

TradeReview

APRIL 2009

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BEAR PROFITS

Short selling is a way
that you can profit



BOOK REVIEW

Active investing



GURU PROFILE

From broker to
precision trader




POCKET GUIDE

for DIY FX Traders



issued by

 CMC Markets

> IMPORTANT INFORMATION ABOUT THIS PUBLICATION

BEAR PROFITS



It must be one of the least understood, yet much maligned activities in the markets. It may also be one of the most divisive topics amongst traders and investors as the mere mention of the word could evoke a myriad of reactions.

And yet when you look at it closely and when you spend time to understand it and how it works, you would most likely appreciate the benefits it could bring to your trading and investment.

In this issue, we will be looking at short selling (or going short). We've interviewed a number of traders who shared their different experiences with short selling and their views on this misunderstood topic.

Whether you're already doing or are very comfortable with short selling, or you don't have any idea what short selling is and how you can use it for your trading and investment, these views and experiences from active traders will give you an insight on the benefits of going short.

**SHORT SELLING IS A
WAY THAT YOU CAN
PROFIT DURING THIS
FALL AND MAKE
SOME MONEY OUT OF
A SHARE**



FOR THIS TOPIC TRADE REVIEW TALKED TO THREE TRADERS WHO HAVE BEEN VERY GENEROUS WITH THEIR COMMENTS ON THIS TOPIC: ANGUS LAING IS A VERY ACTIVE TRADER WHO HAS BEEN TRADING FULL TIME SINCE 2004. DAVID LIMBURG IS THE WINNER OF THE FIRST CMC MARKETS CFD TRADING COMPETITION (HELD IN 2007). JUSTINE POLLARD, ANOTHER VERY ACTIVE TRADER, IS THE AUTHOR OF THE BOOK SMART TRADING PLANS (JOHN WILEY AUSTRALIA).

Trade Review (TR): What is your overall view about short selling or going short?

Angus Laing (AL): Prices/Markets generally spend one third of the time going sideways, one third going up and one third of the time going down. Now the time they're going sideways (within the timescale that you're trading) you don't make money. So that leaves (approximately) equal time going up or down to make money. Going up you make money by going long, going down you make money by going short. So why would you refuse to take one half of the opportunity the market has to offer you by not selling short?

David Limburg (DL): I am happy to play the short side of the market. It adds liquidity to the market. The problems arise with large institutions 'forcing' the price down by using their muscle, and I think this is wrong.

Justine Pollard (JP): I love shorting. It is the trading method that is used to profit during a bear market. It also provides liquidity in the market place. Plus the bonus is that you earn interest when trading short with CFDs rather than paying it.

TR: Do you think going short has a place in your trading? Why? Why not?

AL: Following the reasoning (my response to the first question), why would you refuse the opportunity to make money when the markets are going down by not going short?

DL: Yes, there are some very nice opportunities in a falling market. Generally a market will fall faster than it rises. There is an old saying about the market that it goes up by the stairs and down by the escalator. For someone who relies on the market to make a living, it would be very difficult to make money in a market like we have experienced over the last year if shorting was not an option.

JP: Yes, this is how I profit during a bear market or when a share is in a down trend. I am a trader and my goal is to not only profit during bull markets but to also profit during bear markets and this is only possible through short selling.

I am grateful for CMC Markets for allowing short selling on CFDs throughout the ban of short selling on securities. I would not have been able to profit last year when the ban was set if I was not trading with CMC Markets. I made a 300% return in just 6 weeks during the period of the short selling ban on securities trading CFD through CMC Markets.

TR: Have you done or placed any short trades during the past 12 months or when the global markets have been going down?

AL: I trade commodities with a more or less equal view. I'll take as many short trades over a year as short trades (as long as the conditions lead me to).

DL: Yes, hasn't every trader? How else would you have made money over the last year?

JP: Yes, I have. I have predominantly been short during this period.

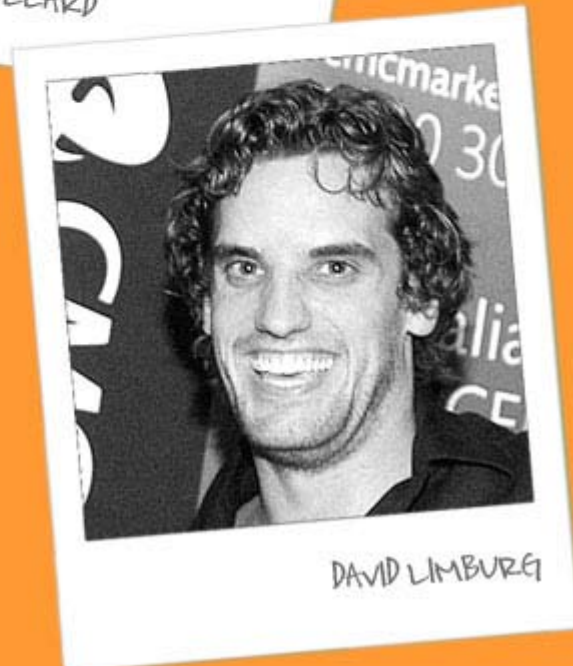
TR: Why do you think some/or many people have a problem or an issue with going short (short selling)?

AL: Mostly people don't like the idea of selling something they don't own yet. Oddly enough they seem happy enough living in a house they don't own. There is the issue of 'potentially unlimited losses' that people don't like though this can be covered with a stop (stop loss order).

I think most importantly people are always taught to think positive, so having the belief that some overpriced financial asset is going to go down may not sit well with many people. Some people find it hard to hold on to (this belief), because it's associated with loss and pain.

DL: There is an ethical question over shorting, and to some extent it is justified. The problem really lies with the large institutions, there should be limits on the extent these large and influential corporations can play the short side.

JP: Many people are scared of short selling. It is not the norm and there is a fear that shorting drives share markets lower. There comes a point when things will not continue rising. A share can only rise so far before the buyers stop buying. When there are no new buyers entering a share, it will not continue higher. Once people start to sell and take profits the share will fall and come down to a more reasonable price level ready for buying again. Short selling is a way that you can profit during this fall and make some money out of a share.<



TR: Have you made money on your short trades?

AL: This varies due to overall market direction, but it doesn't prove one works better than the other. Markets tend to move down more quickly than they move up so potentially shorting can be more profitable.

DL: Personally, I tend to make more on the long side, but that is more due to the unlimited upside of a trade, whereas the downside is limited. The short trades tend to be quick and a bit easier to pick, but the profit is a bit limited. I think there is a place for both long and short in the trading world.

JP: I make more money trading long, as shares can double, triple and quadruple on the upside. They can't double and triple on a downside. A share cannot go beyond zero. Due to the increased volatility of the current market over the last 12 months my position sizes have also been a lot smaller than normal, which in turn means my profits are also lower than normal. But this is the nature of the current market and I have to honour that and size my trades accordingly.

TR: What will be your suggestion for those who have an issue or problem going short?

AL: Turn your computer screen with the price chart on it upside down and carry on as before (2003- 2008). Just sell first, and then buy later.

DL: Look into Contract for Difference (CFD), warrants and options and enter with caution.

JP: Not everyone is comfortable short selling and it is not for you then simply sit out of the market or shares when they are falling. Act on stop losses for long trades and do not try to trade long when the share is going down. There is nothing wrong with sitting out of the market during such times and also learning.

So, how will you handle a bear market?

You have two choices and simply hanging on in hope is not one of these — well, not for me anyway!

You can:

- Act on stop losses for long trades and keep out of the market until conditions become favourable again. This is a strategy that long-term investors are most likely to use.

- Act on stop losses for long trades and start short selling — professional traders use this strategy because their goal is to be profitable in all kinds of markets.

Prepare yourself for a bear market and pre-plan how you will handle it.



ANGLUS LAING

ACTIVE INVESTING

IF WE WANT TO BE SUCCESSFUL IN THE MARKETPLACE THEN WE MUST HAVE A STRATEGY THAT PUTS US IN THE DRIVER'S SEAT WHERE WE HAVE FULL RESPONSIBILITY



With many share owners and investors still feeling the pinch of the impact of the global financial crisis to their portfolio, many are also rethinking the value of getting advice from financial planners or just letting other people manage their portfolio for them.

Whether you're in this category (re-thinking your relationship with your financial adviser) or just seriously considering your investment and how you can take advantage of the next market upmove, Alan Hull's new book *Active Investing*, may be of help.

The revised edition contained some up-to-date analysis of the sharemarket and share price movements affected by the global financial crisis. It touched on the basics of the market, its players and other relevant information that cater to all types of investors and those wanting to invest in the share market.

A very useful feature is the active investing chapter which tracks a sample portfolio over a period of time. It starts with stock selection, monitoring, determining which stocks to buy (given some parameters), how much capital to allocate per stock, determining the stop loss level and monitoring the portfolio's performance on a regular basis.

I believe that if every investor can stick to this routine and build this discipline into their investing strategy, they would substantially increase the probability of growing their portfolio.

While the book offers the tools every investor should aim to have in their investing tool kit, it also assumes that all these tools will be put into good and regular use. That is the idea behind the book's active investing theme.

The chapter called 'Managing the losses makes you profitable', Alan discussed what I believe is one of the most important components of active investing – using stop losses. This may be a new concept for many long-term investors, particularly those who claim to have the very long horizon as their investment timeframe. Alan pointed out that, "It is the ability to take a loss that is the difference between success and failure in the stock market. And it is only with a pre-determined stop loss that we can calculate and manage risk."

I like Alan's comment where he said, "Personally, one of my greatest moments as a trader was the first time I made all my decisions in executing a trade. I chose the stock. I decided when to buy and when to sell. When I completed the trade I felt a surge of self-confidence similar to the first time I drove a car myself. I now realised that my education behind the wheel of a car started from the first solo drive and my real education as a trader started from the first completely self-directed trade. You won't learn how to drive being chauffer-driven, nor will you learn anything about trading and investing by using the advice of others."

FROM BROKER TO

PRECISION TRADER



NICK MCDONALD

More than five years ago, when Nick McDonald decided to be a trader and to leave behind a stable job at a big financial firm in London, many people tried to talk him out of it. They created doubt in his mind by saying things like, “do you know what you’re doing?”, “a lot of people have lost money trading and you will definitely lose money”, “why would you leave a good paying and stable job to go into trading?”

For Nick it was a turning point, and the discouragements did not stop him from pursuing what he wanted to do. “Most of those people – my family and friends – were just concerned for me. In a way it strengthened my resolve to be a trader. It became an additional driving force for me to succeed as a trader,” said Nick.

Today, Nick is not only a successful trader. He’s recognized as one of the leading independent traders in the UK who specializes in currency (FX) and Index trading. His profitable and successful trading methodology has also made him a popular and well-sought trading trainer in many countries.

“I’ve always wanted to be a trader. I worked in a stockbroking company before when I thought I would like to be a broker. I then realized that brokers are not necessarily traders. All they do was buy and sell and execute trades for their clients. They’re not really trading for themselves,” Nick said, recalling his early days in the finance industry.

However, his experience alongside the stockbrokers did not totally go to waste because it helped developed his interest and desire to be a trader.

“One of the things I realized then was that I don’t like having a boss. I hate being told what to do or being ordered around. At the same time I always enjoy a challenge. The more difficult a mental endeavour is, the more I like it because of the challenge,” Nick said.

YOU JUST HAVE TO DO IT.
JUST MAKE A START.



Nick admitted that he had his share of struggles, particularly during the first few years of his trading.

"In a way, it was extra challenging for me because I did not have a huge trading account to start with. Unlike some people who start with a substantial capital (some people say they need \$100,000 to start trading), I only started with a small capital base and went straight to full time trading when I left my job," Nick said.

"For me it was a make or break situation. I had to make it work. I had to succeed, and it turned out well because after six months of trading my small trading capital was not that small anymore," Nick recalled.

Despite what others would consider limitations during his early trading years, Nick managed to maximize his opportunity.

"Over the years I've seen so many people make up excuses – that they don't have the trading skills or they don't have enough capital or they don't have the time.

People will always find excuses and reasons not to do it (get into trading), and that is unfortunate because I believe that if you really want to succeed in trading, you just have to do it. Just make a start... it's the first step in success for any venture" Nick said.

The fact that he only had a small trading capital when he started, in a way, forced Nick to be extra vigilant with his risk management.

"I've always been mindful that I need a strict risk management methodology. This was particularly important when I was starting and I had quite a limited capital. I always believe that the first priority for a trader is to preserve the trading capital and you need a solid risk management approach to do that," Nick said.

After more than five years of trading, Nick remains a strong advocate of limiting your trading losses. For his own trades Nick only risks a maximum of 1 per cent of his total trading capital for any given trade. He said this assures him that he doesn't blow up his trading capital in one go or for that matter on any length of losing streak.

For those who are still trying to find excuses, Nick has this to say, "My suggestion is to trade small, get the experience and take small, calculated risks."

"Many people come to trading with a get-rich-quick mentality," said Nick. "But what I tell people upfront and when they ask me how I became successful in trading is that, you have to put in the hard work. You also need to think like a trader. If you put in the hard work, you can get very rich. But don't expect it to happen next week."

While his training as a stockbroker exposed him to share trading early on, Nick found himself attracted to currencies (FX) and indices when he went full time trading.

"I get better leverage (trading FX and indices) which means that I can take bigger positions when I need to with less margin requirements. At the same time these instruments are very liquid and you need liquidity particularly when you don't want to be holding on to open positions for too long. You should be able to get in and out of trades and if what you're trading is not liquid enough, that may become a problem."

"By nature, currencies (FX) are very liquid and they trade 24 hours a day. You can basically trade it anywhere you are," Nick said.

Though he is a very active trader and trades only on a short time frame, Nick said he usually spends a maximum of two hours a day trading.

"I don't need to be stuck in front of my computer all day to trade. Most of the time I would look at the markets (in the morning) and see if there are trade set ups. Once I've put my trades in I don't have to sit in front of my computer to watch it."

He usually puts his FX trades in the morning and he would be trading indices plus reviewing the forex charts at times during the day. His trading routine may involve scanning for potential trades for about 3-5 minutes and another 10 minutes to put on trades and record the reasoning behind it as and when a trade occurs. On average he trades for about 30 minutes to a couple of hours each day. As a short-term trader Nick usually holds positions for anywhere from a few minutes to a few hours and occasionally a long term trade (for him) of a few days or weeks.

POCKET GUIDE FOR

DIY FX TRADERS

The foreign exchange market affects every single one of us. Whether you're planning an overseas trip, purchasing something made overseas, or just interested in the movements of the market, we all feel the affects of a change in the value of our currency. The values of currencies are determined on foreign exchange (forex) markets by the forces of supply and demand (just like in any other market).

Here's a couple of direct and indirect ways the foreign exchange rate affect each one of us.

Most consumers engage with the foreign exchange market when looking to buy another currency for an overseas trip. In this case it is a simple exercise of handing over Aussie dollars (AUD) in exchange for, say US dollars (USD). Now if the AUD is weak against the USD at the time you purchase the currency, you will receive less US dollars in exchange than you might have otherwise (or you will need more AUD to buy the USD).

Alternatively, if you decide you would like to buy a big new liquid plasma television set made in Japan, you will find the price will be influenced by the AUD/Yen exchange rate.

That is, if the value of the Yen has been rising against the AUD in the months leading up to your purchase, chances are your television set will be more expensive (because the wholesaler will have had to convert more Aussie dollars into Yen before purchasing the TV).

The value of the Aussie dollar can also influence the price of petrol. Let's look at a few scenarios; if the price of oil goes up and the AUD goes down, the price of petrol will rise; if the price of oil goes up and the AUD also goes up, chances are the price at the pump won't move up as high. And if the price of oil goes down, and the AUD goes up, the price at the pump should go down significantly (at least, that's the idea).

FOREIGN EXCHANGE MARKET

The foreign exchange market is where currency trading takes place. The market itself involves participants buying and selling currencies from across the globe, facilitated by banks and other institutions. It's driven by banks, central banks, governments, speculators and corporations.

The need for a market arises because countries/corporations who wish to trade with one another need to be able to value their currencies against each other in order to transact.

One key difference with forex markets is that there is no one exchange. Participants trade with one another 'over the counter'. You might ask: "How do I know what price to bid and to offer?" The answer is in the concept of arbitrage. That is, traders can exchange currencies in any number of different markets, and if they notice price differences they can take advantage of that.

WHETHER YOU'RE PLANNING AN OVERSEAS TRIP,
PURCHASING SOMETHING MADE OVERSEAS, OR
JUST INTERESTED IN THE MOVEMENTS OF
THE MARKET, WE ALL FEEL THE AFFECTS OF A
CHANGE IN THE VALUE OF OUR CURRENCY





DAVID TAYLOR

For example it would make sense to buy a currency in one market where it has a lower value, then sell it in another where it has a higher value.

One final point is that, unlike markets for stocks, foreign exchange has no clear market depth. That is a trader through one bank cannot see other trader's orders, either with that same bank or with other banks. That is because there is no one central exchange where you can see all the bids and offers in the market. Instead, a rate is agreed upon between two parties and the price will change depending on the volume of the transaction. The higher the volume of currency traded, the greater the pressure on the price.

RECENT TRENDS: WHAT'S DRIVING THE MAJORS?

Recent movements in currency pairs have been influenced by a range of factors. Among those include movements in the US dollar and the price of gold – both of which have been influenced by US action to revive the economy and salvage their banking system.

What we are seeing are two forces at play here: the first is a concern that the printing of money by the US Federal Reserve will devalue the USD by increasing USD supply - with the added concern of inflation. This also increases the demand for gold and alternative currencies to the USD (like the Aussie or Euro).

The second is one of fear. There is still concern that the worst may not yet be over. Whenever this fear creeps into the market (on the back of a corporate collapse for example) we see renewed interest in the US dollar.

Moreover, the major currencies also tend to move in fairly predictable ways. For instance, you might hear in the press that 'confidence returned to financial markets overnight' in which case you would likely see a decrease in the Yen and the USD, and increases amongst the more risky currencies like the Aussie, Canadian dollar and Euro.

ONE FINAL POINT IS THAT, UNLIKE MARKETS
FOR STOCKS, FOREIGN EXCHANGE HAS NO
CLEAR MARKET DEPTH



So let's look more closely at the individual currency pairs and the recent trends that have started to form:

Euro / USD

From a technical perspective the Euro is in a downtrend. The one factor saving the currency from free fall is uncertainty over whether we've seen the worst of the global financial crisis.

The currency has been hit hard recently following the increase in the gearing levels of member nations as they support their finance sectors (injecting liquidity into banks). They are also looking at increasing money supply by around 10 per cent over the next 2 years as they use quantitative easing as an alternative to traditional monetary policy. The risk of sovereign default and the printing of money have seriously devalued the Euro against the USD. Look for a recovery perhaps in thesecond half of 2009.

Euro / GBP

The key point to make here is that the Sterling will suffer from quantitative easing being implemented by the Bank of England. By printing more money, the pound, just like the USD, will be devalued. This could help the Euro achieve parity with the Pound.

NZ / USD

The NZD looks like it may be getting some support around the 0.4570/04850 mark. This is very much in the basket of risky currencies, so, if the news flow from the world's major economies surprises to the upside in the second half of 2009, the NZD could push up to 0.5080. Any close above this level could be a catalyst for a further run up.

Yen / USD

The Yen is traditionally a 'safe haven' currency. That is, in times of economic uncertainty, currency traders flock to the Yen or the USD. Recently, however, given the dire state of the Japanese economy, the Yen has seen a decline. In fact the Yen rose to a peak against the USD during the period December through February this year but has since then faded away.

With interest rates at zero per cent, and the economy contracting at a rate in excess of 10 per cent, largely dragged down by the export sector, the fundamental support for the Yen simply isn't there.

Given that the Yen and USD are the two big alternate safe haven currencies, what we've seen recently is investors choosing the USD over the Yen for safety.

AUD/USD

The Aussie dollar has 'fallen out' with the USD over the last 12 months. It was flirting with parity this time last year, however following the onset of the GFC, it has fallen quite dramatically.

Supporting the AUD are our relatively high cash rate and the relative strength of our economy. The fact remains we have still managed to avoid quantitative easing, and our trade surplus (for the moment) continues to improve. These are positives.

All this suggests a fair amount of upside for the currency. On the flipside, we are unlikely to see a strong rebound in the Aussie until world GDP starts to regain some momentum. The Aussie is also a 'commodity currency' which means it gains support from increased demand in commodities (such as iron ore and gold) - this is unlikely to occur in the short term.

Currency markets are currently being influenced by changes in global economic growth, and investor risk appetite. Notwithstanding minor gyrations in the short term, we will likely see relative strength amongst the safer currencies such as the Yen and USD, and continued weakness in the higher yielding currencies such as the Euro and Aussie dollar. Individual currencies though will certainly be affected by the degree to which authorities implement quantitative easing, continued efforts to rescue the major banks, and rallies in commodity markets.

ARE YOU SELLING YOURSELF SHORT?



SELLING SHORT IS ONE OF THE FASTEST WAYS TO MAKE A BUCK AND IT IS ALSO ONE OF THE BEST WAYS TO PROTECT ANY LONG POSITION FOR ANY PERIOD OF TIME

Selling short is one of the fastest ways to make a buck and it is also one of the best ways to protect any long position for any period of time. You even get interest on your money (when you trade short on contract for difference – CFD), rather than paying it out on the long side. So, why is it that many traders lose money when the bear is on the loose?

I may not be the smartest egg in the box; I remember when I started working for a Japanese company in the early eighties, they were dealing in futures and trying to make me understand how to sell a market short. It was like water torture getting my head around it, selling it first then buy it back later on for a profit or a loss. I just couldn't get my egg head around the concept of selling something I didn't have and then buying it back later. And to top it off, what if the market went down and I actually made money?

Many traders sell themselves short by not understanding this concept fully. It is important to be very comfortable with taking your shorts on and off in any situation! If it's your plan to be successful in trading, then it is imperative that you can trade both sides of the market with ease, not even thinking twice about it.

Sure, the first thing that we learn in trading is that the trend is your friend, but I wouldn't hang everything on that relationship, far better to have affairs with everything, including corrections.

It really doesn't matter what you do in a market as long as you know what you're doing! Once you understand that you're just basically trading patterns and understand that there are only trends and corrections of different degrees, you start to build a book of patterns in your head and then you're on your way.

Peter Mathers is a trading consultant with over 20 years of trading experience. He started his trading career with a Japanese futures company and worked in London for several years before coming back to Australia.

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There's definitely a lot of stuff to learn about patterns – Elliott Wave, Gann TradingLevels® and volume – all are just part of the basics of charting, but it remains that you need to get your head around surfing short. Simply because there is more shorting to come, and besides all losses come from corrections of different degrees.

There are even patterns you need to understand in your own head as psychology in trading plays its part – be it market or your own world – the road to trading is a road into yourself. It's a space to be proactive not reactive, as that ancient dude said 'Know thyself', do an analysis on your own thoughts if you can catch them.

So what is selling short?

I suggest start reading the history and the different mechanics. Using Wikipedia type in 'short selling'. A good dose of history will put you in a good position with the concept and its variations.

How can I sell something I don't own?

A friend of mine would explain it like this: It's raining outside and I need to pop out, so I ask the secretary if I can borrow her umbrella. "Sure", she says, and off I go. Along the way I pass a chap selling umbrellas for five dollars.

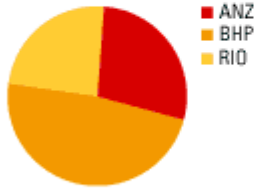
I arrive at my destination and buy what I need and proceed to walk out through the doorway where I stop to open the umbrella and found a woman staring longingly at the umbrella, she says "Will you take ten dollars for your umbrella?" "Well sure" I say, and simply pick up another one on the way back off the chap selling umbrellas for five dollars, thus making five dollars on selling something I didn't have or own.

> APRIL 2009

SNAPSHOT

PROFIT VS TRADING VOLUME SHARE CFDS

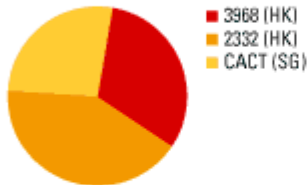
AUS Stocks
Top 3 most profitable for CMC Markets clients



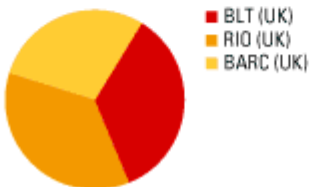
AUS Stocks
Top 3 by client trading volume



International Stocks
Top 3 most profitable for CMC Markets clients



International Stocks
Top 3 by client trading volume



PROFIT VS TRADING VOLUME SECTOR CFDS

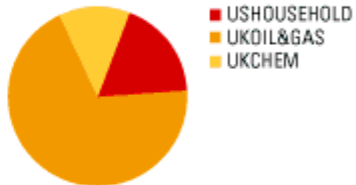
AUS Sectors
Top 3 most profitable for CMC Markets clients



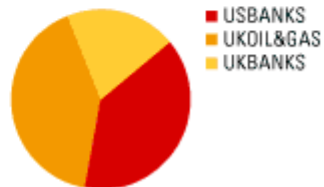
AUS Sectors
Top 3 by client trading volume



International Sectors
Top 3 most profitable for CMC Markets clients



International Sectors
Top 3 by client trading volume



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