research is to respond to the criticism by examining the level of risk management, and the level of strategic awareness among CFD traders.

The epistemological orientation of this research conforms to the philosophy of positivism, and the research approach is consistent with the deductive approach. The research is based on a quantitative data collection method were a survey was carried out with CMC Markets’ customers with 233 respondents.

After examining the usage of risk management tools, position sizing and monitoring; the results suggest that the level of risk management among CFD traders is moderately high. For a trading strategy to function, and hence be successful, it is important that traders are consistent with the various components that a trading strategy consists of. After examining to what extent the CFD traders positions are based on rules and signals as well as loyalty to them, to what extent they optimize their trading strategy, and lastly to what extent they use available strategy methods I came to the conclusion that there is a relatively low level of strategic awareness.

Keywords: CMC Markets, Finance, CFDs, Investment, Derivative, Securities Trading, CFD Trading, Stocks, Risk management, Strategic awareness, Trading strategy, Technical analysis, Fundamental analysis
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Preface

This essay is written in a manner to be understandable for readers who have a basic understanding of the financial markets and securities trading. A person with a general interest in securities trading will especially find this essay both interesting and instructive. An academic background is not needed to comprehend the research and its results.
Risk warning

CFD trading carries a high level of risk to your capital. It is possible to lose more than your initial investment. CFD trading may not be suitable for all investors, therefore ensure that you understand the risks involved. The content of this research should not be relied upon as investment advice.
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1. Introduction

The chapter begins with an introduction to the subject area and a description of its background. With this in place, a problem discussion is presented that in turn leads to research questions, which this essay intends to answer.

1.1 Background

In the latest decade we have seen a dizzying array of financial derivatives emerge in the financial market, aimed at reducing the cost of exposure to financial instruments and satisfying the unlimited diverse risk profiles. These include contracts for difference (CFDs), turbo warrants, mini futures, open-end certificates, etc. While each product has achieved a degree of success, with some finding favor in the mainstream, CFDs have emerged from the flock and are today one of the world's fastest growing way to trade on financial markets (CMC Markets).

A CFD is simply an agreement to exchange the difference in a share value that occurs between the time the contract is opened and the time it closes. The key features of CFDs is the way they allow you to make a highly leveraged bet on the likely price movement of the chosen asset (Freeman 2009). Just like other leverage products, such as warrants, futures options etc, the key advantage with CFD trading is the possibility to profit from a market without having to put up the full value of the position. The competitive advantage with CFDs, in comparison with other derivatives, is the simple pricing where a CFD reflects the price performance of an underlying instrument. Thus, if a person has a basic understanding of the financial market and how it works, they will undoubtedly understand the price mechanism behind CFDs. This puts CFDs in a favorable position, and it comes as no surprise that more trades were done with the latecomer CFDs then warrants on the Stockholm Stock Exchange in the beginning of 2009 (My News Desk 2009).

1.2 Problem discussion

Dr. Schiller, professor of economics at Yale University, explains how financial derivatives democratize finance, as it enables investors with less capital to speculate on price movements in virtually all global markets with easy access to leverage (Academic Earth). This was impossible not too long ago. Hence, the introduction of CFDs in the Nordic market has meant a tremendous freedom for not only large investors, but as well for small investors. However, given the financial crisis not too long ago, financial derivatives have endured much criticism. The main reasons why
derivatives have come under so much scrutiny is that all derivatives transactions have “a loser” in contrast to the ordinary stock market where no one really loses. With derivatives, a profit made by a person, or a firm, is a loss by the counter party (Culp 2003, p.31). Moreover, CFD trading is illegal in the USA, partly on those grounds.

The high risk of financial derivatives is no exception for CFDs. As mentioned earlier, the leverage is the major benefit with CFDs, but it is also the major drawback because it contributes to higher risk. The providers of CFD trading have been criticized for marketing their services too intensively and too extensively, which is considered inappropriate given the product’s complexity (E24 2008). The legal requirements placed on CFD providers for customer’s creditworthiness and knowledge are said to be weak. For an example, a student with only study allowance as only income is allowed to register an account with some CFD provider and trade at hundred times their capital. For an example, CMC Markets, the Swedish market leader in CFD trading, has been criticized for turning to customers who lack good knowledge of the stock market. The Swedish Consumer Agency has objected to the CMC Markets television commercials highlighting the potential for gains in much greater extent than the risks. Avanza’s savings advisor Claes Helmberg adds to the discussion of problems by claiming that CFD trading is nothing for ordinary savers to even consider. When it comes to developing new forms of savings that many will benefit from, this would not even have a queue ticket, he adds. (E24 2008)

To summarize, the criticism towards CFDs based on the extensive marketing accompanying the level of high risk with CFD trading creates an interest in wanting to explore the level of expertise among CFD traders. In other words, is it as bad as one thinks?

1.2.1 Risk Management

A highly debated aspect of CFD trading is risk. As mentioned earlier, CFDs allow traders not having to pay the full value when taking a position, referred to as leverage. Traders deposit an initial safety requirement, also known as a margin, which may represents as little as 1% of the full value\(^1\). In other words, you can buy the equivalent value in indices that are up to 100:1 your initial capital investment. This means that even a small price change in the underlying instrument delivers magnified profits or losses on to your capital, which means you can potentially lose more than your

\(^1\) The requirement differs between CFD providers and underlying instrument.
initial deposit (CMC Markets). Hence, CFD trading is more suitable for investors who have a healthy appetite for risk and understands how to properly manage that risk.

Robert Laforest, head trader at City Index Australia, (cited in Freeman 2009) asserts that the magnitude of the potential losses means those new to CFDs should focus on the risk of loss rather than the hope of gains. Even if trading CFDs is a flexible way to back your judgment on a range of financial markets without an effective risk management strategy, it can lead to substantial losses. It is therefore important to understand risk and learn how to manage and control risk effectively.

1.2.2 Strategic Awareness

Another interesting aspect is strategic awareness. I have so far stated that CFD trading is in need of careful risk management to avoid great losses. However, to be a successful CFD trader one needs to be strategic and have a reachable end goal to strive for (Short Term Trading Strategies 2005). A CFD traders should stack the odds in their favor before making a trade on the real market. To analyze trade styles, mindset and the markets are important strategic tools for success (Contract for Difference). Failures in trading are usually a result of lack of proper training and lack of strategic trading, which lead many uneducated traders to violate the sound and long established rules that apply to any kind of trading (Baird 2001, p.31).

Given the fact that CFD trading is relatively new to the Swedish market, the knowledge about the instrument and various trading strategies is presumed to be low. In addition, CFDs have been, and still are, marketed to people who have no experience in securities trading. This fact leads us to suspect that there is a low strategic awareness in the form of poorly thought through positions, which may result in huge losses due to leverage. A predetermined trading plan, such as when to place an order and when to realize gains is the most important element of trading and it separates profitable traders from unprofitable ones (Schwager 1995, p.456).

1.3 Purpose and Research questions

This study has two main objectives; clarify to what extent CFD traders consider risk management and strategy with their CFD trading. By examining how well CFD traders relate to sound and long established rules within risk management and strategic trading I will be able to take the temperature on the level of risk management and strategic awareness among CFD traders. Do CFD traders
monitor their open positions, and do they trade by pre-defined rules and signals? These are examples of questions that will be answered in this study.

With my research I intend to present a better perception of the current Swedish CFD trader which may form the basis for future training of existing customers, as well as new customers. Thus, in a broader context, this essay will become a tool of improvement for CFD providers.

In order to fulfill the purpose I intend to answer these research questions:

I. What is the level of Risk Management among CFD traders?
II. What is the level of Strategic Awareness among CFD traders?

1.4 Demarcation
This research will only study Swedish CFD traders who are customers to CMC Markets and do not have risk management embedded into their CFD account. This type of account is referred to as a standard account at CMC Markets. Different CFD providers have different requirements on solvency and knowledge level on customers; hence, the results of this research cannot be extended to all Swedish CFD traders. As a result, this research is delimited to CFD traders who have a standard account at CMC Markets.

The empirical survey was carried out with 233 respondents.

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1 For more information on a standard account, please visit [http://www.cmcmarkets.se/apply-account/standard](http://www.cmcmarkets.se/apply-account/standard)
2. Methodology

This chapter describes the scientific approach and the practical arrangements of this research. Moreover the methods of choice and credibility of research findings are discussed.

2.1 Scientific method

Research methodology consists of rules and procedures that are used as tools to solve a specific research problem. Different research problems of course require different approaches, and they all intend to help us choose data collection techniques and analysis procedures for our research problem (Saunders, Thornhill & Lewis 2009, p.106). This section will unfold according to the research ‘onion’ to identify the appropriate choice of methodology required for answering my research questions (Saunders, Thornhill & Lewis 2009, p.138). First I will determine the philosophical commitment, which subsequently will influence the following methodology.

2.1.1 Research Philosophy

Saunders, Thornhill and Lewis (2009, p.106) explain that questions of what method to use are secondary to questions of paradigm, the worldview that will guide this investigation. First, I have to determine the research philosophy perspective that relates to the nature of the knowledge I intend to develop, and naturally it will underpin the choice of research strategy and choice of methods (Saunders, Thornhill & Lewis 2009, p.108). Because I intend to observe the level of risk management and strategic awareness among CFD traders, instead of understanding why, the research will be conducted to the greatest extent in an objective manner. The subjects of the research will not to be affected by me as a researcher, and vice versa. In addition, the possibility to alter the substance of the data collected will be held to minimum to increase credibility. Hence, the epistemological orientation of this research conforms to the philosophy of positivism. (Saunders, Thornhill & Lewis 2009, p.113-114)

Being a positivist as a researcher means this research will be conducted with an observable social reality, and the methods used for interpreting will be similar to those conducted by a natural scientist (Remenyi, Williams & Money 1998, p.32). It is a natural choice for my research because I strive to reach objective conclusions that can be generalized for all CFD traders with a standard account at CMC Markets. In contrast to interpretivism, which is a widely used philosophical position, I am not in need of profound insights into the CFD traders to answer the research questions. If my intention
were to understand why there is a low or high level of risk management and strategic awareness, rather than just measure, I would sympathize with the interpretivistic approach. It would then be a matter of interpreting rather then observing as with the positivistic approach.

2.1.2 Research Approach
In theory I have presented a theoretical frame of reference, which will consist of academic articles, literature, webpages and educational films. It forms important elements of proper trading strategies and proper risk management. It intends to introduce the reader to the concepts and provide with an insight into the subject. I have then empirically examined how CFD traders in reality relate to the important elements of risk management and strategic trading to answer the research questions. Thus, the research approach is consistent with the deductive approach. (Saunders, Thornhill & Lewis 2009, p.126)

In contrast to performing a research deductively, an inductive approach puts more emphasis on understanding the nature of a particular problem, rather than observing it. The examination of a research problem and analysis of data would instead be conducted within its own context rather than from a predetermined theoretical basis; meaning, theory would follow data rather than vice versa as with deduction. In addition, the inductive approach is less structured and might reveal alternative theories; however, this flexibility is not needed in this research. (Saunders, Thornhill & Lewis 2009, p.126)

2.2 Practical method
This section deals with the practical considerations of the research and is an extension of the above-mentioned scientific commitments. It is divided into two parts; the first part deals with the methods used to gather data, and the second part presents the methodology used for interpreting and analyzing the data.

2.2.1 Data collection method
This research has used a quantitative data collection method, which relates to the scientific commitments earlier presented, and complies with the objective of this study. More specifically, I chose to conduct a descriptive survey strategy, as internet-mediated questionnaire, because it enabled me to collect a large amount of quantifiable data from a sizable population in a highly economical
way (Saunders, Thornhill & Lewis 2009, p.144). It was the most appropriate data collection technique given the nature and objective of this study.

2.2.1.1 Gaining access

To conduct the data collection I had to be granted access to a customer base belonging to a CFD provider. Hence, I became familiar with CMC Markets, the Swedish market leader in CFD trading. I studied the organization before making contact, to establish credibility. When approached, I provided a clear account of my purpose and type of access required, and explained the benefits of knowing the level of risk management and level of strategic awareness of existing customers. By demonstrating quick decision-making, the CEO, Mattias Malmström, of CMC Markets agreed to the benefits and I was granted access to and use of their customer base.

2.2.1.2 Design of questionnaire

The theory material in its entirety is overwhelming. Thus, I sorted the material into two categories, risk management and strategic awareness, with three subcategories where each of these serve as investigative areas (Figure 2.1). These investigative areas represent important elements, which were of great assistance when designing the questionnaire (Appendix A). By following this structure, I ensured that the individual questions collected the data that were required to answer the research questions, and achieve the objective with this research.

Figure 2.1 Investigative areas (Own model)

The questionnaire consists of three sections. The first section covers basic information about the respondents’ practical experience and investment horizon, the second section is entirely devoted to measure risk management, while the third section is devoted to measure the level of strategic awareness. The latter two sections are structured accordingly to earlier mentioned investigative areas. Moreover, the questionnaire consists entirely of closed questions. The respondents’ behavior towards
risk management and strategic trading is captured on a 6-point numeric behavioral rating scale, where the end categories are labeled with ‘To a very small extent’ and ‘To a very large extent’. Additional categories of ‘Never/None’ and ‘Don't know’, regarding respondents who cannot relate to the question, are located at the end of the rating scale. As a result of using a 6-point numeric scale I avoided acquiescence response bias, the respondent agrees with labeled answers. By using an even number of possible answers, also known as force choice method, I avoided central tendency bias (Mangione 1995, p.34).

2.2.1.3 Pilot study

In contrast to in-depth and semi-structured interviews, the questions in the questionnaires need to be defined precisely prior to data collection (Saunders, Thornhill & Lewis 2009, p.366). Given that the survey was designed independently, I conducted a pilot study with the purpose to improve the quality and efficiency of the questionnaire; hence, enhance the reliability. Because there is no possibility to help the respondents when answering the questionnaire, it is particularly important to ensure that the survey questions are clear in advance (Bryman & Bell 2007, p.273). In the pilot study I asked the respondents to freely express suggestions for improvements. Fortunately, this resulted in valuable feedback, which led to numerous adjustments, and made the questionnaire more understandable, relevant and accurate.

2.2.1.4 Execution of Survey

CMC Markets randomly selected 2,000 Swedish customers with a standard account who received the questionnaire via e-mail. The survey had 233 respondents, which gives me a response rate of approximately 11.7%. The questionnaires were sent with CMC Markets’ own account at polldaddy.com™. Therefore, they were not perceived as foreign to the respondents in contrast to if I would have sent them from my private e-mail address. In addition, CMC Markets often have good response rates on their surveys with their customers. As a result, given that my survey had CMC Markets as sender, a high response rate was also the outcome in my survey. CMC Markets’ customers have two different accounts; standard account and account with limited risk. If this research would have included the latter customer type, the purpose would be meaningless, with reference to risk management, because those customers already have risk management embedded into their CFD account.

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3 An online software tool that allows creation and administration of surveys conducted over the internet.
2.2.2 Data analysis method

Quantitative data in raw form convey very little meaning before these have been explored and analyzed. Hence, to answer the research question these data have to be processed into useful information. (Saunders, Thornhill & Lewis 2009, p.414)

2.2.2.1 Describing data

Descriptive statistics help me to describe and compare variables (Saunders, Thornhill & Lewis 2009, p.444). As mentioned earlier, I have adopted a descriptive survey strategy because I am interested in describing reality as it is; hence, to adopt a descriptive approach when analyzing the data becomes self-evident. The ordinal data collected allow units to be placed into ranked categories, from none/never to very large extent. Because the survey will not collect absolute values, e.g., how many stop loss orders that have been placed during a specific time; the ordinal scale of measurement has been set from 0 to 7 for analysis purpose.

I have mostly used tables in order to summarize data for individual variables and to enable the reader to easily identify the relative frequency of specific values. The tables present relative percentages in which each category occurs, and thus enables us to identify central tendencies as well as dispersion. To illustrate the major features of the distribution in a convenient form, I have also produced bar charts. However, because graphical presentations take up a large space, the majority of them have been placed in the appendix, while numerical presentations are presented together with text to a greater extent. As a result, this essay is easier to read. (Saunders, Thornhill & Lewis 2009, p. 429-431).

2.2.2.2 Exploring relationships

In research there is a risk that you easily accept the first interpretation because it seems obvious. Hence, to avoid missing valuable interpretations I compare variables to make more valid conclusions. For example, a CFD trader who monitors positions to a lesser extent, perhaps supplements that behavior with using risk management tools to a great extent. The former behavior, or variable, examined independently would lead one to believe that CFD traders have low level of risk management. However, by examining the relationship between the two variables we might realize that the statement is false, and instead the opposite is true. Hence, to examine interdependence

\[\text{0 - None / Never, 1 - Very small extent, 2-5 - No label, 6 - Very large extent and 7 - No idea}\]
between variables I will use contingency tables, also known as cross-tabulation (Saunders, Thornhill & Lewis 2009, p.439).

2.3 Credibility of Research Findings

The chosen method will help me to answer the research questions, and therefore it is important that my map leads me to the right path. It is not a matter of choosing a correct method but instead choosing a method that reduces the possibility of getting the answers, to our research questions, wrong. Hence, attention has to be paid to emphases on research design, described below, which allow me to identify possible virtues with our methodology. (Saunders, Thornhill & Lewis 2009, p.156)

Reliability refers to consistency of findings and reliableness of our methods of measurements. In this research I have used questionnaires to collect data and when performing a self-administered questionnaire there is a risk that respondents may discuss their answers with others and thereby contaminate their response (Saunders, Thornhill & Lewis 2009, p.363-5). Any contamination of respondents’ answers will unfortunately reduce the data’s reliability. On the other hand, the likelihood of distortion for internet-mediated questionnaires are said to be low. A major benefit though with internet-mediated questionnaires is automated data input. Hence, when analyzing data I avoided errors, such as mistakes in data entry, which can be imposed by the human factor and thus interfere with a fair outcome. (Saunders, Thornhill & Lewis 2009, p.156)

Validity is concerned with whether our adopted methods capture what they intend to measure, which in our case is the level of risk management and strategic awareness. Because CFD is a relatively new derivative instrument, not much academic research has yet been produced in the field. Hence, together with the theoretical frame of reference, I created own categories, which I believe constitute proper risk management and strategic awareness. These elements then form the basis for my measurements of the reality. Therefore, there is a risk that the questionnaire, which is based on ‘homemade’ theoretical elements, does not provide adequate or proper coverage to properly answer the research questions. For example, is asking CFD traders to what extent they monitor positions an indication of their level of risk management? (Saunders, Thornhill & Lewis 2009, p.157)

Generalizability, also refereed to as external validity, is concerned with whether the findings of this research may be equally applicable to all CFD traders. I have insufficient evidence to claim that the
results of this study are applicable to all CFD traders. As I mentioned earlier in ‘delimitations’, the different CFD providers have different recruitment processes and place different requirements on their customers. As a result, the level of risk management and strategic awareness can vary significantly. The population of this study represents Swedish CFD traders with a standard account with CMC Markets; consequently, the results of this study are generalized to Swedish CFD traders with a standard account with CMC Markets.
3. Theory

This chapter describes the theoretical influences that underpin the problem discussion and presents the theoretical framework in which the study is conducted. It will assist the process of organizing, structuring and understanding this subject, and it will be applied on the processing and analysis of the empirical material.

3.1 Basic Concepts

The main source for the basic concepts is Investopedia. Besides the following terms, the chapter in its entirety will also provide the reader with a clearer picture of the subject area.

*Derivative* is a security whose price is dependent upon or derived from one or more underlying assets.

*Leverage* is the use of various financial instruments or borrowed capital, such as margin, to increase the potential return of an investment.

*Trader* is an individual who engages in the transfer of financial assets in any financial market, either for themselves or on behalf of someone else.

*Position* is traders’ or investors’ financial commitment to a particular security.

*Short selling / Short position* is the selling of a security that the seller does not own, or any sale that is completed by the delivery of a security borrowed by the seller in the hope of buying it back at a lower price.

*Long position*, opposite of short selling, is the buying of a security such as a stock, commodity or currency, with the expectation that the asset will rise in value.

*Volatility* is a statistical measure of the dispersion of returns for a given security or market index.

*Index* is an imaginary portfolio of securities representing a particular market or a portion of it.
Investment horizon is the length of time that an investor expects to hold a security or portfolio.

### 3.2 Contracts for Difference

CFDs have its origin in the 1980s and was originally used exclusively by the institutional environment. Initially, the main purpose for large financial institutions and banks was to hedge their share positions. These trades were costly and required a high level of administration, making them unattractive to private traders. However, CFD trading has emerged and is today widely used by private investors worldwide. (123 CFD)

The possibility to trade with CFDs in Sweden has been available for a number of years with the number of users and trades breaking new records for each year. CFD offers you all the benefits with ordinary trading without having to physically own the underlying asset. The basic idea of CFDs is that a contract is issued with an indefinite period between a buyer and a seller for the difference in value of an asset at the opening and closing of the contract, upon the request of the buyer. Hence, the underlying asset, such as a stock, is replaced by a contract that reflects the same price movements as the underlying asset. (CMC Markets) CFDs do not have an expiration date, and like other financial instruments with leverage, a daily funding charge is applied to the account for long positions held overnight. Thus, the structure of CFDs makes it inappropriate for long positions, contra short positions. Nevertheless, it is a clever way to get exposure to the price movements of stocks, indices, commodities and currency without ever owning the underlying instrument (Davidson 2006, p.172).

![Figure 3.1 Position with and without leverage](image.png)

<table>
<thead>
<tr>
<th>Day</th>
<th>OMX30 Position(%)</th>
<th>Position(SEK)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>1</td>
<td>0.22%</td>
<td>22.22%</td>
</tr>
<tr>
<td>2</td>
<td>-0.67%</td>
<td>-66.7%</td>
</tr>
<tr>
<td>3</td>
<td>0.44%</td>
<td>44.4%</td>
</tr>
<tr>
<td>4</td>
<td>0.22%</td>
<td>22.2%</td>
</tr>
<tr>
<td>5</td>
<td>1.11%</td>
<td>111.1%</td>
</tr>
</tbody>
</table>

Table 3.1 Development of a position with leverage

<table>
<thead>
<tr>
<th>Day</th>
<th>OMX30 Position(%)</th>
<th>Position(SEK)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>1</td>
<td>0.22%</td>
<td>22.22%</td>
</tr>
<tr>
<td>2</td>
<td>-0.67%</td>
<td>-66.7%</td>
</tr>
<tr>
<td>3</td>
<td>0.44%</td>
<td>44.4%</td>
</tr>
<tr>
<td>4</td>
<td>0.22%</td>
<td>22.2%</td>
</tr>
<tr>
<td>5</td>
<td>1.11%</td>
<td>111.1%</td>
</tr>
</tbody>
</table>
As mentioned earlier, a key advantage with CFD trading is that it offers leverage. This means you can trade without putting down the full value of a position, and in result your profits, as well as losses, are magnified. Figure 3.1 graphically illustrates the percentage movement of a position in OMX30\(^5\) without leverage and with a leverage of 100:1, over a 5-day period. The gray line in Figure 3.1 is not a straight line, but it is in fact depicting the percentage movements in OMX30. As can be seen in Table 3.1, on day 2 the trader is down as much as two-thirds on the 1,000 SEK invested, working on a 100:1 ratio. On the fifth day however, the value of the position has increased with amazingly 111%. Hence, this example clearly illustrates how a position in index OMX30, which has relatively low volatility, can develop over a short period when exposed to a leverage of 100 times the invested capital. To see another more detailed CFD trading example, please consult Appendix C.

### 3.3 Risk management

Risk is the possibility of loss. It can be found in equity investments, such as stocks, and in most other types of investments. Instinctively, risk is something that we want to avoid. There are however risk-free investment alternatives such as government bonds, fixed-income securities or interest account, where the deposit is insured by the State. However, investments usually involve risk and the risk itself is measured as the variation against the risk-free rate of return. Hence, if the total risk exceeds the risk-free interest rate then you want to be compensated for it. The compensation allows us to demand a higher growth in value for higher risk, also referred to as risk premium. (Wilke Sandén 2000, p.41-2)

While risk is the possibility of loss, risk management aims to control and direct that possibility. It is a critical aspect of any financial product. Pardo (2008, p.74) simplified the thoughts on risk management as he describes its essence as:

The management of risk does not mean its elimination, although of course that would be the ultimate and ideal form of risk management. Rather, it means keeping risk within measured, anticipated, and affordable boundaries.

This topic is an issue that all traders have to deal with at one time or another (Bernstein 2000, p. 180). Proper risk management limits risk and its purpose is to lose the least amount of money necessary to achieve maximum trading profit. Hence, a CFD trader must be prepared to make the

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\(^5\) Index of the thirty most heavily traded shares on the Stockholm Stock Exchange.
effort to not only to understand risk, but also to understand how it works and make use of effective risk control measures, to be successful. As mentioned earlier, CFDs are categorized as a high-risk instrument and you can potentially lose more than your initial deposit; hence, risk management becomes one of the most critical aspects, if not the most important aspect, to consider when trading CFDs. (Penton 2007)

In practice, the key to effective risk management is to find methods and techniques that that are most productive and use them consistently (Bernstein 2000, p.180). In the following text I will present the methods and techniques that according to my theoretical framework are key aspects within risk management.

3.3.1 Risk Management tools

When a trader wants to place an order s/he can choose between placing an ordinary market order, which is to sell or buy at the available price, or choose to place a conditional order. There are five different conditional orders; stop loss, guaranteed stop loss (GSO), One Cancels the Other (OCO), limit and If done. However, stop loss and GSO are to a greater extent seen as risk management tools, which can also be derived from their names (CMC Markets).

*Stop loss orders* allow CFD traders to specify a price at which the position will be closed, preventing the trade from further losses (CMC Markets). The order is automatically executed if your position would move beyond a predetermined price level. They can be used to limit risk both when you go short or long, equal to buy or sell. Most traders place their stop loss orders with focus on two factors; the maximum acceptable loss and on the basis of technical analysis. (Temple 2009, p.68-9)

A *GSO* is very similar to a stop loss order. The difference is that a GSO acts like an insurance and hence has a premium of 0.3% of your position, in contrast to a stop loss order, which is free. Besides cost, what differs a stop loss order from a GSO is that the former will only close the position if there are any buyers or sellers at the predetermined price level. For example, if a stock would rapidly fall from 320 to 300 and a stop loss order had been placed to sell position at 310, it would probably not close the position because there were no buyers at 310. However, if you instead would have placed a GSO at 310, the position would have been closed although there were no buyers at the specified price. (CMC Markets)

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6 The premium is from CMC Markets, may differ for other CFD providers.
3.3.2 Position sizing

Earlier studies have shown that new traders have a tendency to take large positions under the mistaken principle that if you want to make money on a trade, you should trade as large as possible (Baird 2001, p.29). Hence, the amount that should be put into each trade, in relation to total capital, is another point of attention within risk management.

This aspect is crucial if the trader wants to survive the losing trades, and continue to make the returns that a trading strategy is designed to make. Normally, only two out of ten trades will make a really solid profit and hence the way to reach monetary success is to avoid big losses by not risking too much of your capital on single trades (Temple 2009, p.104). A CFD trader should at least keep their positions well under 10% of their capital, even with a risk management tool at place (Temple 2009, p.104). By limiting the size of a position, traders are also limiting the size of the possible loss to a smaller fraction of the account, which is according to Elder (2002, p.220) the single most important rule in trading.

Moreover, what differs CFD trading from normal trading is that the size of a position can exceed the size of the deposit balance. Hence, the position sizing of a CFD trader is much more flexible because one can place positions that are up to 100:1 larger than deposit balance. In addition, Temple (2001, p.45) claims that inexperienced CFD traders should not feel compelled to trade 100:1; instead, they should take positions that they feel comfortable with.

3.3.3 Monitoring

To monitor position and affecting factors is an instinctive behavior. With CFDs though, there is a stronger need of monitoring due to leverage (Temple 2001, p.42). CMC Markets’ award-winning trading platform, Marketmaker®, allows their customers to set up their own workspace according to their own personal preferences. Customers can decide for themselves what they want to see at all time, for an example, monitor open trades, monitor margin and leverage, and view real-time market prices, etc. In addition, the customers can download Marketmaker® onto their mobile phone to view position summary in an instant (CMC Markets).

Since leverage products, including CFDs, magnifies losses and profits, it is important to be well attuned to the current state of the market, and especially attuned to the risks exposed to taken positions. For an example, bad news can have an instant negative affect a position, and with
magnification of the losses, the damage can become unmanageable. This statement is particularly true if the trader is inexperienced and uses risk management tools to a lesser extent.

3.4 Strategic Awareness

To be strategic and have a plan for when to take positions is important for any type of trading. Trading strategies vary and there is no right or wrong, but without strategic trading a CFD trader will most likely find it hard to be successful. Common to all skilled traders is that they have tailored a trading strategy that is most suitable for their purposes and goals of their trading. There are two minimum requirements for a trading strategy: a rule to enter a position and a rule to exit. In contrast to above mentioned risk management, a trading strategy is seen as profit management (Pardo 2008, p.75-76). The most important reason to use a trading strategy is to gain a statistical edge, meaning you have tested a trading system and after including both winning and losing trades, it gives you a positive number. There are of course no guarantees of profits with a high level of strategic awareness, but it is a matter of increasing the probability of profits. (Chande 2001, p.9) The process of designing your own trading strategy might seem complex for the beginner but Elder (1993, p.59), a reputable trader, claims that a trading strategy should be kept simple for the simple fact that the crowds, which constitutes the market, are primitive.

3.4.1 Strategy methods

According to Chande (2001, p.15), there are two types of market data. First, we have internal generated market data, which are generated by the process of trading an instrument, such as stocks, and are collected and disseminated by the trading exchanges. Second, we have external data, also referred to as fundamental data, which are generated by governments, economic activity or consumption; in other words, factors that influence supply and demand, production and consumption.

Internal generated data, also referred to technical data, are analyzed by plotting them on a graph or a chart; a method referred to as technical analysis. It is a tool that enables the trader to organize the flows of the market information into manageable form (Elder 2002, p.67). Its purpose is to forecast future direction of prices by studying the past, and is also referred to as applied social psychology, the craft of analyzing mass behavior for profits (Elder 2002, p.43). It is an important tool for designing a trading strategy, which holds buy and sell conditions. Perhaps the most important assumption of technical analysis is that history repeats itself. By using technical analysis a trader can detect patterns
in the past, which can be traded with confidence in the future. This method is closely linked to financial innovations and have observed, invented, tested, and cataloged hundreds of ideas about analyzing technical data. (Chande 2001, p.16)

*Fundamental analysis* is a method of research that studies the earlier mentioned fundamental data. For an example, with shares, fundamental data consists of their profits, balance sheet and growth outlooks. It is built on the premises that a trader can make decisions in a rational and logical manner and forecast financial results based on historical information, contra past stock performance as in technical analysis. Fundamental analysis is a valuable tool if used as a strategy method for long-term investors, but not for daily trading. (Thornsett 1998, p.3-4) Fundamental analysis is less relevant to short-term traders because the long-term value of securities are governed by fundamental data (Temple 2001, p.115). Hence, because short-term traders mainly use CFDs I assume that the latter claim also applies to CFD traders. Nevertheless, the best strategy method is self-evidently a combination of both.

### 3.4.2 Rules and Signals

A trading strategy should provide clear and consistent objective rules and signals to a trader. An ideal trading strategy has a predefined set of rules or procedures that in advance tell the trader when to buy and when to sell. (Bernstein 2000, p.54) A rule may consist of predefined levels of profit or loss to take in each trade, while a signal may consist of entry and exit indicators.

Rather than jumping in and out on a whim, a trader must set up rules and signals and follow them to prevent self-sabotage, and hence enable a profitable trading. (Elder 2002, p.63) If we were to isolate the reasons why people do not follow their rules and signals, we would most likely conclude that it is a lack of discipline, and too much emotional reflection in the decision making process (Develop your Trading Plan). Trading is partly rational and partly emotional, and unfortunately people far too often act on impulse and emotions. Lack of discipline and turbulent emotions, such as greed, fear, and self-doubt, are the enemy of trading consistency. Hence, to be loyal to a strategy, objectivity and detachment from emotions, are the ally to successful trading (Pardo 2008, p.54, 29). Moreover, if a trader is not loyal to a trading strategy it might as well be considered gambling, because there is no possibility to evaluate the effectiveness of a strategy over time.
3.4.3 Optimizing and goal

Traders have different trading systems and sets of rules that they follow for their enters and exits, which are often fine-tuned to optimize returns. There is no such thing as a trading strategy that works on all markets, in all conditions and on all trends; instead, the development of a profitable trading strategy is a trial-error activity in which optimization plays a key role (Katz & McCormick 2000, p. 29). However, to expose your trading strategy to backtesting is a simple way to know in advance if there is any likelihood that your strategy will enable a profitable trading. Investopedia describes its functionality:

It is accomplished by reconstructing, with historical data, trades that would have occurred in the past using rules defined by a given strategy. The result offers statistics that can be used to gauge the effectiveness of the strategy. Using this data, traders can optimize and improve their strategies, find any technical or theoretical flaws, and gain confidence in their strategy before applying it to the real markets.

Nevertheless, backtesting a trading strategy will not alone guarantee future profitability, but it is a valid improvement tool and a step in the right direction to design a winning trading strategy.

Another method to optimize a trading strategy is to study past performance. Successful traders use records from their trading as a tool of learning and discipline, and without record-keeping a trader would not be able to learn from mistakes (Elder 2002, p.63). You can learn a lot from studying past losses and profits in detail to work out why they have occurred. All investors make mistakes and the important thing is that you study your past performance to develop your trading strategy. It will teach you to discipline yourself not to repeat them. Accuracy ratio and profit-loss ratio are two simple methods to use when a trader wants to evaluate past performances. The former puts the number of profitable trades to the number unprofitable trades, while the latter takes averages of unprofitable and profitable trades and divide them. If a trader has a low accuracy ratio it means that the trade selection need improvements. If the profit-loss ratio is low the trader needs to evaluate if losses are cut too late or if profits are taking too early. (Temple 2009, p.106)

Of course, the general goal with a trading strategy is to enjoy long-lasting profits. However, without a tangible goal, traders are most likely not to be successful because they do not have a predefined state of success with their trading (Short Term Trading Strategies). Goal-setting is according to
Chande (2001, p.365), is a highly effective motivational technique to be used for trading. Elder (2002, p.265) asserts that the goal of a beginner should merely be to cover trading expenses, and generate an annual return that is equal to 1.5 times the current rate on Treasury bills. You can easily increase the ceiling of your goal with time. However, the purpose in the beginning is to acquire enough skills to be become a successful trader and enjoy future profitable trading (Elder 2002, p. 251).
4. Results and Analysis

In this chapter the empirical investigation will be briefly presented along with analysis and interpretation. Structure from the aforementioned investigative areas is reused in this chapter. For graphical presentations please consult appendices.

4.1 The Sample

My sample consisted of 233 respondents and all of them finished the questionnaire. CFD trading have earlier been claimed to be an instrument more appropriate for short-term traders, considering the availability of leverage. According to the survey, more than 76% of the respondents are short-term traders; meaning, they hold a position shorter than a week. Hence, the general perception that short-term traders to a greater extent use CFDs is consistent with reality. As Table 4.1 below shows, there is a scattered distribution of the level of practical experience among CFD traders. However, given that the median for the distribution is 3, which is located to the left of the center, we may conclude that the respondents have practical experience with CFDs to a lesser extent. As Figure 4.1 illustrates, the respondents are short term traders with lesser practical experience.

Table 4.1 Relative frequency table of practical experience

<table>
<thead>
<tr>
<th>None</th>
<th>1.VSE</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6.VLE</th>
<th>No idea</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.4%</td>
<td>17.2%</td>
<td>15.5%</td>
<td>23.6%</td>
<td>17.2%</td>
<td>8.2%</td>
<td>13.7%</td>
<td>1.3%</td>
</tr>
</tbody>
</table>

Figure 4.1 Practical experience and investment horizon of the respondents

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VSE and VLE are abbreviations for Very Small Extent and Very Large Extent.
4.2 Risk Management

This section deals with the analysis of the collected data that is related to risk management. A short summary of the theoretical framework’s concepts and models is presented before each analysis. I have also included a subchapter that presents explorations of relationships between variables. It allows me to make more significant deductive interpretations, which in turn allows me to answer the first research question; what is the level of risk management among CFD traders?

4.2.1 Risk Management tools

I begin by analyzing the usage of risk management tools among CFD traders. As mentioned earlier, risk management tools are intended to put restrictions on losses. While GSO guarantees to close your position for a small premium, with $30 as the minimum fee, a stop loss is free of charge and will only close your position if possible. According to theory, even when the trader is intensively monitoring positions and affecting factors, a stop loss order should always be used because it only brings benefits.

Table 4.2 Relative frequency table of risk management tools

<table>
<thead>
<tr>
<th>Tool</th>
<th>Never</th>
<th>1.VSE</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6.VLE</th>
<th>No idea</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stop Loss</td>
<td>14.2%</td>
<td>16.7%</td>
<td>8.2%</td>
<td>8.6%</td>
<td>10.7%</td>
<td>15.0%</td>
<td>24.9%</td>
<td>1.7%</td>
</tr>
<tr>
<td>GSO</td>
<td>67.8%</td>
<td>14.2%</td>
<td>3.0%</td>
<td>4.3%</td>
<td>2.1%</td>
<td>1.3%</td>
<td>1.7%</td>
<td>5.6%</td>
</tr>
</tbody>
</table>

As Table 4.2 indicates, the variation of the usage of stop loss orders was larger than expected. Nearly 25% of all respondents claim that they use stop loss orders to a large extent; but, also a total of 31% has either never used stop loss or uses it to a very small extent. This behavior indicates poor risk management. Moreover, 68% of the CFD traders have never used GSO, which is the only insurance that guarantees to close a position at a predetermined price. In comparison with placing a stop loss order, a GSO is cumbersome to execute. It can only be placed by contacting CMC Markets’ dealing desk in London by telephone. This unusual order process may be a reason for the low usage. However, the why’s are not of interest in this research, and hence from a risk management perspective the low usage is worrying and shows signs of poor risk management. Please consult appendix D for graphical presentations of the distribution.

* 0.1-0.3% of the total value of a position (CMC Markets)
4.2.2 Position sizing

According to theory, a trader should only use a minor proportion of total outstanding capital on individual positions. Although different experts mention different percentages, the common denominator is to only risk a smaller fraction of outstanding capital on individual positions. Hence, the respondents were asked to what extent they do not obey the principle of position sizing. As Table 4.3 below shows, there is a positively skewed distribution. The centre of mass is found in the left part of the table, as nearly half of the respondents answered ‘never’ or ‘to a very small extent’. Hence, this result is to some extent an indication of good risk management.

Table 4.3 Relative frequency table of position sizing

<table>
<thead>
<tr>
<th>Never</th>
<th>1.VSE</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6.VLE</th>
<th>No idea</th>
</tr>
</thead>
<tbody>
<tr>
<td>27.5%</td>
<td>18.5%</td>
<td>15.5%</td>
<td>10.3%</td>
<td>12.9%</td>
<td>6.4%</td>
<td>6.4%</td>
<td>2.6%</td>
</tr>
</tbody>
</table>

4.2.3 Monitoring

To monitor positions and factors that affect them can be seen as an easy way to handle risk, but on the other hand, it is also very time-consuming. Monitoring is an important aspect to manage risk since CFDs involves leverage and thus potential losses are magnified. If a position moves against a CFD trader s/he can manually close that position at any time; hence, by monitoring positions and the news flow, an important affecting factor, to a greater extent the possibility of unexpected adversity decreases.

As Figures 4.2 and 4.3 illustrates on the following page, almost half of all respondents and a third monitor their positions and the news flow to a ‘very large extent’, respectively. The bar charts graphically illustrates how the central tendencies have their weights much closer to the answer labeled to a very large extent, contra to very small extent. Hence, the results are partly indicative of good risk management and could suggest that CFD traders are aware of the advantages with monitoring.
4.2.4 Comparison of variables

So far I have only examined variables independently. In this section I will examine the relationship between usage of risk management tools and monitoring, which I believe is an important interaction. In other words, is it CFD traders who use risk management tools to a lesser extent that intensively monitor their positions? The comparison allows me to discover a new perspective on collected data, and see more than what is obvious. As a result, I will be able to make a better and more precise assessment of the level of risk management.

4.2.4.1 Risk management tools and Monitoring of positions

I established earlier that risk management tools have a low usage. Although a cumbersome ordering process can explain the low usage of GSOs, there is no logical explanation to why stop loss orders are not used to a greater extent among the respondents. Hence, the earlier assessment of poor risk management will be put to the test by examining if a relationship exists between monitoring of positions and usage of stop loss orders. In other words, those who use stop loss orders to a lesser extent, do they monitor their positions to a greater extent, and vice versa? My preconceived view is that the respondents who monitor their positions to a greater extent are more likely to quickly detect positions which moves in the wrong direction, and thus be able to close that position manually, contra with risk management tools.

Whereas earlier presented relative frequency tables provide the distribution of individual variables, the contingency table (Table 4.4) below describes the relative distribution of monitoring of positions and usage of stop loss orders simultaneously. Because many respondents replied that they monitor their positions to a greater extent; as a result, the weight of frequencies are at the bottom of the table.
Because our variables consist of a large number of categories I have grouped the data and excluded the answer choice ‘no idea’, to prevent the table below from becoming too large.

Table 4.4 Relative contingency table of monitoring of positions and usage of stop loss orders

<table>
<thead>
<tr>
<th>Monitoring</th>
<th>Usage of stop loss orders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lesser extent</td>
<td>Lesser extent</td>
</tr>
<tr>
<td>Lesser extent</td>
<td>1%</td>
</tr>
<tr>
<td>Moderate extent</td>
<td>25%</td>
</tr>
<tr>
<td>Greater extent</td>
<td>74%</td>
</tr>
</tbody>
</table>

As is seen in the Table 4.4, 74% of those who use stop losses to a lesser extent monitor their positions to a greater extent. The question stated earlier was worded; those who use stop loss orders to a lesser extent, do they monitor their positions to a greater extent, and vice versa? The answer would be yes if we would disregard ‘vice versa’ in the question. However, because we cannot detect a negative interaction between the variables, the answer is no. As Table 4.4 indicates, the proportion of monitoring between the different categories of stop loss usage are very similar; hence, we cannot determine that there is a relationship between the two variables. If my suspicion of a relationship would have been true, then the contingency table would have shown a negative interaction between the variables, which has been highlighted in the table. To conclude, the result of this comparison refutes my suspicion.

4.2 Strategic Awareness

This section deals with the analysis of the collected data that is related to strategic awareness. I am not interested in determining the profits and losses of respondents with my analysis. Instead, the analysis intends to determine how well CFD traders relate to sound and long established principles concerning strategic trading. In other words, to what extent do CFD traders use available means to improve the probabilities with their trading, and hence create better conditions for their CFD trading. Thus, this section is related to the second research question; what is the level of strategic awareness among CFD traders?

4.2.1 Strategy Methods

The first category to be examined is strategy method. There are two types of market data, internal and external, and they are processed by technical analysis and fundamental analysis, respectively.
Although both methods are important for successful trading, technical analysis is more relevant to short-term traders, and fundamental analysis is more relevant to long-term traders.

The relative frequency distribution for the use of technical analysis and fundamental analysis is presented in Table 4.5 below. Even though the data is dispersed among the various alternatives we clearly see that technical analysis is used to a greater extent, in comparison to the usage of fundamental analysis. This research is not interested in determining what the reason is for the differences; instead, the focus is on the level of usage. Because both methods are important tools for a successful trading strategy they should be used to a greater extent, and a CFD trader should be aware of their importance. The bar charts has an upward sloping formation for the usage of technical analysis; meaning it is used to a greater extent (see Figure 4.4). On the other hand, this formation is missing for usage of fundamental analysis. However, because 76% of our respondents are short-term traders, hold a position less than a week, it partially explains the outcome.

<table>
<thead>
<tr>
<th>Table 4.5 Relative frequency of usage of technical analysis and fundamental analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td>Technical</td>
</tr>
<tr>
<td>Fundamental</td>
</tr>
</tbody>
</table>

**Figure 4.4 Usage of technical analysis and fundamental analysis**

4.2.2 Rules and Signals

Strategic trading involves clear and consistent objective rules and signals. The pre-defined rules and signals are equivalent to entry and exit indicators, which the trader acts upon. Regardless of the complexity of a trading strategy it always leads to concrete rules or signals, which has the purpose to enable a profitable trading and prevent self-sabotage. Moreover, without loyalty to rules and signals
there is no possibility to evaluate one’s trading, and hence no possibility to optimize a trading strategy.

**Table 4.6 Relative frequency of rules and signals and loyalty to them**

<table>
<thead>
<tr>
<th>Rules and Signals</th>
<th>Never</th>
<th>1.VSE</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6.VLE</th>
<th>No idea</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loyalty</td>
<td>1.8%</td>
<td>6.3%</td>
<td>11.2%</td>
<td>19.6%</td>
<td>31.3%</td>
<td>20.1%</td>
<td>9.8%</td>
<td>0.0%</td>
</tr>
</tbody>
</table>

As can be seen in Table 4.6, the answer with highest frequency for rules and signals and loyalty to them is 5 and 4, respectively. Moreover, both variables have a mean of 4, which means that their central tendencies are slightly to the right, and hence closer to greater extent than to lesser extent. In other words, respondents do trade with predefined rules and signals to a greater extent, and are also loyal to them. Nevertheless, theory asserts that rules and signals are necessary to enable a long-term profitable trading, and indiscipline is the enemy of trading consistency. Hence, these variables cannot be partially fulfilled, they must be followed to the greatest extent if their objectives are to be met. For an example, a trader cannot be disciplined to rules and signals to a moderate extent because it would taint the decision making process. In other word, it would be considered as gambling because there is no possibility to evaluate the effectiveness of one’s trading over time. To summarize, we may conclude that the results indicate moderate strategic awareness.

**4.2.3 Optimization and goal**

Before even entering the real market the trader has the possibility to examine whether a trading strategy has any probability of success. By applying a strategy with entry and exit indicators on historical data, a trader can gauge the effectiveness of the strategy, as well as discover technical or theoretical flaws. This method is known as backtesting.

**Table 4.7 Relative frequency of backtesting**

<table>
<thead>
<tr>
<th>Never</th>
<th>1.VSE</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6.VLE</th>
<th>No idea</th>
</tr>
</thead>
<tbody>
<tr>
<td>15.9%</td>
<td>19.7%</td>
<td>14.6%</td>
<td>12.9%</td>
<td>10.7%</td>
<td>8.2%</td>
<td>9.9%</td>
<td>8.2%</td>
</tr>
</tbody>
</table>

When respondents were asked to what extent they backtest their trading strategy most respondents answered ‘to very small extent’, followed by ‘never’ (see Table 4.7). The reason respondents do not backtest their trading strategy to a greater extent should not necessarily be interpreted as an indication of low level of strategic awareness. Backtesting is a service that is not offered by CMC.
Markets, and the group of respondents that base their entries and exits on predefined rules to a
greater extent, is a minor group. Hence, I should be cautious to conclude that the low use of
backtesting indicates a low level of strategic awareness, because many of the respondents have
nothing to backtest.

Another method of optimization is to *study past performance*. It is a matter of looking in the rear-
view mirror of one's trading and evaluate what has gone well, and what has gone poorly. This is a
simpler method to use for optimization as opposed to backtesting, because no special software is
required.

**Table 4.8 Relative frequency of studying past performance**

<table>
<thead>
<tr>
<th>Never</th>
<th>1.VSE</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6.VLE</th>
<th>No idea</th>
</tr>
</thead>
<tbody>
<tr>
<td>5.6%</td>
<td>15.0%</td>
<td>16.7%</td>
<td>14.2%</td>
<td>17.2%</td>
<td>14.6%</td>
<td>15.0%</td>
<td>1.7%</td>
</tr>
</tbody>
</table>

As can be seen in Table 4.8, it is a fairly even distribution of frequencies when respondents were
asked to what extent they study their past performance. Given the establishment of theory, the fairly
even distribution of frequencies means that most of the respondents will find it more difficult to
learn from their mistakes, and thus optimize their trading. Every investor makes mistakes; however, CFD traders cannot afford the same number of mistakes as with ordinary trading since the losses are magnified. Hence, I do interpret this result as an indication of low strategic awareness
in that the respondents partially are less able to evaluate and optimize current trading.

To have a *goal* with one's trading is considered as a highly effective motivational technique. It does
not promise long-lasting profits; nevertheless, without a predefined state of success traders are most
likely not be successful.

**Table 4.9 Relative frequency of respondents with a goal**

<table>
<thead>
<tr>
<th>Never</th>
<th>1.VSE</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6.VLE</th>
<th>No idea</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.7%</td>
<td>6.9%</td>
<td>11.2%</td>
<td>13.7%</td>
<td>18.0%</td>
<td>22.7%</td>
<td>21.5%</td>
<td>4.3%</td>
</tr>
</tbody>
</table>

As can be seen in Table 4.9, there is a negatively skewed distribution where the mass of the
distribution is concentrated on the right of the table. Hence, the respondents do have a target the
aim for to a greater extent; hence, they are more likely to succeed with their trading.
5. Conclusion

This chapter aims to summarize the results of the analysis. The results related to the individual investigative areas will be reviewed before the research questions are answered.

5.1 What is the level of Risk Management?

At first, I examined the usage of risk management tools, and a quarter of CFD traders use stop loss orders to a very large extent, while nearly 70% had never used a GSO order. Nearly half had either never, or to a very small extent, violated the principle of not using larger portions of outstanding capital on individual positions. CFD traders also monitor their positions and affecting factors to a greater extent. Hence, with the problem discussion in mind, the results suggest that the level of risk management among CFD traders is moderately high.

5.2 What is the level of Strategic Awareness?

CFD traders use technical analysis to a greater extent, while fundamental analysis is used to a lesser extent. With how important technical and fundamental analysis are to enable a long term strategic profitable trading, the usage of both strategy methods are relatively low. CFD traders base their trading on predefined rules and signals to a fairly large extent, while the loyalty to them were at a lower level. Again, with the importance of structure and discipline to enable a successful CFD trading; hence, the reasonable interpretation is that the results are relatively poor. With optimization, the survey showed that CFD traders do not backtest their possible trading strategy to any greater extent. In addition, there was a fairly even distribution when CFD traders were asked to what extent they study past performance. Hence, given that above-mentioned components must be followed to a large extent for the very purpose of a trading strategy to be achieved, we may come to the conclusion that their is a low level of strategic awareness.
6. Discussion

This section presents a discussion of the results and place them in a wider context.

In the problem discussion I asked; is it as bad as one thinks? The questions refers to the criticism of CFD trading and its providers. The criticism is partly based on the argumentation that the risk is overwhelming and should be restricted to professional traders who have the knowledge preconditions needed. However, after my research I must admit that it doesn't look that bad. The CFD traders handle risk impressively well. The unexpected moderate high level of risk management among the CFD traders can be compared to a driver whose car lights suddenly stops working while driving on the highway, the natural reaction is that s/he will instantly become more diligent and active as a driver because the probability of ending up in a car crash has just increased. The sudden malfunction of the car lights is equivalent to a person that lack the knowledge preconditions needed and trades with hundred times their capital for the first time. In other words, the results of this study leads me to believe that the higher risk with CFDs makes investors more cautious and active, in contrast to investors who indulge in ordinary stock trading.

The results also shows that the level between risk management and strategic awareness differs, whereas CFD traders to a greater extent indulge in risk management. According to Maria Malmqvist, training manager at CMC Markets, they have courses in risk management once or twice a month which are free of charge for their customers (Dagens Industri 2009). On the other hand, according to Joakim Sandblom, sales executive at CMC Markets, they have a policy against teaching trading strategies and this is reflected in the results of this study. The motive behind this policy is understandable, if a trader would lose money using a trading strategy provided by CMC Market s/he would naturally hold CMC Markets accountable for the losses. However, I would recommend CMC Markets to teach their clients simple methods of creating own trading strategies. They already offer a wide range of strategic tools, why not provide with more guidance on how to use them to enable a profitable trading? To teach strategic behavior, I believe, would provide CMC Markets with a competitive advantage in an increasingly competitive industry.

To carry out a survey with customers of a company is always a difficult task, regarding gaining access. The survey in this research was only carried out with customers of CMC Markets. As a result, the conclusions cannot be extended to all CFD traders, because different CFD providers have different
requirements on solvency and knowledge level on their customers. In addition, some CFD traders have risk management embedded into their account, which means that the purpose with measuring the level risk management of those CFD traders would be meaningless. Thus, the results of this research cannot unfortunately be extended to all Swedish CFD traders; instead, they are applicable to CFD traders who have a standard account at CMC Markets. If I could, I would conduct my survey against all Swedish CFD traders in order to extend the results of this research to all CFD traders in Sweden. However, given the nature of this study and time frame, I am still pleased with the results, even if the results have unwanted restrictions on generalizability.

As mentioned in the introduction chapter, the results of this study are useful for CFD providers, especially CMC Markets. The results allow CMC Markets, as well as other CFD providers, to get a better understanding of CFD traders, regarding risk management and strategic awareness. To a wider extent, the results should be taken into account for educational purpose. It is important that their clients are successful with their trading, because it will reflect customer satisfaction. Hence, this research takes the function as a tool of improvement for CFD providers. Nearly 70% of the respondents had never used a guaranteed stop loss (GSO), which is the only insurance that guarantees to close a position at a predetermined price. Given the importance of a GSO at surprisingly large movements, a suggestion would be that CMC Markets inform their customers about this particular risk management tool and its benefits, with the purpose to avoid dissatisfied customers in a future context.

6.1 Suggestions for further research

After I carried out this investigation, I realized how extensive this research area is. It is only the author's own inventiveness that sets the limits. Below I will present some suggestions on possible further research.

In this type of study the selection of research criteria is of great importance. I produced my own research criterions, based on my theoretical frame, which I believed were most important in assessing the level of risk management and strategic awareness among CFD traders. However, it might be interesting to study other investigative areas within the two categories, which may have lead to other results.
Trading is a very complex activity that requires many important characteristics for success. Psychology is said to be an important aspect of trading, especially with discipline in mind. It is a trait that separates serious calculated traders from impulsive gamblers, also known as amateurs. Hence, it would be interesting to examine the trading psychology of CFD traders and its relation to success.

It would be interesting to examine whether CFD traders who manage risk well and are more strategic indulge in trading to a greater extent. In other words, if a CFD trader is more skilled and informed, will s/he trade more? From the company perspective, more trading mean higher revenues. Thus, it would be interesting to examine whether a relationship exists between knowledge level and level of trading activity; hence, estimate the return for further training of customers.
7. References

7.1 Books


Thornsett, M. C. (1998) *Mastering Fundamental Analysis - How to spot trends and pick winning stocks like the pros.* Dearborn financial publishing, United states of America


7.2 Articles


7.3 Electronic sources


Dagens industri: Rusningar till placeringsar som kan ge snabba klipp (2009), http://di.se/Nyheter/?page=/Avdelningar/Artikel.aspx%3FArticleId%3D2009%255C12%255C15%255C365762%26SectionId%3DEttan, Retrieved at 2009-12-16


7.4 Other

Short Term Trading Strategies (2005), Educational Film, CMC Markets, United Kingdom

8. Appendices

Appendix A - Survey

Egenskaper
1. Till vilken utsträckning har du praktisk erfarenhet från handel med CFDs?
2. Vilken genomsnittlig tidslängd har dina positioner?

Riskhantering
3. Till vilken utsträckning använder du stop loss?
4. Till vilken utsträckning använder du garanterad stop loss(GSO)?
5. Till vilken utsträckning använder du större delen av ditt innestående kapital på enskilda positioner?
6. Till vilken utsträckning bevakar du dina öppna positioner?
7. Till vilken utsträckning bevakar du det dagliga nyhetsflödet?

Handelsstrategi
8. Till vilken utsträckning baseras din handel på teknisk analys?
9. Till vilken utsträckning baseras din handel på fundamental analys?
10. Till vilken utsträckning handlar du efter förbestämda regler eller signaler?
11. Till vilken utsträckning skulle du säga att du är lojal mot din handelsstrategi, handelsplan eller taktik?
12. Till vilken utsträckning backtestar du din handelsplan?
13. Till vilken utsträckning studerar du din handelshistorik?
14. Till vilken utsträckning har du ett konkret mål med din CFD-handel?
Appendix B - Survey in English

Characteristics
1. To what extent do you have practical experience in trading CFDs?
2. What is the average length of time of your positions?

Risk Management
3. To what the extent do you use stop loss?
4. To what the extent do you use guaranteed stop loss (GSO)?
5. To what the extent do you use most of your outstanding capital on individual trades?
6. To what the extent do you monitor your positions?
7. To what the extent do you monitor the daily news feed?

Trading Strategy
8. To what extent is your trading based on technical analysis?
9. To what extent is your trading based on fundamental analysis?
10. To what extent is your trading based on rules or signals?
11. To what extent would you say you are loyal to your trading strategy?
12. To what extent do you backtest your trading strategy?
13. To what extent do you study your past performance?
14. To what extent do you have a specific goal with your CFD trading?
Appendix C - CFD trading example (CMC Markets)

Placing a trade
North Sea Oil Plc are traded at 150/150.50 SEK You think the price will rise, so you decide to buy 100 CFDs at 150.50 SEK. Thus, 100 CFDs at 150.50 SEK gives you position size of 100 x 150.50 = 15,050 SEK.

Margin
You have a safety requirement of 10% of the value of the position. Therefore, 15,500 x 10 % = SEK 1,505 will be allocated from your account against this trade as initial margin. If the share price falls by more than 10 percent, you can lose more than SEK 1,505 you invested.

Commission charge
You pay a brokerage fee of 0.08% of the value of your total position. To determine how much commission you pay, you multiply your position size by the commission charge. In this example, the commission is 15,050 x 0.0008 = SEK 12.04

Close your position
You now have a CFD position of 100 NSO worth SEK 15,050 to your account. Later that day you see that the price of the NSO has risen to SEK 156/156.50. This means that you have been right in your belief that the stock price would rise, and you decide for yourself to close your position and sell at SEK 156.

Profit / Loss
You originally bought your NSO at SEK 150.50, and you are now selling at SEK 156, which means that the price rose 5.50 kronor. Hence, 5.50 x 100 CFD = SEK 550 SEK in profit.

You also payed 0.08% in commission when you closed your position, which is 12.48 SEK. Your profit after commission charge is 550 - 12.48*2 = SEK 525.
Appendix D - Graphical presentation, Risk Management

Note: VSE and VLE are abbreviations for 'Very Small Extent' and 'Very Large Extent'

Risk management (Questions 3-4)

- Figure 8.1 - Stop Loss
- Figure 8.2 - GSO

Position sizing (Question 5)

- Figure 8.3 - Position sizing

Monitoring (Questions 6-7)

- Figure 8.4 - Monitor positions
- Figure 8.5 - Monitor news flow
Appendix E - Graphical presentation, Strategic Awareness

Note: VSE and VLE are abbreviations for ‘Very Small Extent’ and ‘Very Large Extent’

Strategy methods (Questions 8-9)

Rules and signals (Questions 10-11)

Optimization and goal (Questions 12-14)