The Path to PROFITS

By Matthew Corica

Investors have never had a better time to take advantage of the excellent trading opportunities now developing in the current financial climate. Existing share market investors or even people new to the financial markets can potentially profit from recurring market trends by trading commodity and financial futures. The Australian futures market was originally established in 1960 and now provides benchmark financial contracts such as the SPI 200 Index.

A futures contract is an exchangeable standardised contract, traded on a regulated exchange, and used to buy or sell a fixed quantity and quality of an underlying commodity or financial instrument, at a certain date 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 sell one futures contract to close that market position.

The biggest advantage and easiest method available currently for private investors is the ability to legally short-sell indexes such as the SPI 200. The overall market can be traded by using the SPI 200 futures contact, which is the derivative of the S&P/ASX 200 Stock Market Index, and is the equivalent of a balanced portfolio over the top 200 Australian shares. The SPI 200 contract tracks the ASX 200 and is worth $25 per one point move to the trader. This means that trading opportunities exist for long or short term traders with the same risk as if you owned a basket of the underlying shares.

Short-selling is the ability to sell the SPI 200 Index creating an open position in the expectation to buy-back at a later time to profit from a fall in the market. The short-selling of index futures is legal and necessary for the markets to function correctly as it creates liquidity and a fair market environment. Short-selling can be utilised by private investors and is not the domain of institutions or professionals.

The biggest myth concerning the futures markets is that someone is always saying “trading futures is too risky”, but they neglect the simple concept that there is “no reward without risk” and that trading shares, if not managed correctly, usually involves more risk in some circumstances. From my experience, the people who make these statements refuse to learn about and have never traded a futures contract, while usually remaining on the wrong side of physical shares during bad economic times in the hope of a recovery. I have seen too many self traders lose money or give up investing altogether because they do not have the knowledge to take advantage of both rising and falling trends, or to simply hedge their existing share market portfolio during bad economic times.

The most effective way to trade the futures markets is by using back-tested mechanical trading strategies to determine what the best trading methods are over the long-term. Mechanical trading removes illogical decisions based on emotions. Most people new to financial markets that I have talk to believe a mechanical strategy is simply a technical rule determining when to enter a trade, which is an incorrect and financially dangerous methodology. If you use a mechanical based strategy, then every aspect of trading must be simulated before trading live money. The strategy must be fully automated and the rules should cover entry, exit, position sizing, stop-losses, early exits and any other possible outcomes. If you can successfully develop a complete rule based trading strategy that works, then you can master the financial markets.

The best means to produce long-term success is by developing trend following based mechanical trading strategies. I have personally developed strategies that have produced annual returns from 20% to 60% compounded in markets such as Crude Light (OIL) and High-Grade Copper. These strategies are discovered by back-testing or simulating the trading criteria of a mechanical based theory without risking large amounts of money during the discovery process. I have developed my own proprietary computer software for back-testing commodities and financial futures. If you have no experience writing computer software and wish to develop your own mechanical strategies, then you can either learn how to write computer code or you can simply paper-trade to test your own ideas. I have tested the Crude Light (Oil) and High-Grade Copper markets to be able to give you an example of the potential returns, for a commodity based trend following strategy. I found by using an established strategy from January 2008 to December 2008 that trend following would have produced a 143% increase in trading capital from Crude Light (Oil) and 94% from High-Grade Copper.

The biggest problem that I have seen with most self traders is they do not have the patience to stay with a sound trading strategy, which is why they usually never benefit from market trends. Patience is the key to being a successful trader because the lack of a complete mechanical trading strategy and the desire to "make it quick" is always the down fall of a new trader who then usually walks away bitter, broke and no better for the experience. The desire to make your fortune quick instead of one step at a time is the fastest way to transfer your wealth to someone else that has practiced patience and sound trading techniques.

If you have ever had the desire to trade indexes, currencies, financials, interest rates or commodities then now is the best time to start learning and getting involved with the markets. Futures markets will always experience rising or falling trends, and with an abundance of free information available on the web there is no reason for any investor to exclusively trade the share market when there are better alternatives and opportunities to make profits in rising, or more importantly falling markets.

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