How to invest in global stocks through CFDs

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There are many ways to gain exposure to global stocks: you can buy a managed fund, an exchange traded fund or, increasingly, just buy the stocks yourself through an internationally connected broker. But you could also consider a contracts for difference (CFD) platform.

CFDs allow you to make heavily leveraged investments that give you exposure to a share, an index, a commodity, a currency and more or less any other investment class you can think of.

Because of the leverage they allow, they come with something of a reputation for risk and are often associated with semi-professional day traders. But used carefully they can be an effective method of gaining international exposure.

Key points

- CFDs allow you to invest in individual international shares as well as global indices
- The margin requirement will vary depending upon the size and liquidity of the company
- Don't invest more than 2pc of your trading capital on a single position
- You must consider future movements in the value of the Australian dollar and putting a hedging policy in place

Most of the bigger CFD platforms offer international shares in one form or another, as well as access to stock indices. For example, IG Markets covers 16 international exchanges, including Australia. And since one of those is global markets operator Euronext, you can trade stocks from dozens of countries.

CMC Markets offers hundreds of stocks in the United States, Britain and various European and Asian exchanges, while MF Global offers all FTSE companies with a market capitalisation of greater than £50 million, alongside stocks within the S&P 500, Nasdaq-100 and various other exchanges.

City Index offers access to exchanges including the London Stock Exchange, the Nasdaq and the Hong Kong Stock Exchange.

A question of leverage

CFDs provide a greater degree of leverage than is possible with any other method of share trading – far higher than margin loans, for example. But the precise amount varies. "The leverage depends on the stock," says IG Markets' Chris Weston. "We look at the liquidity, the market cap, the volatility within the stock, and assess exactly how much margin we're going to offer." However, whereas Australian banks can trade on a margin as low as 5 per cent – meaning 20 times leverage – it would be unusual to be granted such freedom on an international stock.

"Share CFDs can range from 5 to 50 or more per cent as a margin requirement, depending on the size and liquidity of the company," says David Land at CMC Markets.

Clearly, a stock such as GE or Pepsi will be closer to the 5 per cent end, while a smaller US stock, or perhaps one listed on a less liquid market in Asia, will be closer to the 50.

Many of those who invest through CFDs use what is known as a stop-loss – if a position falls by a predetermined amount, the platform exits the trade automatically to limit your losses. This is regarded as prudent risk management but also has an impact on the margin allowed.

"If you were investing in a stock for which we would allow a 25 per cent margin normally, if you then do a guaranteed stop-loss, because you're taking less risk we'll give you more margin," Weston says.

"We might bring it up to 15 per cent or 10 per cent. So by putting guaranteed stop-losses on the trade you can leverage up."

CFD providers say that there are a number of advantages to using their services. "If you look at the UK and US, you can trade multiple exchanges," Weston says.

"In the UK there are four or five exchanges you can trade. Our platform will take the best bid and offer from each individual exchange and put that into one ticket."

Increasingly, stocks appear on more than one exchange too.

"If you're trading you don't care which index you are trading from," he says. "You need to know the best bid and price from any of those exchanges."

Don't forget the currency

For anybody considering buying international stocks, the performance of the currency is an issue. B ut generally speaking if you buy a stock in the US and it goes up, that's great – unless the Aussie has risen against the US dollar by even more, in which case you'll lose money despite buying a winning share.

"There are a number of factors to consider in investing offshore, and currency risk is one of them," Weston says. "You need to bear in mind what's going to happen with the domestic currency. If you think the Australian dollar is going to appreciate as well, you'll probably want to put some hedging policy in place."

Weston says the most popular venues for international share investing through CFDs are Britain and US. "The reason Australian investors like the UK is that there are stocks there they have a relationship with: BHP, Rio," he says.

The UK is arguably a friendlier time zone for Australia-based investors if they want to be hands-on and active, he says.

An Australian wanting to trade in New York generally has to stay up until midnight to do so. IG Markets also sees some activity in Japan and Hong Kong.

Land also mentions the US and UK, but adds: "One area we've done a lot of work in is the Hong Kong market. It's proven to be quite a popular area for people who focus their energies on technical set-ups."

Hong Kong appeals to technical traders because it's liquid but also in the same time zone as Australia; the same applies to a certain degree to Japan.

Another advantage of CFDs is cost. When you buy a UK share through IG Markets, the commission is 0.1per cent, and for Japanese shares 0.2 per cent. Going through a physical broker is far more costly.

Brokers argue the CFD investor never actually owns the share, instead just getting exposure to it, which is not the same thing. Weston agrees this is true but says investors can trade through direct market access, meaning the trade does go through the physical market.

"You don't take ownership of the physical stock but we guarantee the trade and hedge against it."

Riding the index

Indices are popular for CFD investors venturing overseas. They offer leveraged exposure to an entire market, providing a more diversified position than leveraging into a single share.

"Rather than trading a specific share through CFDs, many people like the ability to trade the index," Land says.

"That could be one of several indices available in the US, while regional markets like Hong Kong are very popular to trade, as is the UK. It allows you to take exposures on the wider market rather than the risk of specific shares."

Weston sees the same trend. "There's huge interest in Australian clients trading the FTSE but also the DAX [Germany], CAC [France] and the Dow futures as well," he says.

A twist on the index theme is the increasing prominence of exchange traded funds on leveraged platforms. Already commonplace on margin-lending menus, ETFs are increasingly appearing on CFD lists, too.

This can have some useful effects. iShares, for example, offers indices that may not otherwise be available on CFD platforms, while City Index offers an ETF that tracks the Chinese markets. Leveraging into an ETF is a lot like leveraging into an index: there's diversified exposure with one investment.

It stands to reason that investors should prefer index investments when they go global.

After all, that's how they tend to use CFDs at home.

When the research group Investment Trends released its findings on the Australian CFD market in 2010, some 52 per cent of investors said they traded CFDs over Australian indices and 27 per cent said their last trade was over an index.

That's a global theme, too. "The trend towards indices is consistent with what we observe in our UK CFD research," Mark Johnston, principal of Investment Trends, said when the report was released.

Keeping risk in hand

For anyone using CFDs, risk management is key. "There are two big things we look at in educating people on managing risk," Land says. The first is using a stop-loss – and using it properly.

"One thing people have to be aware of is looking at their entry point, their stop-loss point and their overall position size, and determining how much risk that puts them in."

Land feels that on any individual position a person should risk no more than 2 per cent of their overall trading capital. "It's not just a matter of having a stop-loss," he says. "That's very important, but it's also about having a position size where, if you do get stopped out of a trade, it leaves you with a loss that's only a small percentage of your capital."

The other is limiting the amount of leverage people apply to their total capital. "This might mean that, if I had $10,000 in trading capital, I wouldn't want to lever myself by more than three times," Land says. "I wouldn't take on any more positions once I'd got to a maximum of $30,000 exposure to the markets.

"It's balancing your position risk by the use of stop-losses and sensible position sizes, but also covering total exposure to the market by controlling the amount of leverage you hold in total. Those two concepts are the real keys of managing trader risk."

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