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FUTURES LINGO

SPREAD TRADING

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WHAT IS SPREAD TRADING?

Definition

A trading strategy that involves simultaneously buying and selling two different financial instruments.

Legs

A spread is made up of two offsetting positions, called legs.

Purpose

To take advantage of the price discrepancy and reduce financial risk.

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TYPES OF SPREAD

CALENDAR SPREAD

Definition

Simultaneously buy one contract in one month and sell one in another month for the same contract.

Examples

Buy FCPO Dec 2024 contract and sell FCPO May 2025 contract to trade on the price differences.

INTERMARKET SPREAD

Definition

Simultaneously buy and sell two different, but related futures with the same contract month.

Examples

Use Gold-Silver spread to trade on the relationship between gold and silver futures prices.

COMMODITY SPREAD

Definition

Buy and sell futures contracts that are related in the processing of raw commodities

Examples

Processors of soybeans use Soybean Crush spread to buy soybean futures and sell soybean meal and soybean oil futures.

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EXAMPLE

You think the price of crude palm oil will increase and decide to buy the near-month contract and sell the far-month contract.

Buy	Sell
FCPO - Dec 2024 contract	**FCPO - May 2025 contract**
@3,500	**@3,600**
The price increases to 3,600 and you sell to close your position.	The price increases to 3,670 and you buy to close your position.
Profit = 3,600 - 3,500 = 100	Loss = 3,670 - 3,600 = 70

Net profit = (100 -70) x RM25
= RM750

Note: Minimum fluctuation of FCPO is 1 pt = RM 25

BENEFITS OF SPREAD TRADING

Less market volatility

Reduce the impact of adverse price movements in a single market and diversity trading strategies.

Hedging

Allows hedgers to control price risk by locking in price disparities between two contracts.

Arbitrage Opportunities

Exploit price differences between contracts of the same commodity but different contract months.

Source: CME Group, Earn2Trade, Investopedia, StoneX One, Wallet Investor