TRADING SIMPLY PODCAST

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Podcast # 2

Episode topic: What is spread betting?

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What is spread betting

Host(s): David Thomas

Introduction

Main content:
So ‘what is spread betting?’

Spread betting is a means by which I can trade UK listed companies. Now I have chosen only to trade UK listed companies. When in fact you can spread bet commodities such as wheat and you can spread bet oil, you can spread bet the price of gold, you can spread bet currency pairs, you can spread bet house prices, interest rates… there’s a whole host of financial markets that you can actually spread bet which is a bonus to spread betting actually because there’s a wide range of markets you can trade you don’t have to just trade UK listed companies like myself.

But, essential as I say, I have chosen to spread bet UK listed shares because that’s my area of expertise.

Now, I suppose the main difference between shares and spread betting is, with shares for example, if you wanted to buy shares in Tesco, say for example they were trading at £4 a share. And you wanted to buy 1 share (this is just an example), so you would need four pounds for your one share of Tesco, plus you’d need to pay your broker a commission for buying those shares on your behalf and placing them into your share trading account.

Commissions usually range between 10 and 20 pounds in the UK to buy and sell shares, but of course, you’d also need to pay a commission to your broker once you come to sell your shares. Say for example your 1 share of Tesco you bought at £4 rose over the next three days to £4.50 and you decided to take your profits on that, obviously when you sold it at £4.50 would make 50 pence, that would be your capital gain and also you would need to pay your broker a commission for selling those shares. Again the commissions range between 10 and 20 quid so let’s take the worse case scenario of those commissions. And that trade would have cost you 40 quid to make 50 pence so obviously that’s not economically viable, but again we’re just using an example.

With spread betting, those same Tesco shares valued at £4, I don’t need to give my spread betting provider £4 for each share of Tesco that I want to buy. I only need to stump up what is called margin. Now, margin is simply a name for the deposit you can say, that a spread betting provider require you to have to place a trade on any of their markets. So for example, if this margin rate or deposit was something like I don’t know 10%, then I would only need to actually give my spread betting provider 10% of the value of the trade that I wanted to place.

So for example if I wanted to buy my Tesco shares at £4 a share, I wouldn't have to stump up £4, I'd only need to stump up 10%, which is only 40 pence. So you can see immediately it's quite a cost effective way of trading because that then allows me to use the rest of that money in my account that I would have used buying just Tesco shares to look for other opportunities in the stock market to open more positions on other companies.

Now that's quite a simple description you could say of spread betting. There are other advantages to spread betting which I won't go through today. But I just wanted to make a quick podcast to explain basically what spread betting is. And as the name suggests actually, the spread betting providers in the UK come under the, I think it's the gambling or gaming commission legislation. So it means that any profits that you realise on any spread betting trades, they're free of CGT because with all gambling etc in the UK any winnings from such activities are free from CGT.

Now that's one advantage to spread betting over traditional share trading because with traditional share trading, you are charged CGT on any profits that you may realise.

Also, one other thing I did forget to mention about spread betting is that spread bet contracts only last for a certain amount of time. So for example, with shares you can be a holder of shares for a very long time indeed. Years in fact, so long as the company you hold shares in doesn't go bankrupt or the company is taken over by another company in which case you would have to get rid of your shares. But with spread betting, a spread bets last in periods of three months, so from January to March, from March to June, from June to September and from September to December.

They're the longest contracts, so they are three month contracts. So if you hold a spread bet open say at the beginning of March, that contract will expire at the end of March. So you'll have to buy a new contract in that company again once that contract has expired. But everything else remains the same.

It's more cost effective, there's no CGT to pay and no commission, oh which reminds me. You can tell I haven't made notes for this show at all but, it's a new format I'm working with anyway but I won't into that.

Yes speaking of commissions, there is no commission to pay when you spread bet. Instead, what you do pay is what is known as the spread hence the name spread betting which is where it comes from.

The spread is the difference between the buy and the sell price. In financial jargon, it's what is known as the bid and the ask price. Now in traditional share trading that's the kind of jargon that is used the bid and the ask. Now the ask price is the price at which you can buy shares at and the bid price is how much you would get if you come to sell those shares so in our Tesco example of £4 a share, you could get an ask price or a buy price for £4.01 and you could get a bid price or a sell price at £3.99.

Spread betting doesn't use that kind of jargon it uses simple language: a buy price and a sell price that's it. But anyway, onto the spread.

So that's what's known as the spread: the difference between the buy and the sell price and with a traditional stock broker, that's the spread you would normally see i.e. 401 to buy and 399 to sell.

If it was a spread betting provider it may be 402 to buy and 398 to sell. So you can see that is slightly wider than the stock market. It's slightly wider for a reason. The reason is so that spread betting providers can make money from the spreads that they quote you. That's how they make their money. They don't charge a commission, they charge an extra spread. As you can see, if you were to buy a spread bet in any company in any financial market whether it's a UK equity or a commodities or anything else, it would cost you slightly dearer. Only ever so slightly and it would cost you slightly more to sell as well. And that's where they make their money each side of the spread.

Different spread betting providers quote different spreads so. Some spread betting providers will have wider spreads than other spread betting providers. And it's your duty as a good customer and a good citizen to shop around and find the best spread betting provider in terms of spreads that you can find.

Some people have more than one spread betting account for this reason. So they can take advantage of the spread. But anyway, that is exactly how spread betting providers make money. And it's good to know because I would rather know how they do that than not because I'd be questioning whether or not they were trying to make money out of me in some other way but because I know how they do that then I'm perfectly happy with that.

That's it really. I hope this podcast helps you out with your trading and with your understanding of what spread betting is.

So for a quick recap of what we've explored today in regard to what is spread betting.

We can say that spread betting has slightly wider spreads than traditional share trading. We've also looked at how prices of spread bets on UK shares match the prices of the actual company in the stock market. And unlike traditional share trading, profits from spread betting are not subject to CGT under current UK tax law. I must make that clear because that can change at any time. One last thing I suppose I'd like to add is that spread betting firms are regulated under UK law by the Financial Services Authority.

Do remember that for in depth information on what is spread betting, you are able to download my free ebook called 'Understanding the Risks of Spread Betting UK Shares'. To do that, simply go to the blog at www.tradingsimply.com. On the front page to the right hand side in the side bar there's a subscription box if you complete that. You'll receive an email which will give you a link to a download page where you can download my free ebook.

That's all for today and we'll see you soon.

Cheers bye.