Part 4:

Advantages of Trading Futures

This is the fourth in a six-article series on how to trade futures, brought to you by Bursa Malaysia Derivatives Berhad (BMD) and OSK Investment Bank Berhad, in conjunction with BMD's 'Talk Futures' campaign aimed at creating awareness and educating investors on derivatives trading.

It can be said that futures trading holds many advantages. It is, for one, an alternative asset class. Investors do not need to be bogged down with individual stock analysis in equity markets as one usually trades a broad index of stocks.

With futures trading, investors can profit from commodities which historically have been non - correlated to equities. Most importantly, with this alternative asset class, investors can diversify their portfolio and readjust their risk appetite.

Another advantage of futures trading is the ability to trade all seasons. Unlike the stock market, futures market can be trades during bull as well as bear markets. With the advantage of trading all season, investors can then maximize their return. For example an investor can short sell the market in Futures. It is, in Malaysia, restricted to short the equity market thus making the stock market a one way profit; which means that investors can only profit if the market is on its way up.

However, in the futures market, investors are allowed to short the market thus making futures trading potentially more flexible.

Most importantly, futures trading can help to protect your portfolio and undermine certain price volatility that may move against your interest. During periods of market uncertainties, futures trading can be used to reduce risk for the investors with weaker risk appetite.

However, futures trading can also provide the investors with a better risk appetite an added advantage. Given the volatility of the market, investors who enjoy taking risks (speculators) can maximize their profit from the ups and downs of the market with very minimal trading cost.

One of the most distinct advantages in trading Futures is the ability to leverage. Leveraging allows the individual to control an asset of a greater value compared to their initial investment. When trading futures, you are required to post an initial margin and maintain it at a certain prescribed level.

To put it simply, margin is the amount of money that you need to put forward to hold a futures contract. For example if an investor deposited US$21600 into your margin account to purchase one silver futures contract, he is now controlling 5000oz. of silver which has a total value of US$200,000 (silver at US$40 x 5000oz.) with an initial margin of only US$21600.

Leveraging, as shown in the example above, enables an individual to use a small amount of capital (US$21600) to control a large amount of asset (US$200,000).

Trading Futures can be less time consuming than individual stocks. Considering that an individual can bet on an index, this is an advantage to most investors because they do not have to go through the trouble of stock picking or stock screening. Investors do not need to go through lengthy financial reports, or try to figure out company's P/E ratio. Trading Futures enables you to trade on the whole index and thus remove the hassle of picking 'cheap' and 'good' stocks to buy.

Another advantage of futures trading is its low transaction costs. Normally commission rates on Futures contract are lower than for the equivalent value say for equities. Now with the advent of online trading, commission rates are even lower. OSK Investment Bank has an online trading platform, which allows clients to execute orders themselves. No membership fees or setup charges are required to start an online account on the OSK188 Futures Web platform.