How to Trade Oil for Beginners

By Matthew Corica

Market trading opportunities are now available, for small investors that were once only considered the domain of large institutional or sophisticated commodity speculators. The most profitable trading that I have experienced, for my clients, over the last two years is from the Crude Oil market due to the substantial rise and subsequent fall resulting in some spectacular profits over this short investment period.

The Crude Oil market can be traded by using futures or CFD contracts. The standard futures contract, for Crude Oil is 1000 barrels (42,000 gallons) in size and is valued at $10 USD per one tick move, with the tick size being 1 cent. For example, if the Crude Oil was to move from $65.00 to $66.00 on a long position then that would result in a $1000 USD profit to the trader. If you wish to trade a smaller version of the standard Crude Oil contract, then there are MINI CFD contracts available that cover 500 barrels of oil instead of the standard 1000 barrels. The MINI CFD is half the contract specifications of the main contract and will expose you to only half the margin rate and risk. CFD stands for Contract for Difference, which means that there is a profit or loss based on the difference between buying and selling prices, and it is an agreement to pay or receive a price difference.

Crude Oil futures can give the trader the ability to quickly buy or sell without delay in a highly liquid and regulated market. A futures contract is used to buy or sell a fixed quantity and quality of an underlying commodity, at a fixed date and price in the future. Futures contracts can be broken by simply offsetting the transaction. For example, if you buy one futures contract to open then you simply sell one futures contract to close that market position.

The current margin to hold the main contract is around $10,000 AUD at present. The leverage of the main contract is currently, for example, the equivalent of trading a $65,000 USD ($80,000 AUD approx.) position per contract in the Crude Oil market. The margin is basically a deposit, and is the amount of money that is required to open a buy or sell position.

The trader gains leverage by taking positions using margin, and there is no cost in interest payments because futures are standardised exchange traded contracts, unlike direct equity ownership of physical shares. The main trading hours are from 9:00 AM until 2:30 PM, and the electronic session is from 6:00 PM until 5:15 PM via the CME Globex trading platform, Sunday through Friday. There is a break from 5:15 PM until 6:00 PM of 45 minutes between trading days. The trading hours are based on New York time, and the market can be access using any licensed Australian on-line or full service futures and CFD broker. Most trend following trades are placed during the day with an Australian broker and then executed when the market opens in New York at Market-on-Open or at a prearranged limit price.

The advantage of trading Crude Oil is that our clients benefit from the down-side by selling the market short. Short-selling is the ability to legally sell the futures contract creating an open position in the expectation to buy-back at a later time to profit from a fall in the market price. We issued recommendations to short-sell the market, taking advantage of the down-side movement, on several occasions from August 2008 to January 2009, and prior to that we recommended to our clients long-buy positions to trade the up-side of the market from October 2007 to July 2008. I based all my recommendations on our proprietary mechanical trend following strategy that is designed to detect and document all these trading opportunities.

I have found from years of testing and trading that a 20-day break-out signal works particularly well as an entry indicator, for trading Crude Oil futures. If developing trading strategies, then significant consideration must be placed on the entry, but even more so there should be predefined techniques in place for position exits, and a correct method of calculating the leverage per trade based on current market volatility. If leverage is not correctly calculated, then the trader runs the risk of taking a hit on trading capital.

The calculation of the correct leverage per position is the most over-looked component of trading, and is usually the main reason why most self traders lose big after a profitable streak. Surprisingly, this calculation is very simple and determines the correct leverage by lot-sizing (number of contracts) based on the current trading account balance and market volatility. Real trading is a science, not an art, and you have to lose to win. The old saying "you must lose to win" is from the hard reality that real trading is based on statistical analysis, and that you must suffer small losses to benefit from larger profits, that is, if you wish to consistently make money with a successful trading strategy because there is no such thing as a strategy that makes money on ever single trade. The rules based trading strategy, that we designed, automates the complete process of trading the Crude Oil market taking every contingency into consideration.

Every day, trend followers take calculated risks and trade the Crude Oil futures market, and those individuals that do the work can substantially profit from this highly liquid market. If you have been struggling with the current share market conditions, then now is the time to start learning and becoming involved in the commodity markets. The Crude Oil market will always produce trends at different stages, and with the abundance of trading activity available there is no reason to exclusively trade shares when there are potential leveraged gains from trading the direct movements in price via commodity futures or CFD contracts.

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