EXAMPLE 1: BULLISH - LONG CALL

MARKET SCENARIO

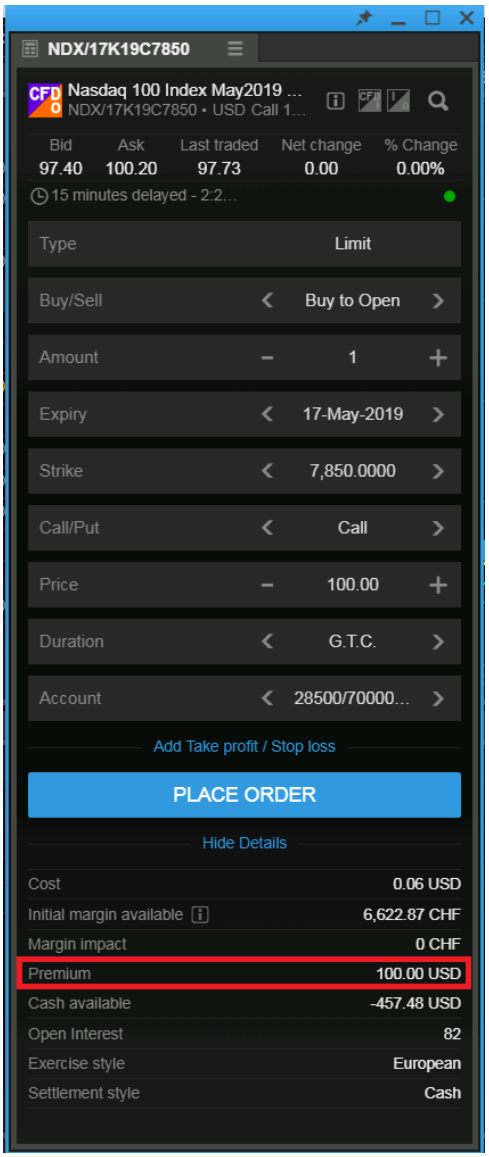
Nasdaq is trading at 7,805 around the all-time high.
Our view is that Nasdaq will continue to trade higher, however in 3 days the American Q1 GDP will be announced. Since these are important economic data, opening a long index position via CFD or Future at the highest price would carry a high risk: in fact in case of a negative release, there could be a correction in the market. Therefore, it might be safer to apply a bullish strategy using a Call option.

CFD Options play the best role in this situation because you can benefit from rising markets with limited risk. Options are ideal for a scenario of uncertainties where volatility is expected.

The below chart shows the bullish market trend where the old all-time highs of 2018 have been taken off. However, the first good support of the bullish trend is around 7,541 (the 26 days exponential moving average).

TRADING WITH CFD OPTIONS

The first step is to select a strike and an expiry.
As an example, we choose the next expiry “Nasdaq 100 Index May2019” Call option and we fill out the trade ticket with amount 1, expiry May 17th, 2019 strike 7,850, type Call, price 100 and duration of the order good till cancel (GTC).
The current market price is $100, which corresponds to our premium paid since our amount is only 1 option.



The **breakeven point** at expiry of the position will be 7,950, calculated as follow:

Strike price of the Call + Premium Paid.

SCENARIO 1 – ITM Option

Let's assume that the day of the expiry the Nasdaq index closes at 8,130[1].
In this case, the purchased call option is expiring in the money (ITM) and therefore a profit will be credited into the account.
The **total profit** will be calculated as follows:

(Closing price of Nasdaq – Strike price of the Call) x amount
(8,130 -7,850) x 1 = $280

[1]4.16% higher than the price at the moment we buy the out of the money (OTM) option

To determine the **net profit** from this bullish strategy, we must deduct from the total profit the premium paid: $280 - $100 = $180

The **return on investment (ROI)** will be 180%, calculated as (Profit/Premium paid) * 100: ($180 / 100) *100

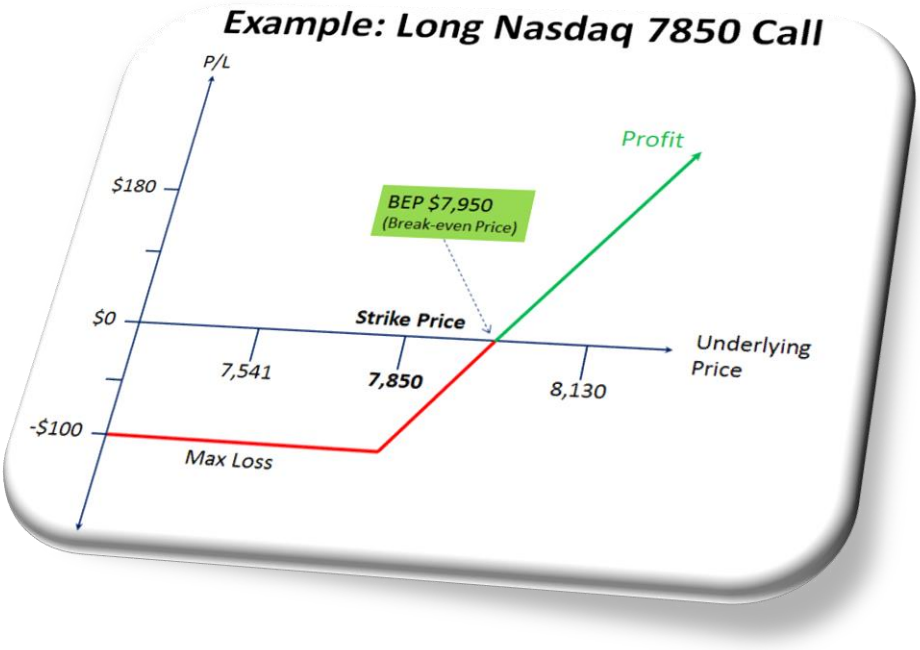
If you had bought the CFD index instead of trading the CFD options, the profit would have been $325[2], greater than the option. However, the ROI in proportion would have been lower (only 166%[3]) and the risk higher.

Note: if the market moves up before the expiry, the CFD option can be sold by squaring the position. If the option still has a market value, it can be traded at any time before the expiry.
In fact, the original price of the option ($100) is changing constantly, i.e. if it moves to 210, we can sell the open position and close the option. The squared positions disappear from the account and we receive $210[4].

SCENARIO 2 – OTM Option

Now let's assume our assumption was wrong and that instead of going up, the market closes on May 17th below the strike, at 7,541[5] (the price of the support, represented by the 26 days EMA shown in green at the top of the chart).

With the long Call CFD option the maximum loss is limited to the premium paid of $100.
If we were long of the CFD on the future Index, the loss would have been $264[6] instead, therefore higher.



[2] (Price of the Nasdaq index at expiry – price at the opening) x amount: 8130 - 7805
[3] Profit/Initial margin x 100. Initial margin requirement for Nasdaq CFD index is currently 2,5%, therefore: (325 / 195) x 100 = 166%
[4] Net profit of $110 (difference between opening and closing price).
[5] 3.38% below the price at the moment we buy the out of the money (OTM) option
[6] End price - Price of Nasdaq index at the moment I wanted to trade (as displayed in the chart) = (7,541 – 7,805) = $264.

EXAMPLE 2: BEARISH - LONG PUT

MARKET SCENARIO

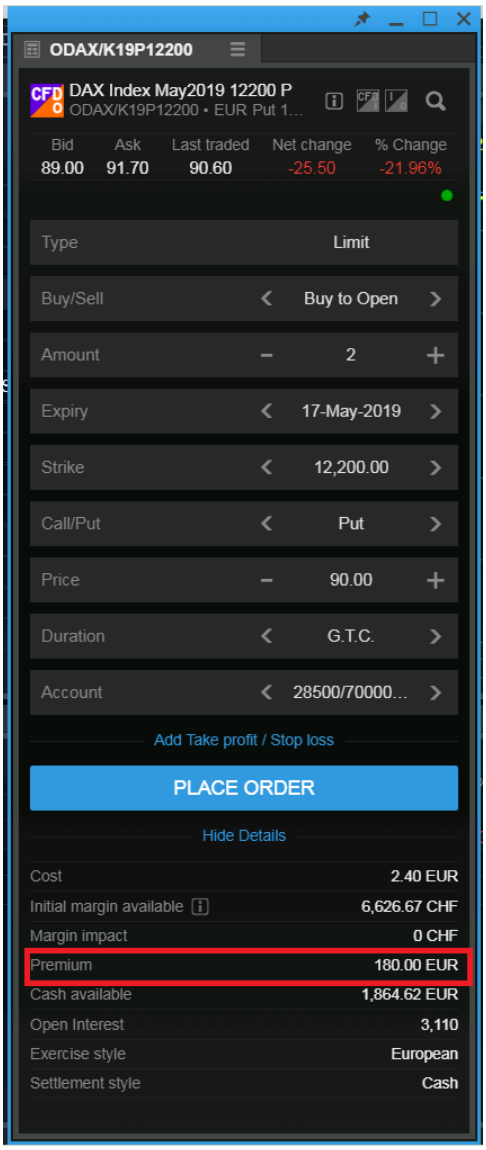
DAX index is trading at a double top around 12,253 and, therefore, there is a chance of a correction towards the moving average at 11,887. However, the indicators are still showing a bullish trend.
To limit the cost of being on the wrong side of the market, but still want to invest in a bearish strategy, we can buy a Put option.

With a long Put strategy you can benefit from falling markets with a limited risk.

TRADING WITH CFD OPTIONS

First we select a strike and an expiry.
The following picture shows the simple trade ticket that needs to be filled out with the amount[7], expiry, strike, type Put, price and duration of the order.
In our example, we choose the “DAX May 2019” PUT option with strike at 12,200, expiry May 17th, 2019 and a current market price of 90. As the amount we select 2 x index.
Therefore our cost to enter in this bearish strategy with CFD option will be €180[8].

[7] Minimum amount is 1, equal to 1 x index, while increments are multiple of 1; this constitute an advantage compared to the listed options in EUREX where the DAX size is 5 x index and increments of 5 x index as well.
[8] Since we buy 2 options, we have to multiply the cost of €90 x 2.



The **breakeven point** at expiry of the position will be 12,110, calculated with the following formula:

Strike price of the Put – Premium paid[9].

SCENARIO 1 – ITM Option

Let's assume the day of the expiry, the DAX index closes at 11,850[10] (just below the 26 days EMA, shown in green on the above chart 1).
In this case the purchased Put option is expiring in the money (ITM) and, therefore, the profit will be credited into the account.

The **total profit** will be calculated as follows:

(Strike price of the Put - Closing price of Dax) x amount.
(12,200 – 11,850) x 2 = €700

[9] Per contract. In numbers: 12,220 – 90 = 12,110. Any extra point traded below 12,110 is net profit, and needs to be multiply by the amount (2 in our example).
[10] 3.28% below the price at the moment we buy the out of the money (OTM) option.

To determine the **net profit** from this bullish strategy, we must deduct from the total profit the premium paid: €700 – €180 = 520

The **return on investment (ROI)** will be 288%, calculated as Profit/Premium paid x 100: (€520 / €180) * 100.

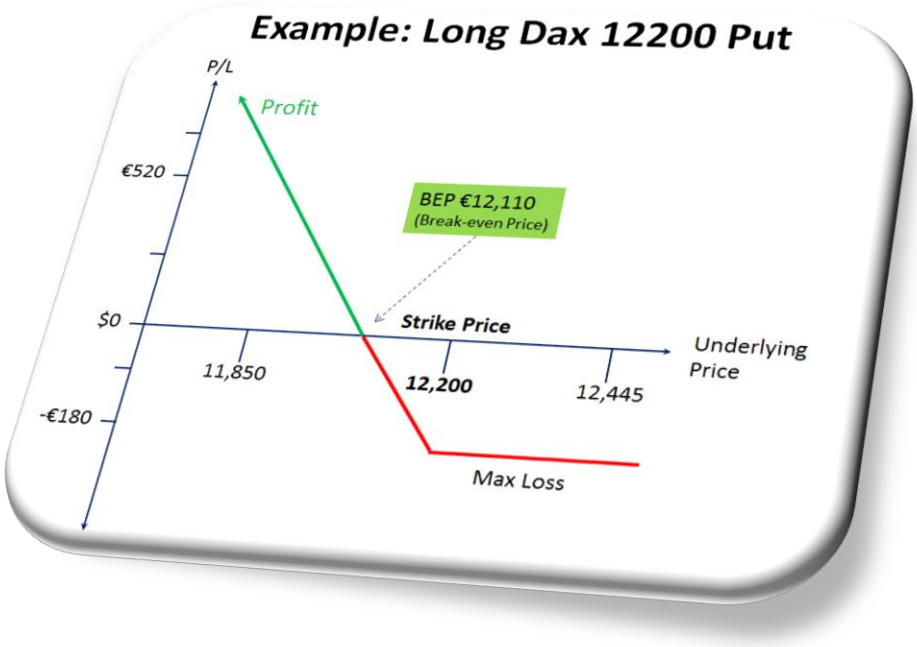
If we had sold the 2 CFDs index instead of trading via CFD options, the profit would have been €806[11], greater than the option. However, the ROI would have been only 82%[12] and the risk higher.

Note: if the market moves down before the expiry, the CFD option can be sold by squaring the position. If the option still has a market value, it can be traded at any time before the expiry.
In fact the original price of the option (€ 90) is changing constantly: i.e. if it moves to 170, we can sell the open position and close the option. The squared positions disappear from the account and we receive €340[13] in cash.

SCENARIO 2 – OTM Option

Now let's assume the client assumption was wrong and that instead of going down, the market closes on the May 17th above the strike, at 12,445[14].

With the long Put CFD on option, the maximum loss is limited to the paid premium of €180.
If we were short with the CFD Future Index, the loss would have been €384[15], therefore higher.



[11] Formula is the same as the one for the profit, without considering the premium as nothing would have been paid: (market price of the Dax CFD index at the moment – closing price of the expiry) and (12,253 – 11,850) x 2 = €806.
[12] Current Dax CFD index margin requirement is 4%, therefore €980 (for 2 CFDs).
[13] New price of the option x amount = €170 * 2. The net profit will be €160, as the option premium paid was 180, while we received €340 at the moment of the closing.
[14] 1.57% above the price at the moment we buy the out of the money (OTM) option.
[15] Opening price – closing price of the CFD index at the moment we wanted to trade (see price in the chart).
(12,253 – 12,445) x 2 = - €384