



NISER
National Institute For Socio-
Economic & Environmental Research



Index Trading Strategies

I recently wrote about explaining Contracts For Difference.

The current trading environment is certainly an interesting place and it is times like these where traders with a trading plan, utilising solid techniques and logical strategies survive when others don't. When individual stocks become overly volatile and liquidity becomes an issue, it is often useful to look at trading the whole market or particular sectors within the market. To trade the whole Australian share market, you can gain exposure to the S&P/ASX 200 Index. This index measures the performance of the 200 largest index-eligible stocks listed on the ASX.

A stock's weight in an index is determined by the float-adjusted market capitalisation of the stock. The float adjustment removes controlling and strategic shareholdings from the market capitalisation calculation to ensure that only the portion of the company's float that is truly available to investors is included in the index calculation. Also, stocks in the index must have enough trading activity to meet certain liquidity thresholds to ensure that funds tracking the index can buy and sell index constituents relatively easily.

A number of strategies can be applied revolving around the index and combining individual stocks or market sectors within it.

Using Contracts for Difference (CFDs), a trader can gain leveraged exposure to the Australian 200 index by trading the Australia 200 Cash Contract. Despite the shorting ban, traders are still able to short sell this contract utilising a number of effective strategies.

Hedging

The Australia 200 cash contract is a quick, cheap and efficient way to hedge an existing share portfolio in times of market volatility.

Example;

Let's presume an investor held a balanced share portfolio valued at \$250,000 on the 30th October. The index was trading around 4500. To cover a \$250,000 balanced share portfolio, the trader could have short sold two (2) Australia 200 cash contracts. This would have a face value of \$225,000, so although not a perfect hedge, it provides



NISER
National Institute For Socio-
Economic & Environmental Research

P: + 61 7 5442 5050 F: + 61 7 5442 5060
E: niser@niser.org.au W: www.niser.org.au
49 Maple St Corroy QLD 4563 Australia



NISER

National Institute For Socio-Economic & Environmental Research

NSX
THE NATIONAL STOCK
EXCHANGE OF AUSTRALIA



protection. Since then the index has dropped to 3900, some 600 points. The trader's share portfolio would have suffered a loss while the short position on the index would have generated a profit of \$30,000. The capital requirement to take the short positions would have been \$10,000.



This is designed to be a market neutral strategy. Alternatively, if you just wanted to reduce a proportion of your exposure in the market, you could short the index to an equivalent of 50% of your share exposure.

Moving forward, the recent low set in October may be another level to watch. A break of this may see a further move the 3500 level. To protect your portfolio you may want to hedge your position should the index fall below 3700, with the view that the index could fall another 200 points before finding support.



NISER

National Institute For Socio-Economic & Environmental Research

P: + 61 7 5442 5050 F: + 61 7 5442 5060
E: niser@niser.org.au W: www.niser.org.au
49 Maple St Corroy QLD 4563 Australia



NISER
National Institute For Socio-
Economic & Environmental Research

NSX
THE NATIONAL STOCK
EXCHANGE OF AUSTRALIA



Index Tilting

This strategy can be applied when a trader has a bias towards a particular sector or area within a market. For instance, if the trader believes that the Australian market is oversold, they can buy the entire market through an index CFD. If the trader is more bullish on the materials sector for instance, they can buy an additional contract in the materials sector effectively tilting the index towards materials.

Index/sector stripping

Index stripping builds on the idea presented above and can be applied when you have the belief that the index will rise but a particular sector or sectors within the index will under perform the broader market. The trader buys the Australian 200 index and may sell the Health Care sector for instance. This strategy can be applied to individual shares within a sector as well, for example if you are bullish on the consumer discretionary sector but feel that Pacific Brands is an over valued stock with little potential in the near term. You can buy the sector and short Pacific Brands.



NISER
National Institute For Socio-
Economic & Environmental Research

P: + 61 7 5442 5050 F: + 61 7 5442 5060
E: niser@niser.org.au W: www.niser.org.au
49 Maple St Corroy QLD 4563 Australia



NISER
National Institute For Socio-
Economic & Environmental Research



A bear market like this presents many opportunities, the most significant of which is the impetus to look at alternate strategies, to learn new techniques and improve your knowledge in the markets. In a bear market it is important to have at least some protection on the downside This will enhances performance over the long term, despite the short term pain that you may be experiencing.

*Please note that the strategies outlined above have not been explained in detail and do require a certain amount of experience or assistance.

MDS Financial maintains offices in Sydney, Melbourne and the Gold Coast. NISER can assist local businesses or individuals, please contact them. Sean Rothsey is Executive Chairman of the ASX listed diversified financial services company MDS Financial Group Ltd. (MWS: ASX). He works in Cooroy and lives in Sunshine Beach.

If you would like to discuss these issues further please contact Sean Rothsey at niser@niser.org.au or 5442 5050 or your own financial advisor or visit www.mdsfinancial.com.au

I collated this for your information from The Cube Financial Group Pty Ltd AFSL 232455 ("Cube Financial") a subsidiary of MDS Financial Group Limited with the following disclaimer: This information is prepared for the general information of traders and investors. The information does not take into consideration the specific needs, investment objectives or financial situations of any person. Any individual reading this should discuss, with their financial planner or advisor, the merits of any recommendation or offer presented in this material for their own specific circumstances and realise that not all investments are appropriate for every individual.



NISER
National Institute For Socio-
Economic & Environmental Research

P: + 61 7 5442 5050 F: + 61 7 5442 5060
E: niser@niser.org.au W: www.niser.org.au
49 Maple St Corroy QLD 4563 Australia