

Trading Share CFDs: Best Practices

Taurex Trading Guides

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Introduction

Share CFDs, or contracts for difference, are a type of derivative product that enables you to trade on the price fluctuations of shares in the stock market. Unlike traditional share trading, where you buy and sell actual company shares, share CFDs allow you to take a position on the price movement of a share without owning the underlying asset. This means that you can profit from both rising and falling markets and use leverage to magnify your returns. Share CFDs also offer access to a broader range of markets and instruments than conventional share trading, as you can trade on global indices, sectors, exchange-traded funds (ETFs), and individual shares. However, share CFDs also involve risks and challenges, such as the spread cost, margin requirements, overnight financing, and market volatility. Therefore, it is essential to understand how share CFDs work and what factors affect their prices before you start trading them.

As a Taurex client, you can trade over 1500 CFDs across six asset classes, including forex, indices, metals, commodities, cryptocurrencies, and shares. You can explore share CFDs trading with fast execution and unmatched conditions and trade CFDs on some of the world's largest companies, such as Apple, Amazon, Tesla, and more, with tight spreads and rapid execution. You can also choose from different trading platforms, such as the Taurex native app, MT4 and MT5, or via FIX API, depending on your preferences and needs.

What are the main advantages of share CFDs over standard shares?

The stock market is one of the most popular and lucrative arenas for investors and traders. It is a place where people can buy and sell shares of publicly listed companies, which represent ownership stakes in those businesses. By trading shares, investors and traders can participate in the financial performance of the companies, as well as benefit from the price fluctuations of the shares. However, buying and selling actual shares can be costly, time-consuming, and restrictive. That is why many traders opt for trading share CFDs or contracts for difference instead. Trading share CFDs has some advantages over trading actual shares, such as:

- ✓ **Lower commission and cost than trading actual shares.** One of the main benefits of trading contracts for difference (CFDs) is that you can enjoy lower commission and cost than trading actual shares. When you trade CFDs, you only need to pay the spread, which is the difference between the bid and ask share prices. The spread is usually lower than the commission charged by traditional brokers for share trading. You do not have to pay additional fees or charges to buy or sell shares, as you would with traditional share trading. This can reduce trading costs and increase profit margins, especially if you trade frequently or in large volumes. CFDs also offer other advantages, such as the ability to go long or short, access to a wide range of markets, and leverage. However, CFDs also involve some risks, such as market volatility, margin calls, and counterparty risk. Before entering a CFD trade, you should always be aware of the potential losses and gains.
- ✓ **Higher leverage than trading actual shares.** Another benefit of trading contracts for difference (CFDs) is that you can access higher leverage than when trading actual shares. Leverage is the ratio of your trading capital to the total value of your position. For example, if you have \$1,000 in your account and trade with a leverage of 10:1, you can control a position worth \$10,000. This means you can trade with a small amount of money and earn higher returns, as the leverage will magnify any price movement in your favour. However, leverage also works both ways, so the leverage will also magnify any price movement against you. This means you can lose more than your

initial investment, so you must be careful and use risk management tools, such as stop-loss and take-profit orders, to limit your losses and lock in your profits. Leverage can be a powerful tool for CFD traders, as it allows them to trade with a larger exposure than their available capital. However, leverage also increases the risk of the trade, as it amplifies both the potential profits and losses. Therefore, CFD traders should always be aware of the level of leverage they are using and the margin requirements for their positions.

- ✓ **Short selling** is a trading technique that allows you to profit from both rising and falling markets. It involves selling an asset that you do not own, such as a stock, a commodity, or a currency, with the expectation that its price will decline in the future. Then, you buy back the asset at a lower price and close your position, earning the difference between the selling and buying prices as your profit. When you trade CFDs, you can easily short sell any share available on the platform without borrowing or delivering the actual shares, as you only trade the price difference. This makes short-selling easier and more accessible, as you can short-sell any share available on the CFD platform. Short selling can be a useful tool to hedge your portfolio against market downturns, as you can offset the losses from your long positions with the gains from your short positions. It can also help you diversify your trading strategies, as you can exploit both bullish and bearish market conditions and capture price fluctuations in both directions. At Taurex, you can go short on Share CFDs and benefit from price declines by selling a CFD contract without owning the underlying shares. However, it's important to note that CFD trading, including going short, carries certain risks. The value of Share CFDs can fluctuate rapidly, and if the price goes against your position, you may incur losses.
- ✓ **Ease of access and a wide selection of markets:** One of the advantages of trading CFDs with shares is that you can access the market easily and conveniently through an online CFD broker, such as Taurex, which offers a user-friendly and secure trading platform. You do not need to own the underlying shares or deal with the complexities of the stock market, such as commissions, exchange fees, or stamp duty. You can simply open and close your positions with a few clicks on your computer or mobile device. Moreover, you can also trade CFDs on stocks in a variety of markets, such as the US, UK, Germany, and France. This can give you more opportunities and flexibility to trade according to your preferences and strategies. You can diversify your portfolio, hedge your risks, or take advantage of different market conditions and trends. You can also trade CFDs in different time zones, as the market is open 24 hours a day, five days a week.

What are some disadvantages of share CFD trading?

Trading share CFDs can be a rewarding way of capitalising on the stock market's fluctuations. You can trade share CFDs on various global companies and enjoy the benefits of low commissions, high leverage, and access to both rising and falling markets. However, trading share CFDs also has some drawbacks and risks, such as:

- ✓ **Overnight fees:** Another disadvantage of trading in share CFDs is the cost of holding a position overnight. Unlike trading in the actual market, where you own the shares, trading in CFDs involves a contract that needs to be renewed daily. This means that you have to pay a fee for every day that you keep your position open, which is calculated based on the interest rate differential between the two currencies involved in the trade. This can reduce your profits or increase your losses, especially if you hold a position for a long time or trade with a high leverage. The overnight fee is also known as the swap or rollover fee, and it can vary depending on the broker, the asset, and the direction of the trade. Some brokers may charge a higher fee for holding a short position than a long position, or vice versa. Some brokers may also offer a swap-free account for traders who follow certain religious beliefs that prohibit interest payments. You should always check the overnight fee rates and conditions before opening a CFD trade and factor them into your trading plan.

- ✓ **Leverage: A Double-Edged Sword:** CFDs' most significant advantage, leverage, can quickly turn into a devastating disadvantage. It allows you to control positions much more significant than your capital, amplifying both profits and losses. Imagine you believe a stock will rise and invest \$1,000 in CFDs with 10x leverage, controlling \$10,000 worth of stock. If the stock rises 10%, you make a \$1,000 profit (10% of \$10,000). However, if it falls by 10%, you lose your entire \$1,000 investment, not just the initial \$1,000. Beginners often underestimate the impact of leverage, leading to significant losses exceeding their invested capital. Leverage can be tempting for traders who want to maximise their returns, but it also increases the risk of the trade, as it exposes them to higher volatility and margin calls. A margin call is a situation where the broker requires the trader to deposit more funds to maintain their position, or else the broker will close the position at a loss. To avoid margin calls, traders should use a lower leverage ratio, monitor their margin level, and use stop-loss orders to limit their downside risk.

- ✓ **No Ownership Rights and Limited Benefits:** Owning shares extends beyond mere financial gain, offering voting rights, pre-emptive purchase opportunities, potential employee stock purchase plan access, and even tax advantages compared to CFDs. This deeper engagement fosters a sense of ownership and informed decision-making while CFDs remain focused on short-term price movements. Carefully weigh these benefits against the lack of dividends and stock splits before choosing the investment path that aligns with your financial goals, risk tolerance, and desired level of involvement with the underlying companies. Remember, it's about finding the strategy that resonates most with you, both financially and emotionally. When you trade CFDs, you do not own the underlying shares, but only a contract that mirrors their price movements. This means that you do not have any rights or obligations as a shareholder, such as voting in annual general meetings, participating in rights issues, or receiving bonus shares. You also do not receive any dividends or benefit from any stock splits that may occur. However, some brokers may adjust your CFD position to reflect the effect of dividends or stock splits, either by crediting or debiting your account or by changing the number or price of your contracts. You should always check the broker's policy on corporate actions before trading CFDs.

- ✓ **Liquidity risk:** A fourth disadvantage of trading in share CFDs is the risk of low liquidity in the market. Liquidity refers to the availability of buyers and sellers in the market, which determines the ease of executing trades and the stability of prices. Low liquidity can lead to wider spreads, higher slippage, and delayed execution, which can affect your trading performance and costs. Liquidity can vary depending on the time of the day, the popularity of the asset, and the market conditions. Therefore, you need to be aware of the liquidity of the share CFDs you are trading and avoid trading during periods of low liquidity. Liquidity risk can be mitigated by trading in CFDs that are based on liquid underlying assets, such as blue-chip stocks, major indices, or commodities. You can also use limit orders to specify the price at which you want to enter or exit a trade rather than market orders that execute at the best available price. You can also use stop-loss orders to close your position automatically if the market moves against you by a certain amount.
- ✓ **Counterparty risk:** Another drawback of trading in share CFDs is the risk of the broker defaulting or failing to honour the contract. Since you are not trading with the actual market but with a broker, you are exposed to the risk of the broker not fulfilling its obligations or going bankrupt. This can result in the loss of your funds or the inability to close your positions. This is why you should choose a regulated broker, such as Taurex, which is authorised by the Financial Services Authority of Seychelles and follows strict security standards to protect your funds and data. Counterparty risk can be reduced by choosing a broker that segregates your funds from its own, meaning that your money is kept in a separate bank account and cannot be used by the broker for its own purposes. You should also check the broker's reputation, customer service, and dispute resolution process before opening an account. You can also diversify your trading portfolio by using different brokers or platforms for different CFD trades.

Best practices to engage in trading with CFDs on shares:

Trading share CFDs is a popular investment and can be a profitable way of speculating on the price movements of thousands of global companies. However, it also involves significant risks and challenges that require careful planning and execution. To trade share CFDs effectively, you can follow some effective practices, such as:

- ✓ **Do your homework:** Before you enter a share CFD trade, you should do thorough research on the company you are interested in, the industry it operates in, and the market conditions that affect its performance. You should also use various analytical tools and methods, such as technical and fundamental analysis, to identify the trends, patterns, and entry and exit points of the share price. Technical analysis involves studying historical price movements and using indicators and signals to predict future directions. Fundamental analysis consists of evaluating the financial health and performance of the company and its competitors, as well as the external factors that influence its value, such as earnings, dividends, news, and events. You can use the premium tools provided by Taurex, such as Acuity, Trading Central, and Swiset, to get unparalleled market insights and timely analysis. These tools can help you access real-time data, expert opinions, and actionable recommendations that can enhance your trading decisions and strategies.



- ✓ **Diversify your portfolio:** One of the most popular strategies in trading is diversification. This means that you should not put all your eggs in one basket but trade a variety of share CFDs across different sectors and regions. This can help you reduce your exposure to specific risks and uncertainties that may affect a single company or industry. It can also help you benefit from the potential collective growth and opportunities that may arise in different markets. For example, you can trade share CFDs from the US, UK, Germany, and France and from sectors such as technology, healthcare, energy, and consumer goods. By diversifying your portfolio, you can increase your chances of finding profitable trades and balancing your losses and gains. Diversification can also help you smooth out the volatility of your portfolio, as the performance of different share CFDs may not be correlated or may even move in opposite directions. This can reduce the impact of market fluctuations on your overall returns and help you achieve more consistent results. However, diversification does not eliminate the risk of trading, as all share CFDs are subject to market forces and other factors that may affect their prices. Therefore, you should always conduct thorough research and analysis before trading any share CFD and use appropriate risk management tools, such as stop-loss and take-profit orders, to protect your capital.
- ✓ **Use risk-management tools:** Trading share CFDs involves a high degree of leverage, which means that you can open a large position with a small amount of capital. While this can amplify your profits, it can also magnify your losses. Therefore, you should always use risk-management tools to protect your capital and limit your downside. One of the most essential tools is the stop-loss order, which automatically closes your position when the price reaches a certain level that you specify. This can help you prevent further losses and preserve your trading account. Another important tool is the take-profit order, which automatically closes your position when the price reaches a certain level that you set. This can help you secure your profits and avoid missing out on favourable market movements. You should also monitor your CFD positions and adjust them according to the market conditions and your trading goals. It is important to also be aware of your margin level, which is the ratio of your equity to your used margin. If your margin level falls below a certain percentage, you may receive a margin call, which requires you to deposit more funds or close some of your positions. You should avoid overtrading or using excessive leverage, as this can increase your risk and reduce your margin level.

Conclusion: A Balanced Perspective on Share CFDs

Share CFDs present an intriguing option for investors, offering potential benefits like lower costs, leverage possibilities, wider market access, and the ability to profit in both rising and falling markets. However, these advantages come intertwined with inherent challenges, demanding informed navigation and responsible trading practices. You can trade share CFDs with online trading brokers, such as Taurex. It is important to choose a broker who matches your needs. With Taurex you can trade with competitive spreads, fast execution, and advanced trading tools. However, before you start trading share CFDs, you should be aware of the pros and cons of this type of investment and how to manage the risks involved.

Before venturing into the world of CFDs, carefully weigh the cost-effectiveness against the additional fees and risks involved. Leverage can magnify profits, but remember, it equally magnifies losses. Utilize it cautiously and with a firm grasp of risk management strategies. While CFDs allow profiting from declining prices through short selling, understand the complexities involved before employing this tactic. The wider market access offered by CFDs comes with the responsibility of understanding international market dynamics.

Be mindful of overnight fees, liquidity risks, and counterparty risks associated with CFDs. Opt for reputable and regulated brokers like Taurex for added security. Remember, responsible trading practices are paramount. Conduct thorough research, diversify your portfolio, master risk management techniques, and understand margin levels. CFDs may not be suitable for everyone; carefully assess your financial situation, risk tolerance, and investment goals before engaging.

Ultimately, a balanced perspective on CFDs acknowledges both their potential benefits and inherent challenges. Responsible and informed investors can utilise CFDs as a tool within a broader investment strategy but always prioritise careful due diligence and sound risk management practices.

Have a question? Get in touch.

Our knowledgeable support staff are available 24/5 via telephone, live chat, email, or a support ticket.



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