Exclusive article by spread bet guru Malcolm Pryor

The Investor's Guide to Spread Betting

"What every investor needs to know"

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Foreword

Spread betting has been around for a while now, but it's still only used by a minority of private investors. At Digital Look, we see it as our mission to inform about all aspects of investing – from providing award-winning data and research tools to alternative investment devices. Spread betting gives the private investor a wealth of new techniques and opportunities, especially in these volatile times.

This guide looks at a number of these opportunities including how you might hedge your investment portfolio using spread betting and how you can use spread betting to diversify your investments. We've also got an exclusive article by Malcolm Pryor, author of the bestselling The Financial Spread Betting Handbook, a brief introduction to Technical Analysis and an interview with a new spread bettor. And we wrap-up with a section on how having the best research tools around can improve your spread betting performance.

For a full education guide on how spread betting works, visit www.DigitalLook.com/spread_betting

We also run a number of free educational seminars - find out more at www.DigitalLook.com/events

Digital Look is an Appointed Representative of CMC Spreadbet Plc.

Contents

Please remember that Spread Betting is a leveraged product and carries a high level of risk to your capital. It is possible to incur losses that exceed your initial investment. This product may not be suitable for all investors, therefore ensure you fully understand the risks involved and seek independent advice if necessary.

Why would investors spread bet?

by Andy Yates

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Andy Yates, Director of leading investment website DigitalLook.com explains why spread betting is not just for Christmas - and why investors should not ignore its subtle charms…

First let me get a few things straight:

1. I'm not a leading world expert on the financial markets (but then again who is these days?).

2. I'm not going to reveal the hidden secret of untold market riches. If I knew would I really be wasting valuable trading time writing this guide?

3. I am fallible and I have yet to make the perfect trade or build the perfect portfolio.

So if you think this guide is about a magical get rich quick formula - goodbye and good luck.

That's better and I am glad I got that off my chest. Now let me tell you just what I am.

I am an investor. I care about investing my (very) hard earned cash in the right places and making a sensible and consistent return. That's why I and my colleague Mark Pritchard set-up the financial research portal DigitalLook.com in the first place - to give us and investors just like us as much help as possible to put our money in the right place at the right time.

So why, I hear you cry (go on you can cry louder than that) is this guide about spread betting?

First, I should take a minute to outline a few assumptions I am making:

- That you're a bright spark (or at the very least have a bit of spark) and that I don't have to go through the old example of how spread betting works (you can read more at **www.DigitalLook.com/spread_betting)**. You've also got a fair inkling of the stock market and how it works.

- You have a computer with a decent internet connection.

- You are willing to open your eyes rather than keep them screwed tightly shut.

So, at first glance spread betting, with its 'in-out and shake it all about' reputation may appear a million miles away from the relatively cerebral and less hyperventelating induced climes of your average long term investor.

You may be the person who wants to build a long term nest egg rather than worry about laying an egg every time you look at the FTSE.

However, one thing that we've learnt at Digital Look is that spread betting and investing can be firm bed fellows if you're serious about your financial health.

Yes, investing is good for the long term - and given the recent turbulence probably a longer term than many had previously imagined. However, spread betting can be an important weapon in a modern investor's armoury.

Let's explode some common myths about spread betting:

1. Spread betting's for punters, not investors - Nonsense!

Used in the right way, spread betting is just another way to reach the same goal of backing an asset that moves the right way. Just think of spread betting as a useful tool to help our overall wealth-life balance with some important advantages over traditional trading methods.

While the punter just trades on a tip, the savvy investor researches their potential trades in detail and weighs up whether to spread bet or invest in the traditional way.

2. Spread betting's for traders - Oh come on!

Sure, spread betting attracts day traders, but why should they have all the fun? In these difficult times, you don't have to watch open-mouthed as your portfolio plummets. Used in the right way, spread betting can be used to hedge your long-term investment positions and provide some short-term pain relief.

And shouldn't private investors take opportunities to make money without paying tax? The Government could change their mind of course, but for now, spread betting doesn't attract CGT or stamp duty.

3. Capitalism is dead - long live socialism - Get real!

OK comrade, the foundations of the edifice that is capitalism have taken a bit of a battering. But that is more due to a temporary plumbing problem with the banks rather than subsidence. If you want to keep your money under the mattress and not take any risks then I wish you luck with your nice cup of tea and latest episode of Countdown ….

Some final thoughts:

- If you're an investor you'd be foolish not to at least investigate spread betting.
- Find out what it's about and how it works and then see if it's right for you.
- I did and have found that – along with other forms of trading - it has its uses.
- This guide will go on to explain how to make sure you use rather than abuse the advantages spread betting has to offer investors.

Spread Betting Winners vs Losers – what's the difference?

by Malcolm Pryor

Malcolm Pryor is an active spread bettor, a trading coach and the author of "The Financial Spread Betting Handbook" (Harriman House, 2007).

There is no doubt that some people do very well spread betting. Others then think that it is an easy game, that all you have to do is open an account and the money will come rolling in. The reality is that like most other activities in life there are good ways and bad ways to set about spread betting, and generally the winners have put effort into learning relevant skills which enable them to be successful at it.

This is one of the central themes of my first book "The Financial Spread Betting Handbook". In it I use the analogy of mountain climbing to try to cast light on the route to successful spread betting. The first stage is to get to base camp. For the spread bettor this translates to a range of activities including:

- selecting a spread betting firm
- setting up an account
- getting all the right resources including software, hardware, data feeds and other information
- becoming thoroughly familiar with all operational aspects of spread betting, including all the different order types, and when to use each type
- acquiring street wisdom, learning to avoid common pitfalls

The second stage is climbing the mountain. For the spread bettor this means:

- finding suitable strategies to use in spread betting. These could be trend

following, counter trend, day trading or strategies which don't depend on overall market direction, for instance pairs trading
- learning techniques to time entry into and exit from bets
- learning how to determine bet size
- choosing which instruments to trade.

The final stage is reaching the summit. For the spread bettor this means:

- matching strategies to individual preferences and objectives
- planning and record keeping
- reviewing performance and adapting
- risk management and discipline
- developing a winning attitude, continual development.

There are ten areas in particular which really differentiate the winners from the losers.

1. In control

A winning spread bettor has a plan for every trade, and trades in line with the plan. Losing spread bettors tend to pick trades on a whim. A simple test here is, could you explain why you have taken each trade to someone who doesn't trade so they could understand the gist of it?

2. Responsible for results

Winning spread bettors have the mind set that whether they win or lose depends on them. Losing spread bettors tend to look to blame everyone except themselves for their losses. One common scenario for a loser is to take a trade based on another person's advice, then blame the advisor if it doesn't work out. The advice may come from a book, a magazine, a newspaper, a website, an internet chat room, or a broker. By the time a winner takes a trade it is their own trade, irrespective of where the idea for it may have originally come from.

3. In tune with markets

Whatever your time frame, there is a bigger picture to be aware of in a higher timeframe. If you are a day trader trading off 10 minute charts you should be aware of what the 30 minute or hourly charts look like. If your trading decisions are based on daily charts you should be aware of what the weekly charts look like. Winners are aware of the bigger picture and make trading decisions in line with them. Losers ignore the bigger picture, and are generally not in tune with the markets. A classic example of not being in tune with the markets were the losing spread bettors who kept on placing **up** bets during the powerful market declines in mid 2008.

4. Having an edge

Winning spread bettors have a methodology that suits them which, in the long run, should be net profitable. Losers don't. If you don't know what your edge is you probably haven't got one. Typically losers either have no system, have a system which will in the long run lose, or are not aware that they need a system. A roulette player is a good example of someone with no edge. In the long run they will lose because of the house advantage, the odds are stacked against them. A winning spread bettor's system will at the very minimum define rules covering:

- when to enter a bet
- how to determine bet size
- when to exit a bet at a loss
- when to exit a bet at a profit.

5. Using methods that suit you

Winners do, losers don't. Considerations here include objectives, personality, beliefs, attitude to risk and available resources including time. Suppose for instance that you are trading a trend following system. One approach is to wait for a temporary halt or pullback in the trend before entering. This enables stop levels and risk to be predetermined with clarity. However, sometimes a pullback is the start of a major correction, so this style of entering a trend is only suitable for people with excellent discipline who will get out promptly if the stop is hit.

6. Understand the risks, rewards and odds of your methods

Again, winners do, losers don't. A winner will be able to say that over 100 trades he will expect X winners and Y losers, and that the average size of a winner will be Z times the average size of a loser. Note that there are many successful configurations of these figures. Each of these three configurations produces the same net outcome:

- win 75% of the time, average winner same as average loser
- win 50% of the time, average winner twice average loser
- win 25% of the time, average winner 5 times average loser

7. Bet size

Winners have an appropriate bet size for their strategies and for their objectives. Losers don't (and this is one of most common causes of failure). One commonly used benchmark is keep bet size to a level where if the bet is a loser you only lose a maximum of 1% of your spread betting funds.

8. Focus on exits

Winners spend as much time designing exit strategies as designing entry strategies. Losers don't. Design considerations include where to place the initial stop, and then whether (and how) to move it if the bet moves in your favour. There are a wide range of technical analysis tools which can be used here.

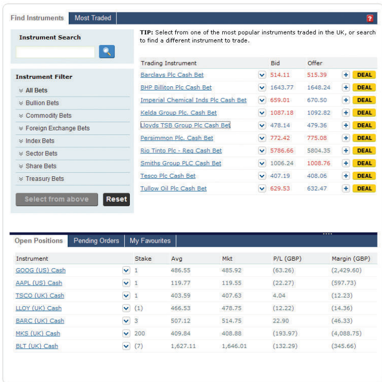
9. Written plans and rules

Winners, in contrast with losers, usually have fully documented plans including trading systems and rules, budgets and targets, contingency plans. On a day by day basis potential trades are planned in advance (and usually documented) before the trading day starts.

10. Monitoring performance

Winners do, losers don't. On a daily basis ask, what went well, what went badly, did I make any mistakes, if so what can I learn?

On a periodic basis, e.g. monthly, look at the trading results and compare them to the budget / what you expect. Is the system on track? Does it need updating? How have I operated it? How can I operate it better in the future?



What every spread bettor needs to know about TA

by Michael Hewson

Michael Hewson is Digital Look's Technical Analyst. He regularly speaks at seminars and conferences including Digital Look's regular *Introduction to Technical Analysis* seminar. You can read his Analysis article every Wednesday at www.DigitalLook.com.

Spread Betting and Technical Analysis

One of the most popular arguments amongst market commentators is what works best – the Fundamental or Technical approach? So if you're a spread bettor which should you look at?

While there's room for both views, I feel that the technical approach is extremely useful when it comes to spread betting. By understanding how charts work and by recognising the patterns they contain, you gain fascinating insight into where and when to enter trades. While timing is always important, it's essential with spread betting.

It's all in the price

There's one common tenet underlying the technical approach and plenty of evidence to support the fact that it works. It operates under the basic premise that "everything is discounted in the price". The technician takes the view that the "price reflects all fundamental information currently available to everyone". This means therefore that the price should be a fair reflection of the underlying fundamentals.

This also allows the spread bettor to trade a vast array of different markets without having to have an economics or accountancy degree.

And it's not just Fundamentals that are in the price, it's emotions too; markets work on 3 emotions – hope, greed and fear. All of these can have a predictable effect on the price.

It's also worth noting that this method of analysing markets has been around since the 1880's in the west - even longer in Japan. Even though they evolved independently of each other they use the same rules of thumb when looking at trading strategies.

Defining objectives and selecting your market

An important question to consider is do you want quick profits, or do you prefer to wait and see a gradual profit accumulated over time?

If you're looking at quick profits then you're looking at fairly active markets with a quite high daily range in comparison to the price spread. A tight bid/offer spread and a fairly good trading range should equate to a reasonable chance of making good money on a day to day basis. A tight bid/offer spread also equates to a good amount of liquidity; helpful if things do go wrong as it gives you greater opportunity to get out of the position if needs be.

Evaluate the past – history repeats itself

As well as understanding that "everything is discounted in the price", another key tenet of the technical approach is to evaluate the past. Dow Theory works on the premise that "history repeats itself".

Looking at past price action on an asset can give clues as to how the price will behave in the future based on previous experience. Human behaviour can to a certain extent be predictable given a defined set of circumstances. This is how the technical approach can work. Seeing where previous highs and lows have occurred in the past and how the market has behaved previously when at these levels can give clues as to what might happen next and allow the trader to set rules

in relation to a particular set of circumstances.

Another important rule in charting is to trade with the trend – if the market is going up, buy it. If it is going down, sell it. A common mistake investors and spread bettors tend to make when placing a trade on either a recommendation or when a stock meets their criteria, is to buy blindly without looking at the current trend of that particular stock. Using price charts as part of your investment arsenal can be extremely useful when looking at placing a 'buy' or 'sell' trade.

Most technicians look closely at the overall trend of the stock in question before timing an entry into a trade. Why buy a stock at 150p when the trend indicates it may be 120p a week later? You might be able to pay a cheaper price if you wait. Alternatively as a spread bettor you can go short – something that isn't easily available to the private investor through traditional means. The other thing you can do on most platforms is to place a 'limit' order at the price you think the stock will go – effectively pre-ordering the stock at the resistance level. This is why the concept of trend is so important in any market and for spread betting in particular.

Using Support and Resistance and trend lines to identify which way a market is moving is a tried and trusted method.

Remember our previous assumptions that "History repeats itself" and that all markets are driven by human emotions? Both are important when it comes to the idea of support and resistance.

The basic idea behind support and resistance theory lies in the fact that in understanding the future we need to look at the past. Price levels that were significant in the past will be of importance to the price action in the future. Usually a support or resistance level is identified by previous lows or previous highs and is a level beyond which prices may have difficulty in moving.

Should the price break the support or resistance line, we often see an acceleration of the price movement. And then, as you can see in the chart below, the role of the line itself reverses – hence the resistance line below becomes the support line.

Horizontal support and resistance levels are the most basic tool used by the technician to identify market breakout points and can offer the quickest profits if traded prudently. The example below illustrates this point perfectly.

Conclusion

The use of technical analysis is a useful tool which allows the spread bettor to be able to identify trends, support and resistance levels, and price targets for profit and loss levels as well as getting a feel for the liquidity and volatility in a market. The price is the barometer or the heartbeat of the market. Learning how to interpret this information is at the core of modern day technical analysis, something that the fundamentals cannot give you.

To learn more about Technical Analysis, go to www.DigitalLook.com/events and come along to one of my training sessions or online demos.

The story of a new trader

by Richard Leader

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Andrew is a corporate consultant in London who started spread betting in April 2008. Here is his story:

"What first attracted me to spread betting was the idea that I could grow my capital faster than through the more usual funds and pensions route. I still invest in funds but see them more as a managed savings account for the longer term. What spread betting offers me is something more active to do with my money.

Starting out

OK, I should have done more research before I started trading. Or rather, I did do the research but I should have been more disciplined in sticking to it. Initially, I wanted to trade the FTSE and did some pretty rigorous analysis of historical patterns – particularly open and close prices.

For the first month or so, I did well – the market was on the up, the feeling in the market was positive and I was following the trend. However, as the profits rolled in, I became blasé and took a less rigorous approach to my research and strategy.

There were three grave errors I was making. They all seem so obvious now but they didn't seem so clear at the time:

1. I didn't realise that the market was moving against me on a more consistent basis – a new trend was forming and I wasn't noticing it. I thought my system worked and my losses were a temporary blip

2. Over-confidence and an attempt to regain losses led me to risking too

much per trade. Rather than betting £1 a point on the FTSE, I was getting greedy and entering at £10 or more, sometimes up to £30 a point.

3. Unbelievable as it seems, I was trading without stop losses on the platform. While I had them in my head, I was spending too much time screen watching – and when I wasn't screen watching, I was losing money.

Starting again

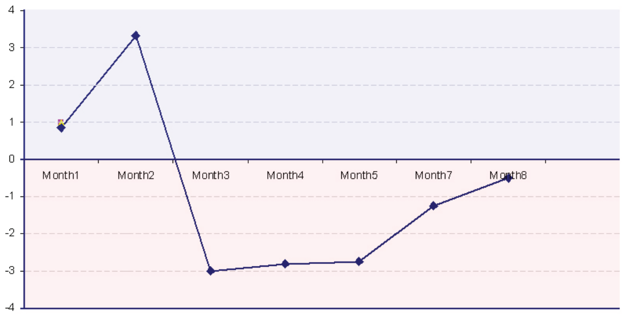
I realised what I was doing and I stopped for a couple of weeks to sit back and think about what I'd done. I'd initially funded my account with a decent-enough amount to trade with, but all-told, I lost alot more than that amount. I needed to rethink my whole trading strategy and work out how to get that money back and start to make a profit.

One thing is clear to me now: I didn't really understand my own risk profile. I was trading much too riskily.

After re-evaluating my approach, I started trading again. However, I still didn't really understand my risk profile and I became too cautious. I decided to always have a stop loss, but I was setting them too close, leading to me getting stopped-out too often just on normal price movements. I was back making good trades but getting no-where because of an overly aggressive stop loss policy.

Third time lucky

I now better understand my own risk profile – and I'm sure this is something that will evolve in time. The chart below shows my earnings over time – you'll see what made me over-confident (early big wins!) and where it all went wrong.



You'll also see the middle period where I was too risk-averse – I wasn't losing money but I wasn't really making any either.

Now, things are back on the up; I've now recouped half of my losses. I have a realistic trading plan. I plan to be positive in the next 3 months (sooner probably but only if the trades are there to be placed). I'll revaluate my strategy again should I get back in profit. While the money is the motivator, my plan is built around the number of points. I know how many points I need to 'earn' to breakeven for example.

Trading strategy for individual shares:

I use Digital Look's Stock Screener to target shares for further research. I look specifically at PE ratios and the balance sheet. I also screen on share price.

I set my stop loss at around 10% of the share value or at an overall loss of £100. That's what I'm prepared to lose on any give trade. I only trade at £1-£5 a point.

I'm no screen-watcher anymore, so I also set a limit order – looking for profits at around double my stop loss. This means I need to be right more than 50% of the time to profit. At the moment, my win:loss ratio is around 70:30. If this declines, I'll reappraise my stops and limits.

The future

Once I start to make a profit (assuming I do), I'll start to build-up my bet price bit-by-bit, though I won't be making the mistake of diving back in at £30 a point again!

All told, I'm putting in between 5 and 10 hours a week on my spread betting. Here's something else I've learned: When I put in 8 hours research and 2 hours trading, I tend to win. When I put in 2 hours research and 8 hours trading and screen watching, I tend to lose. And that, for me at least, is the key."

How to use spread betting to diversify your portfolio

by John Harrington

John is a highly experienced financial journalist who regularly presents Digital Look's *How to Trade from the News* seminar.

I don't know if people still keep eggs in baskets, but the old adage still applies. Unless you are prepared to keep a very close eye on your basket and are utterly sure of the workmanship of said basket, it is generally a good idea to spread your risks.

This means more than putting your money into three Icelandic banks rather than just the one!

It means thinking about your core portfolio and the threats to it, and either hedging against those threats, or reducing your dependence on a particular part of it. Here are my tips for how to diversify:

1. Become a commodities trader

Spread betting opens a number of doors to us private investors. Looking at a specific example, British Airways is often susceptible to the price of oil. Filling your garage with barrels of oil isn't going to do much to hedge your position here, but spread betting the price of Brent Crude might.

2. Go abroad

People keep telling me the world is getting smaller and we're all internationalising. Shame no-one told my broker. Buying foreign stocks can be an expensive exercise in form-filling but if I want to diversify my portfolio by investing in international markets, spread betting might be the answer. I get instant and cheap access to thousands of foreign stocks giving me opportunities from American Express to Zhaojin Mining…

3. Sector selector

Sometimes you have an investment idea based on your perception of social or fiscal trends but you are not sure which company is going to benefit from it. For instance, you might think that military spending by governments is going to continue to rise and defence stocks are traditionally solid performers in a recession.

So which stock should you buy? BAE Systems? QinetiQ? Smiths Industries?

You can do lots of research to find out which one is most likely to benefit from increased military spending but do you really feel qualified to gauge whether one company's military communications technology is better than another's?

Save yourself the effort and just buy the whole UK defence sector, and if there are one or two companies in that sector you don't much like the look of, take the down bet on those stocks.

4. Russia crusher

There's nothing to stop you taking a view on a whole country's stock market, either. Not so long ago, Russia was flying high on the strength of soaring oil prices and a huge population that was in a hurry to catch up with the West. But then, Russian stock market indices started falling faster than the temperature on a winter night in Moscow.

You can participate in the wild ride from the comfort of your office without ever having to learn a word of a foreign language. You can do so without having to worry about liquidity problems; can you say the same thing about those shares you bought in some dodgy potato vodka company in a weak moment last Christmas?

Summary

Spread betting offers a range of options to diversify and hedge long term positions. So here you have it. Four new baskets for all those eggs!

Why investors need the best research tools

by Emily Trant and Richard Leader

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Emily and Richard are members of the DigitalLook.com Investment Club and have been putting a few of the research tools through their paces on DigitalLook.com

Why do investors need the best research tools for spread betting? Well why wouldn't you? Spread betting is not the same as taking a punt on the horses – it has its place in a balanced portfolio of wealth management. You wouldn't select a pension, buy a house or invest in an ISA based on gut instinct alone so why should spread betting be any different?

There's a wealth of different research tools and data on DigitalLook.com, from broker recommendations to streaming charts, from all the latest news to full fundamental data, and Level 2, DigitalLook.com provides a highly integrated research centre.

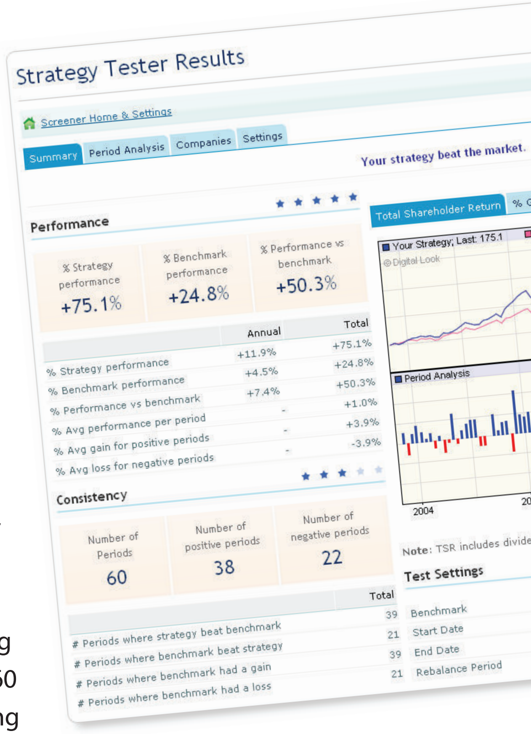
Stock Screener

Let's start with the Stock Screener – a powerful tool that enables you to enter your search criteria and find matching stocks. It's the daddy of all our research tools! The Screener enables us to look for stocks using a vast array of fundamental and technical data.

As an example, we plugged-in the data for a typical Value Investing screen (looking for a positive price change and EPS growth and for low P/E ratios and PEG), and found 9 companies currently meeting these tough criteria.

We can then investigate these 9 companies in more detail and start making some decisions about whether they would make good long term investments. Or, I can also look at whether this style of stock selection is suitable for a shorter-term horizon. To do this, we're going to test our criteria.

Back Tester



The Back Test facility takes our criteria and shows how the strategy would have worked had we applied it in the past. It assumes that every month we would have bought every stock that met our criteria and sold those that no longer did.

The test shows our strategy would have turned over a nifty 75% gain in the last 5 years.

But this means buying and selling 36 stocks a month on average – not very practical using a traditional broker.

However, with spread betting it's looking like a more decent strategy. In the last 60 months we would have had 38 winning months and 22 losing months. Even if we had stop loss and stop gains set up to be exactly equal, we still would have made a decent profit. But in reality we would have applied further analysis to run our gains and cut our losses, so could have done even better than the 75% gain.
Of course, as all the best investment guides say, past performance does not guarantee future results!

Like most investors with busy day jobs, we don't have time to watch the screen all day to determine the exact moment to trade. Instead, we place the trades we want with sensible stop losses, guaranteed stop losses and stop gains to lock in profits or cut any losses quickly.

Email alerts

We can save this Screen so we can see the results any time. This also gives us the flexibility to tweak the criteria if needs be. Next, we set up an email alert so when new companies trigger our criteria we can place a trade, or if companies no longer meet our criteria so we can take a view as to whether we need to exit.

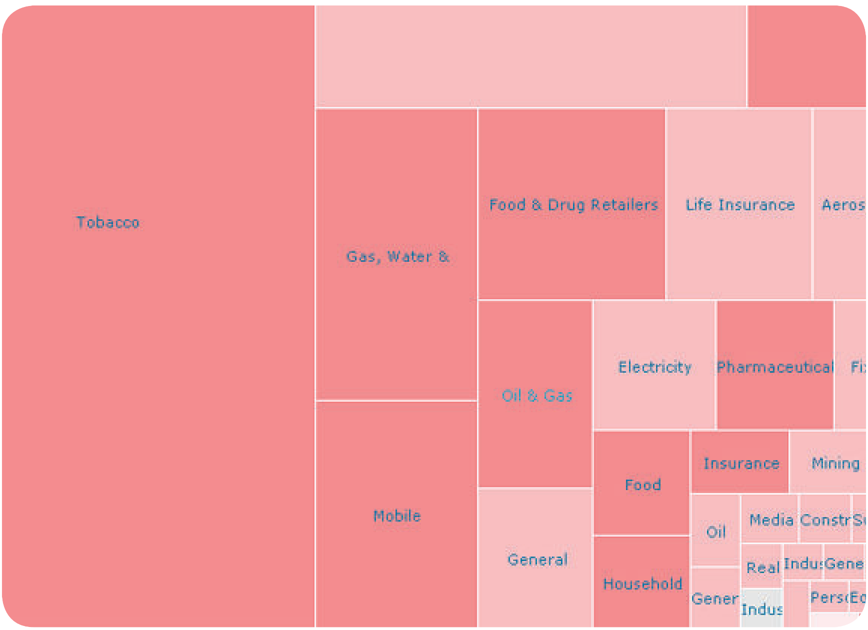
We can also set-up a Trigger Alert around the Buy or Sell price of any given stock.

Finally we'll monitor our performance and if it isn't living up to expectation we'll tweak the strategy and re-test it until we find one that works better for us.

The screener, back tester and alerts form just one part of the research centre. There's a whole other section on visual tools – incorporating heat maps, bar charts, scatter plots and our favourite, the market map.

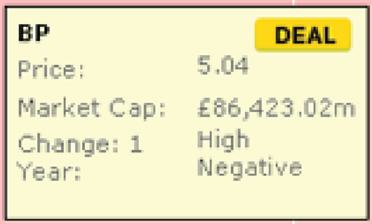
Market Maps

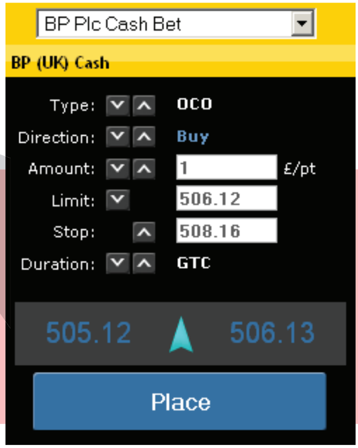
Market maps show what's happening in two different dimensions – here, the size of the box shows the average size of company by sector and the colour shows the share price performance over the last 30 days (you can define these criteria yourself). Not a good day on the markets as it happens. But not to worry – it



shows us opportunities to go short.

By clicking on a sector, we get to see the same data for the constituent companies – so let's look at Oil & Gas – a badly performing group of companies today (shown in dark red):





In this example, BP is showing a high negative trend over the last 30 days – we can enter a trade directly from here, or we can click in the box to read more about BP and see all its data.

We can change all the data points directly from here – we can look at broker recommendations, trade volumes or indeed some 200 different criteria.

We could go on about using the whole suite of tools on DigitalLook.com but really it boils down to two approaches:

1. Applying your strategy to a screening tool and looking for opportunities with specific characteristics

2. Using the visual tools to browse the market and look for shorter term trends you can take advantage of with the low cost of spread betting

Personally we like to do a bit of both. There are opportunities for profit in any market conditions and we like to think that with the right tools you can find those opportunities faster than the other guy or gal.

Inside you'll discover:

- Why would investors spread bet?
- Spread betting winners vs losers – by Malcolm Pryor, author of The Financial Spread Betting Handbook
- What every investor needs to know about Technical Analysis
- The story of a new trader
- How to use spread betting to diversify your portfolio
- Why investors need the best research tools

Useful links

- www.DigitalLook.com/spread_betting
  Further spread betting information and our education guide

- www.DigitalLook.com/events
  Educational events including free seminars and webinars

Find out more at www.DigitalLook.com

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