

Spread Trading

A Whole New Way To Trade

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Introduction: What is a Spread?

Spread trading in futures is as old as the hills, yet it is an entirely new concept for most current traders in futures. In this introductory piece, we will show you that spreads can be the most conservative, safest way to trade in the futures markets.

But first, what exactly is a spread?

A Spread Defined

A spread is defined as the **sale** of one or more futures contracts and the **purchase** of one or more offsetting futures contracts.

You can turn that around to say it the opposite way: "A spread is the **purchase** of one or more futures contracts and the **sale** of one or more offsetting futures contracts.

Either way you say it, it is a spread.

A “hedge”

A spread is also created when a trader owns (is long) the physical vehicle and offsets by selling (going short) futures. This kind of spread is called a “hedge” and is the reason for which futures markets were originally created.

Furthermore, a spread is defined as the purchase and sale of one or more offsetting futures contracts normally recognized as a spread by the fact that the two legs of the spread are actually related in some way.

“Related” markets explicitly excludes those exotic spreads put forth by some vendors, which are nothing more than computer generated coincidences, which are not in any way related.

Exotic spreads such as Long Bond futures and Short Bean Oil futures may show up as reliable computer generated spreads, but bean oil and bonds are not really related. Such spreads fall into the same category as believing the annual performance of the stock market is somehow related to the outcome of the Bolshoi Ballet.

In any case, for tactical reasons in carrying out a particular strategy, you want to end up being:

- Simultaneously long futures of one kind in one month, and short futures of the same kind in another month. (Intramarket Calendar Spread)
- Simultaneously long futures of one kind and short related futures of another kind. (Intermarket spread)
- Long futures at one exchange and short related futures at another exchange. (Inter-exchange Spread)
- Long or short an underlying physical commodity, and short or long a futures contract. (Hedge)
- Long or short an underlying equity position, and short or long a futures contract. (Hedge)
- Long or short financial instruments, and long or short financial futures. (Hedge)

The primary ways in which spread trading can be accomplished are:

- Via an Intramarket spread
- Via an Intermarket spread
- Via an Inter-exchange spread
- Via ownership of the underlying while simultaneously offsetting with a futures contract

Intramarket Spreads:

Officially, Intramarket spreads are created only as calendar spreads. You are long and short futures in the same market, but in different months. An example of an Intramarket spread is that you are Long July Corn and simultaneously Short December Corn.

Intermarket Spreads:

An Intermarket spread can be accomplished by going long futures in one market and short futures of the same month in another market. For example: Short May Wheat and Long May Soybeans.

Intermarket spreads can become calendar spreads by using long and short futures in different markets and in different months.

Inter-Exchange Spreads:

A less commonly known method of creating spreads is via the use of contracts in similar markets, but on different exchanges. These spreads can be calendar spreads using different months, or they can be spreads in which the same month is used.

Although the markets are similar, because the contracts occur on different exchanges they are able to be spread. An example of an Inter-exchange calendar spread would be simultaneously Long July Chicago Board of Trade (CBOT) Wheat, and Short an equal amount of May Kansas City Board of Trade (KCBOT) Wheat. An example of using the same month might be Long December CBOT Wheat and Short December KCBOT Wheat.

Why Spreads?

The rationale behind spread trading is one of the best-kept secrets of the insiders of the futures markets. While spreading is commonly done by the market “insiders,” much effort is made to conceal this technique and all of its benefits from “outsiders,” **you** and **me**. After all, why would the insiders want to give away their edge? By keeping **us** from knowing about spreading, they retain a distinct advantage. Spreading is one of the most conservative forms of trading. It is usually much safer than the trading of outright (naked) futures contracts.

Let's take a quick look at some of the benefits of using spreads:

- Intramarket spreads require considerably less margin, typically only around 25% - 75% of the margin needed for outright futures positions. Some spreads carry as much as a 95% discount to the margins required for outright futures.
- Intramarket spreads offer a far greater return on investment than is possible with outright futures positions. Why? Because you are posting less margin for the same amount of possible return.
- Spreads, in general, trend more often than outright futures. They also trade for longer periods of time because the trends are based on reality as opposed to market manipulation by insiders and market movers.

More benefits of using spreads:

- Spreads are often trending when outright futures are flat.
- Spreads can be filtered by virtue of seasonality, backwardation, and carrying charge differentials, in addition to any other filters you might be using in your trading.
- Spreads, much like options, can be used to create partial futures positions. In fact, many things that can be done with options on futures can be accomplished via spread trading.

More benefits of using spreads:

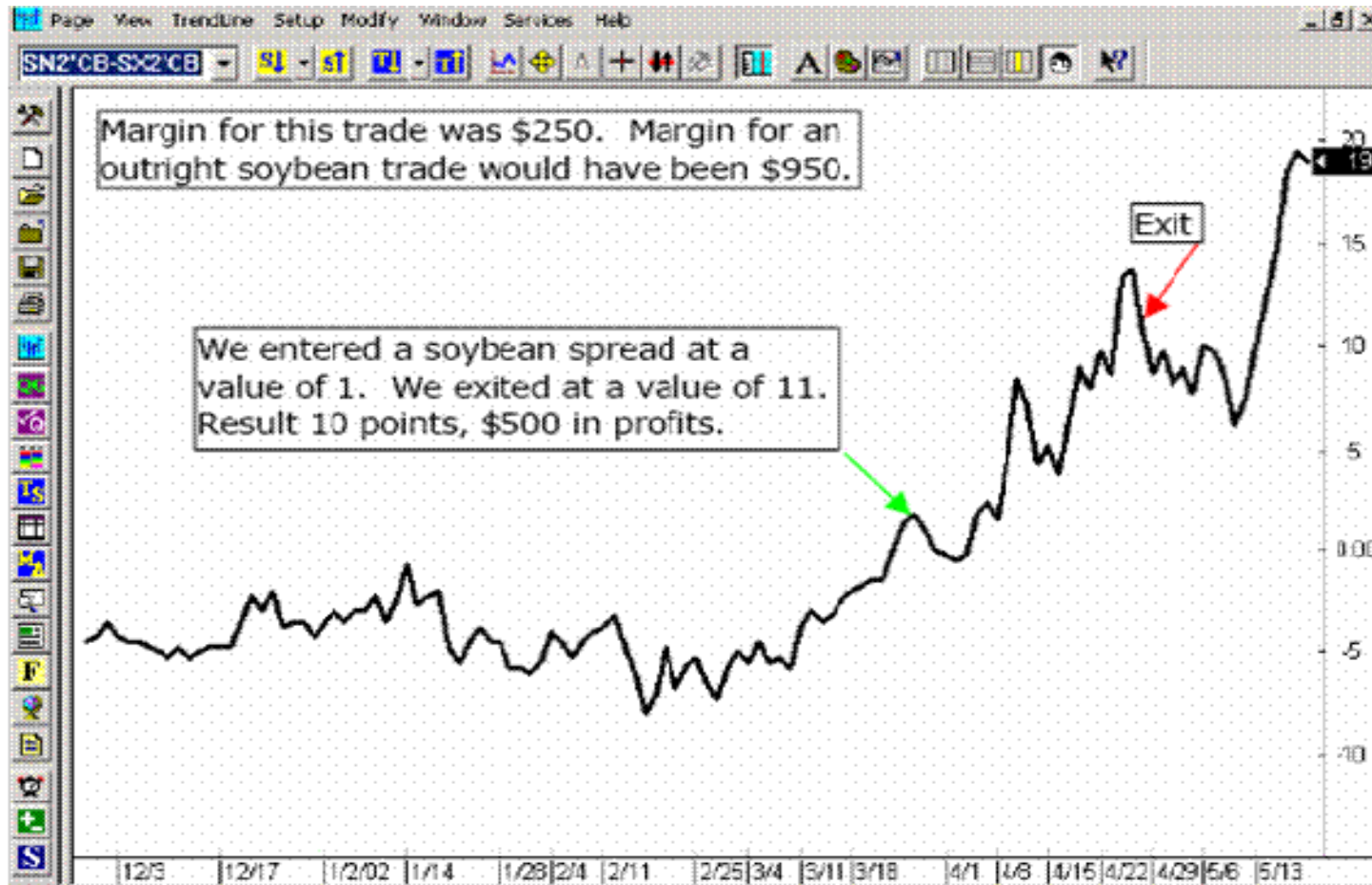
- Spreads allow you to take less risk than is available with outright futures positions. The amount of risk between two intramarket futures positions is usually less than the risk in an outright futures position. The risk between owning the underlying and holding a futures contract involves the least risk of all. Spreads make it possible to hedge any position you might have in the market. Whether you are hedging between physical ownership and futures, or between two futures positions, the risk is lower than that of outright futures. In that sense, every hedge is a spread.
- Spread order entry enables you to enter or exit a trade using an actual spread order, or by independently entering each leg of the spread (legging in/out).
- Spreads are one of the few ways to obtain decent fills by legging in/out during the Close of a market.

More benefits of using spreads:

- Live data is not needed for spread trading, possibly saving you \$\$ in exchange fees, and costs for data.
- You will not be the victim of stop running when using Intramarket spreads, because there are no stops, only exit points.

What Can You Expect?

Here are some examples of what you can expect from Intramarket spread trading. We think you may pleasantly surprised!





Although you would have made money on the outright futures, you would have suffered from serious whipsaw during the entire length of the trade. At one point, there was a major draw-down on your margin account as prices plunged below your entry point. Who needs such aggravation?

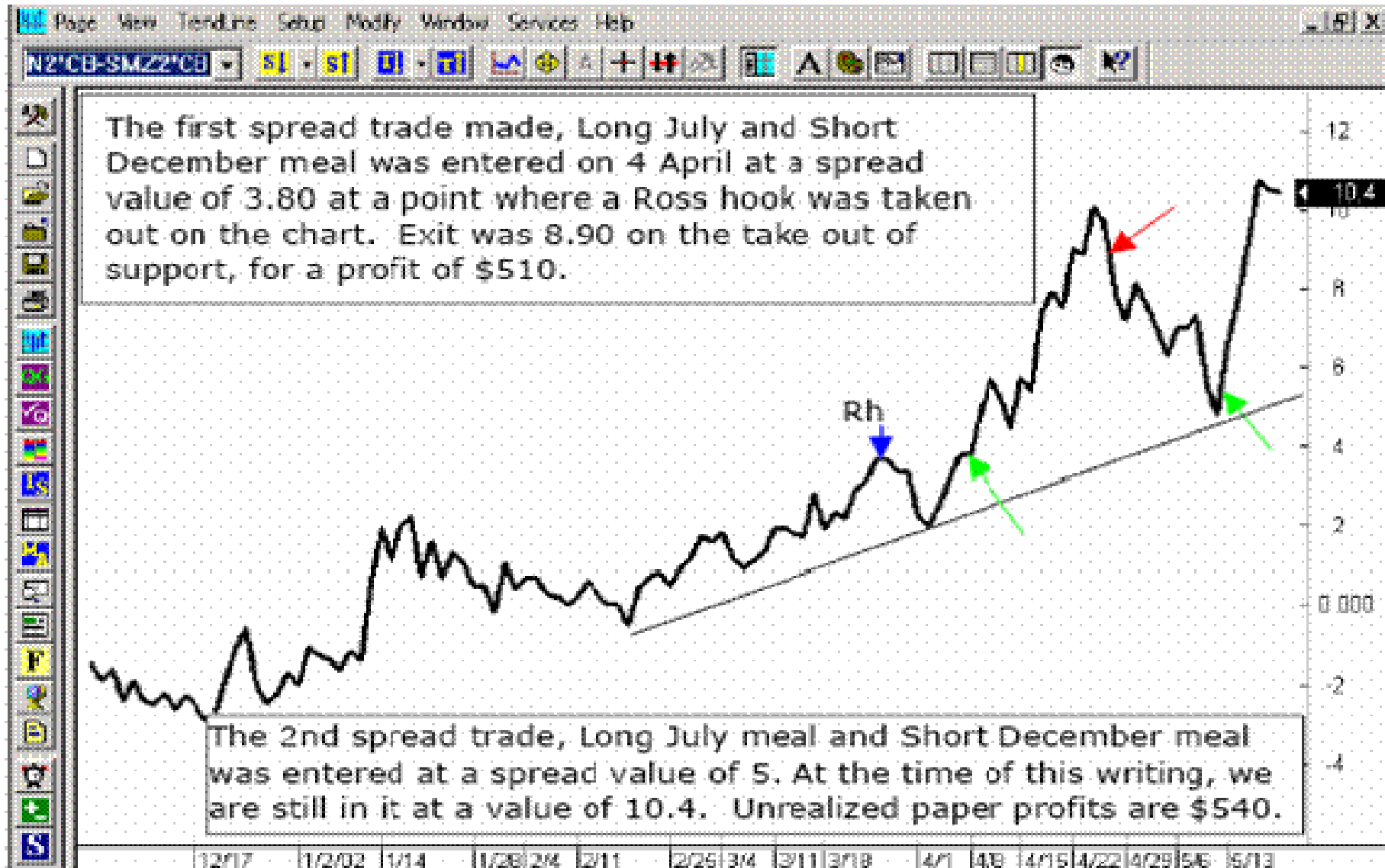
Certainly, we don't look forward to the kind of trading represented by what would have happened on this outright soybean trade. Prices were choppy and sloppy throughout the duration.

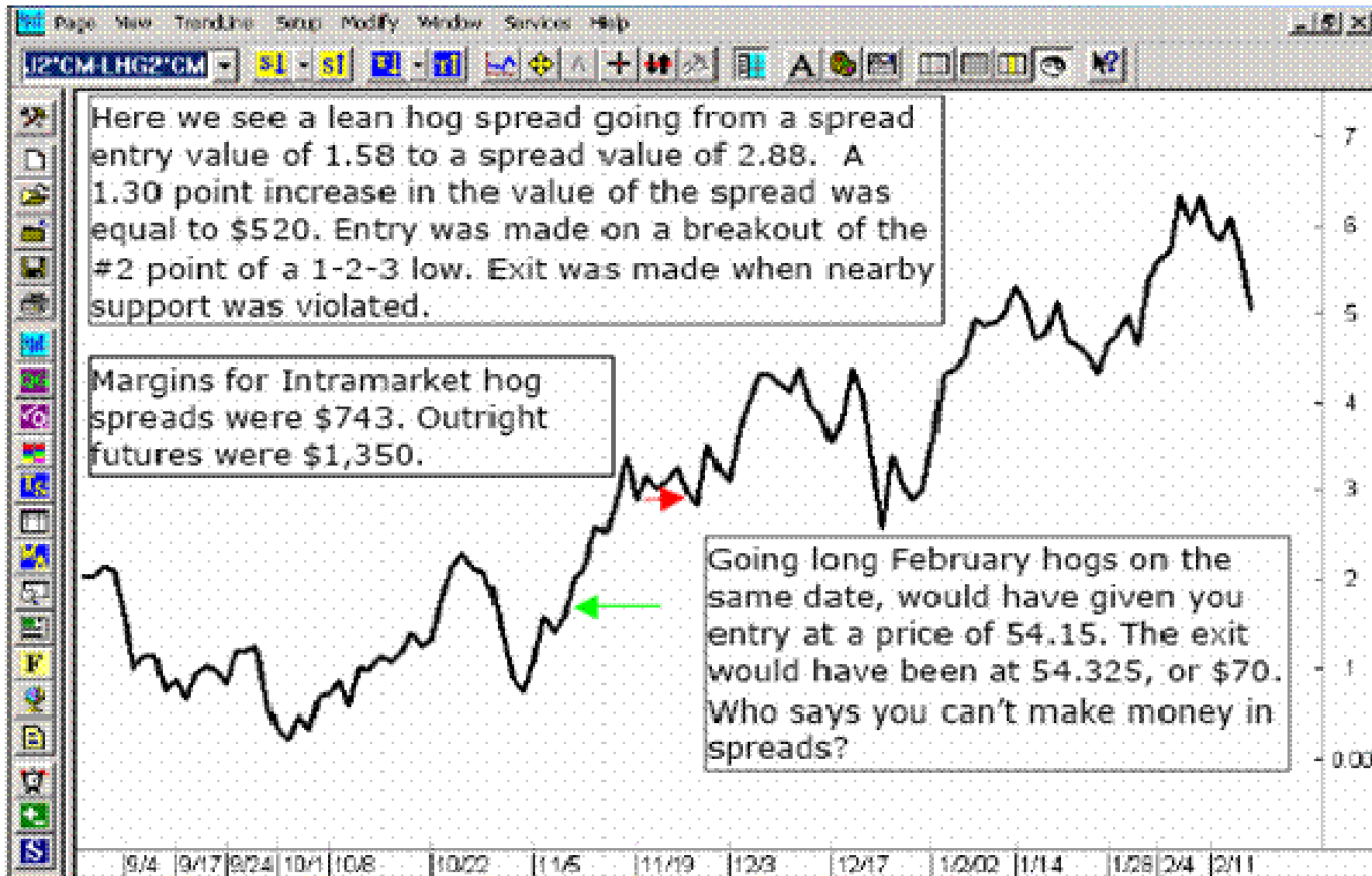
Perhaps you think you would have gone in and out while prices were chopping around. However, it is never a good idea to churn your own account. Commissions and fees would have taken a substantial amount from your available capital.

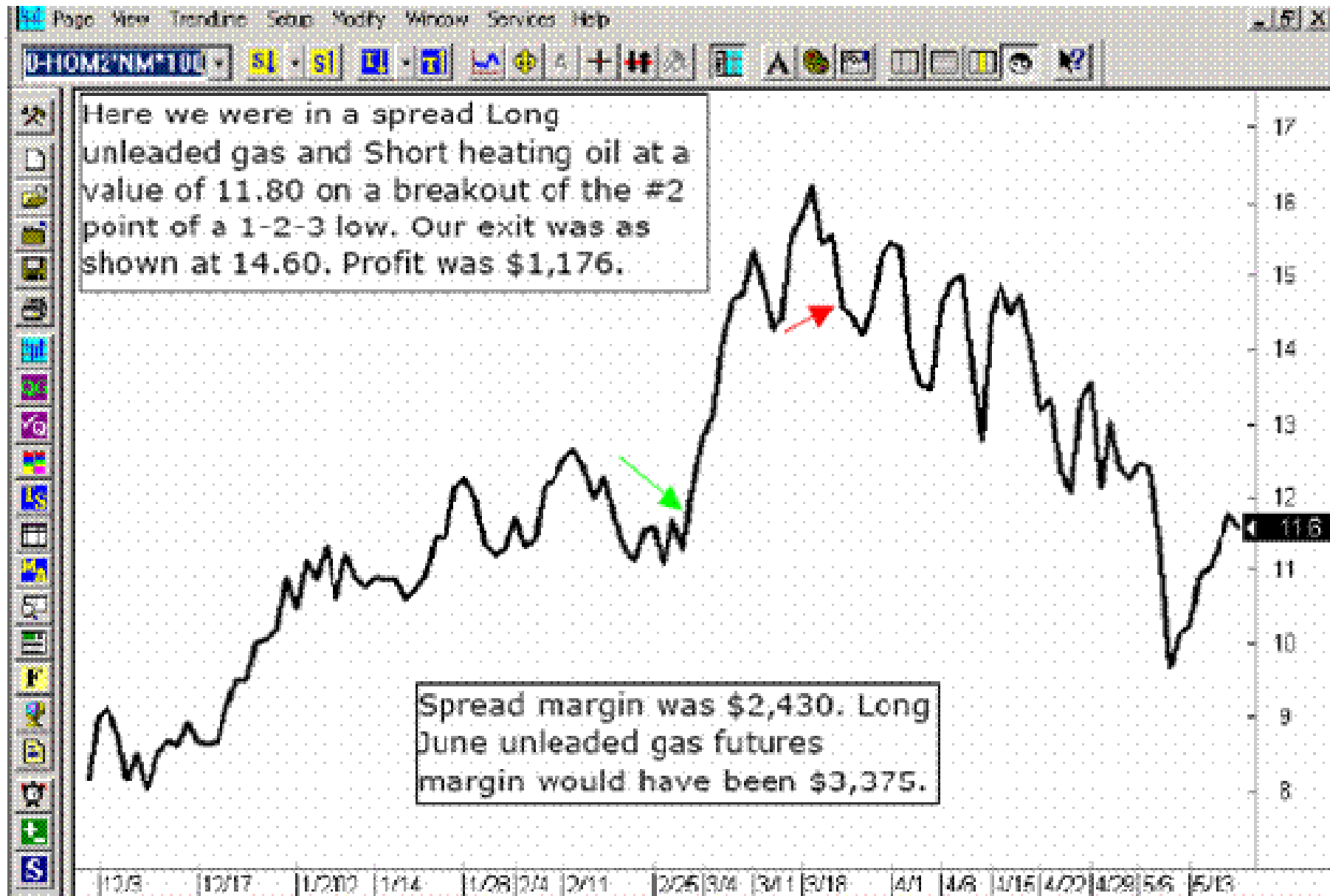
The spread made 11 points.

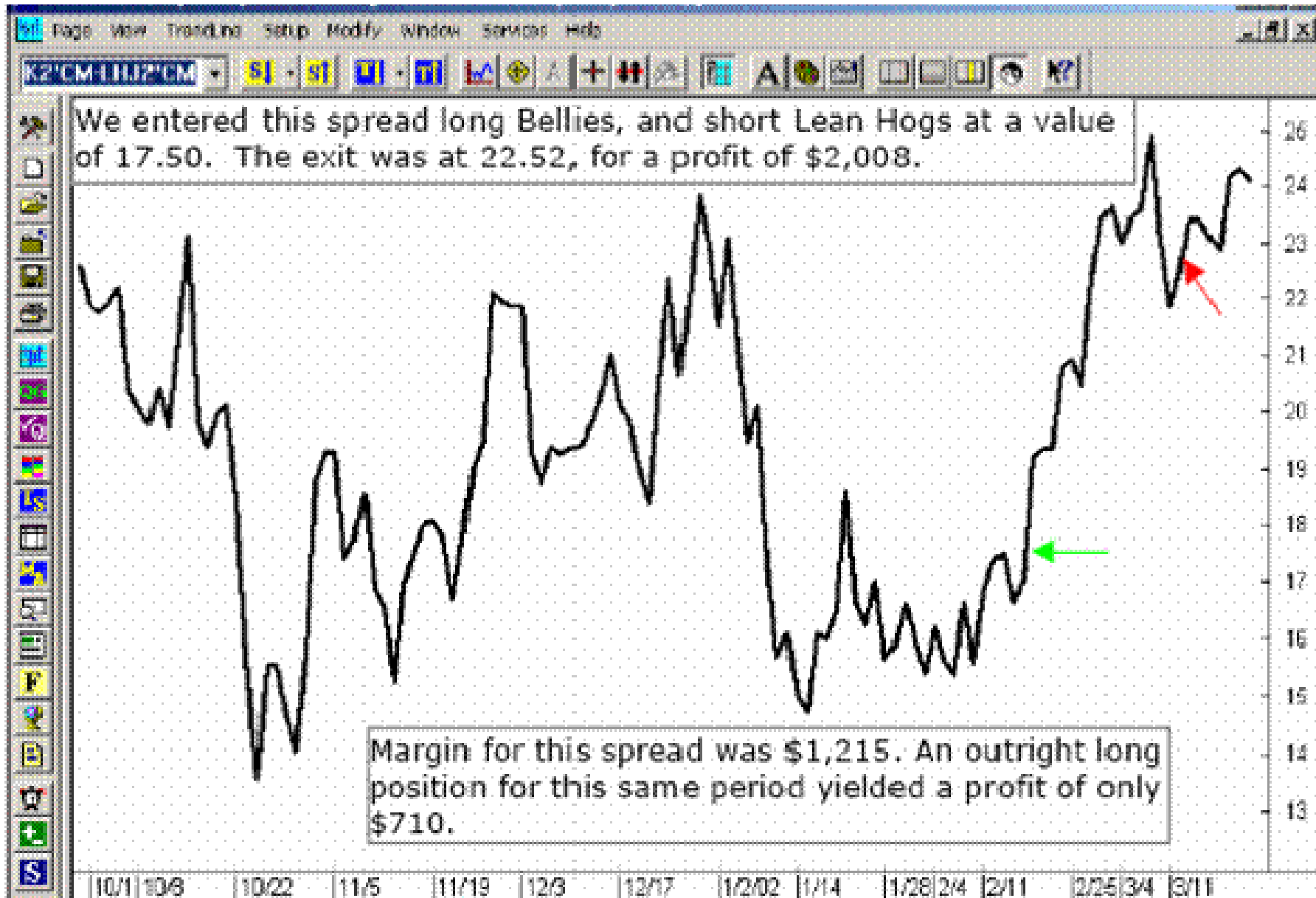
The outright soybean trade made 12.5 points.
But to get that extra point and a-half you had to
put up more than three times the margin, and
you had to withstand a huge draw-down.

The following two Intramarket trades in Soybean meal were taken based on seasonality:







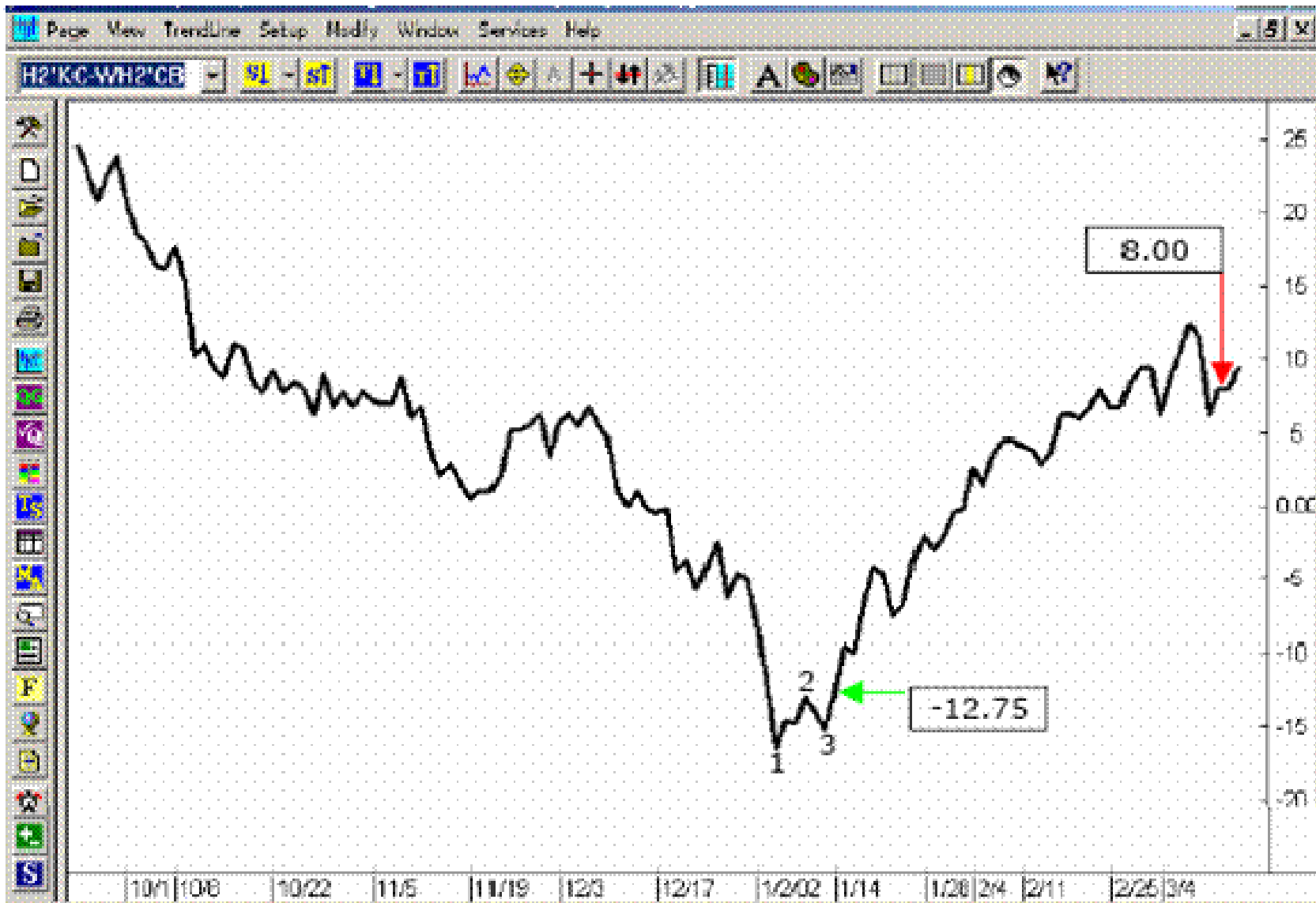


Lastly, we show an inter-exchange spread. This one was made between Kansas City wheat and Chicago wheat.

We went Long Kansas City wheat and Short Chicago wheat on a seasonally based trade when prices made a 1-2-3 low and then broke out past the #2 point.

Our entry was at -12.75 (a negative value), and we were looking for the trade to become positive. It far exceeded our expectations by moving to a spread value of 13.

We exited at 8. This spread made us 20.75 points or \$1,037.50. The margin required to put on this spread was \$1,243.00: \$743 for the Chicago wheat leg of the spread and another \$500 for the Kansas City wheat leg of the spread.



Intermarket and Inter-exchange spreads usually, but not always, require the posting of two margin amounts, since the exchanges do not offer the lowered margin requirements that are available for intra-market spreads.

Nevertheless, there are many Intermarket and Inter-exchange spreads that can make you considerable amounts of money.

On the next page, we show you an Intermarket spread which does carry lowered exchange markets.

It is a spread between the 30-year T-bond and the Ten-year notes. Some people think that interest rate futures hardly ever trend and that spreads between them are usually flat.

We are of a different opinion, as you will soon see.



We entered this spread Long Ten-Year notes and Short T-bonds.
 The spread value at entry was 26/32nds.
 Our exit was when the spread value was 3 points plus 17-1/2 32nds.
 Each point in this spread was worth \$1,000. 17-1/2 32nds was worth \$531.25.
 Total for the spread was \$1,531.25. Margin was \$1,148.

- Compare the spread margin of \$1,148 with regular T-note margins of \$1,890 for an outright futures position.
- What would have happened had you been long outright T-Note futures during that same time period? Get set for a shock!!
- You would have lost a lot of money in outright futures during the same period that you were making \$1,531.25 in the spread.

How can this be?

It is because T-bond futures fell much faster than T-note futures plunged. But the melt down in T-bond futures was much more severe.

You see, it can happen that even while futures are plummeting, it is possible to make a significant amount of money in a spread, and you can do so without fear that insiders are going to run the stops. This is why the Chicago Board of Trade is willing to offer reduced margins for this Intermarket spread.

Compared with the \$1,531.25 we made in the spread, you would have lost about 5 – 1/2 points in an outright T-note futures trade.

The loss would have been \$5,500.



SPREAD ADVANTAGES

- **Generally less risk**
- **Reduced margins**
- **More efficient use of capital**
- **Lower volatility**
- **More positions possible**
- **Trend longer and more often**
- **No stop running**
- **Require less liquidity**
- **Less concern with slippage**
- **In some situations, greater chance of winning**
- **Seasonality**
- **Correlation**
- **Inverted Markets – both ways**
- **Spreads can trend when the underlying is going sideways**

Does trading in spreads sound interesting to you?

We have barely scratched the surface of what is available in the almost lost art of spread trading. There are times when seasonal spreads, coupled with chart formations, make a lot of sense. Backwardation in any market often provides an excellent signal for entry into a spread. There are also “Correlation” spreads. You will learn how and when to enter these marvelous spreads, and you will learn how to create your own library of correlated seasonal spreads.

You will learn how and when to use backwardation as an entry into spreads.

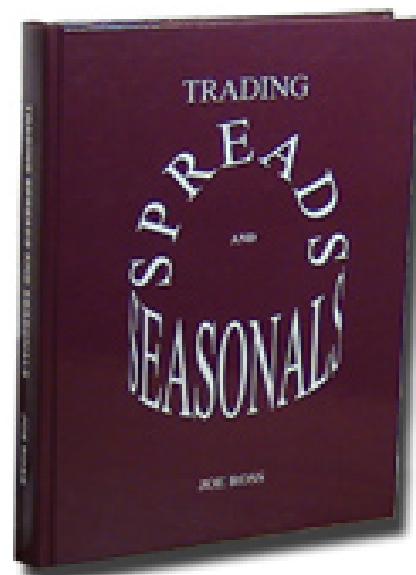
These techniques, along with seasonality, correlation, and observation are covered in our web course.

We also give you the rationale behind all of these spreads – Vital information that you need to know.

We include examples, examples, examples, so that you can begin to use spreads in your own trading.

Along with the course, a must read is Joe Ross's manual entitled **Trading Spreads and Seasonals**. This manual will open up an entire new world for you.

<http://spread-trading.com/books.htm>



Need or want more? We offer a one-day seminar entitled “**Profitable Futures Spread Trading.**”

At the seminar, you will learn how to plan your spreads, and how to apply the “Law of Charts” to your spread trading. You will also learn about spread management, and how to set up profitable spread trades. You will learn how observation spreads can make you a lot of money, and all you need to do them is to see them. We show you how and when to enter and exit spreads using the “Traders Trick Entry.”

We explain why Seasonal Spreads work.

We will show you:

- > How and where to obtain the right information for trading spreads
- > How to find the right "time window" for entering a spread
- > How and when to "leg into" or "leg out" of a spread trade.
- > How to use Intermarket spreads
- > How to earn profits using spreads.
- > How to manage spread trades, applying reality trading to spread trades; and much, much more.

We put you on the path to what we believe is the safest and most profitable way to trade in the futures markets.

**Does the lost art of spread trading
seem interesting to you?**

**Are you itching to see the kind of money
you can make trading spreads?**

If you think this might be for you, then you can get started
right now.

Go **immediately** to:

www.spread-trading.com

and pick up our spread resources, subscribe to / buy / order
our spread trading services to get started!!

We're done, but you need to know where to go from here. What are the next steps you might want to follow?

Depending on where you are in your spread trading education, you may want to consider the following:

- Best Books for your Spread Trading Education: "**Trading Spreads and Seasonals**" by Joe Ross. In Trading Spreads and Seasonals (for futures traders), Joe Ross brings you down-to-earth with his vast knowledge of one of the most fundamental ways anyone can ever learn to trade.
- **Futures Beginners Course** (e-book). Joe's Futures Course for Beginners arms you with vital information and insights - it will help you to get to the next level of understanding towards a more rewarding trading life.
- **Futures Spread Trading Online Seminar with Joe Ross** is The World's Only Complete Futures Spread Trading Seminar — learn one of the most profitable and relaxed ways to trade!
- **1-Month Mentoring with Andy Jordan**. Futures Training by Trading and Interacting One-on-One with a professional Trading Mentor in Real Time. The training is for beginning, intermediate, and advanced traders. Please contact Andy Jordan if you need further information. He will discuss with you the best way to become a successful spread trader.
- Sign up for our Daily Spread & Position Trading Newsletter: **Traders Notebook™**. Traders Notebook directs you to all the spreads you might want to trade. Subscribers have daily access to online help and advice. Traders Notebook also lets you in on high probability futures position trades.
- **Private Tutoring for Spreads – One-on-One online with Joe Ross**

Visit www.spread-trading.com/whatisnext.html to find out more details about these and more spread trading product or service we have available.