DGCX
بورصة دبي للذهب والسلع
DUBAI GOLD & COMMODITIES EXCHANGE

Trading Calendar Spreads on DGCX

Trading Calendar Spreads is an alternative strategy to trading futures contracts outright and targets price movements between different delivery months. Known as a "Calendar Spread", this market-neutral trading strategy uses two offsetting futures contracts (i.e. one long and one short) which have the same underlying instrument but different delivery months.

A Calendar Spread, also known as an inter-delivery month spread, is the simultaneous purchase of one delivery month of a given futures contract and the sale of another delivery month of the same underlying contract. This type of spread is called a "calendar spread" because it is based on different calendar months. For instance, buying a June DGCX WTI contract and simultaneously selling a September DGCX WTI contract. A market participant can profit (or lose out) as the price difference between the two calendar months widens or narrows.

What is Contango & Backwardation?

A calendar spread represents the price differential between successive months of futures contracts. There are two types of spreads. One is "Contango", which is also called "cost of carry". Cost of carry includes the cost of insurance, interest and storage of the underlying physical commodity, or the dollar amount required to "carry" the commodity from one month to another.

When excess supply of a product is expected, it is not uncommon to find latter months trading volume well above nearby months. Spreads will not generally trade past the cost of full carry. In most cases, spreads will only trade at full carry if there is ample physical supply of the given commodity.

When there is a short-term shortage in supply/demand, it is common to find the front calendar month trading higher than latter months, leading to what is known as a backwardation scenario. This is in order to ration nearby demand and maintain acceptable supplies. This scenario has taken place many times in recent years in the WTI market.

Basic Spread Trading Strategy

Unlike the purchase of outright delivery month contracts, calendar spreads are generally affected more by supply and demand factors (i.e., fundamentals), than by money flow or technical influences. The rate of price change of one calendar month versus the other is more important with spread trading rather than the absolute market trend which is the case for single outright contracts.

Traders participating in calendar spread trades therefore focus mainly on the spread relationship between two delivery months. In most cases, money lost in one leg of the spread will be made up in another leg of the spread. In a successful spread, the gains in one leg will obviously outweigh the losses sustained in the losing leg.

Benefits of Trading DGCX calendar spreads

Calendar spreads require considerably less margin than outright futures positions. DGCX charges zero margin for trading calendar spreads. As a result, calendar spreads may offer a higher return on investment than outright futures positions, because less margin is required for the same amount of possible return. Using calendar spreads also provides the opportunity to benefit from changes in the inter-month volatility.

- Spreads, in general, trend more often than outright futures, as spreads often trend even when outright futures are flat.
- Spreads allow less risk taking than outright futures positions, while still benefiting from fundamental movements in the product. Risk is lower because the spread is less volatile and does not move in absolute terms to the same amount.
- Spreads can be filtered by virtue of seasonality, backwardation, and carrying charge differentials, in addition to any other filters you might use in your trading.
- Spreads can be used to create partial futures positions. In fact, many trading techniques can be accomplished via spread trading.

Example of a spread trade using the DGCX WTI contract

On DGCX, spread contracts are quoted with bid/ask prices with quantities as shown in the below table.

CONTRACT	Bid Quantity	Bid Price	Ask Price	Ask Quantity
DWTIX10Z10	10	$2.25	$2.30	20

The impact of buying and selling a spread contract results in generating two separate trades. Selling a spread contract creates a sell position in far month futures contract and a buy position in near month futures contract while buying a spread contract creates a buy position in far month futures contract and a sell position in the near month futures contract.

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Action	Impact		Trade Status
Buy Spread	Sell Near month	Buy Far Month	2 separate trades are generated
Sell Spread	Buy Near Month	Sell Far Month	2 separate trades are generated

Now assume you have sold a calendar spread comprising two contracts for DGCX WTI futures (1,000 bbl): 1 barrel of September at $67.40 and October for $69.65. Assume that in your opening position, you've bought (long) 1,000 barrels from the September contract, and sold (short) 1,000 barrels of the October contract. The spread value of the position is now $2.25/bbl, the difference between the two contracts. After one week, due to the change in September and October WTI futures prices there is an increase of $0.50/bbl in the net spread value and results in profit of $500 as shown in the below table.

	Opened Position US$/bbl	Position After One Week US$/bbl	Change US$/bbl
Sept WTI Futures – long	67.40	64.00	- 3.40
Oct WTI Futures short	(69.65)	(65.75)	+ 3.90
You Paid	+ 2.25	- 1.75	+ 0.50
			$ 500 profit on 1,000 barrels ($ 0.50 x 1,000)

However, let's set up a different scenario where after one week, the spread between the September and October contracts has increased to $2.75/bbl due to the price change in September and October WTI futures. In this case, the net spread value decreases by $0.50/bbl and results in loss of $500 as shown in the following table.

	Opened Position US$/bbl	Position After One Week US$/bbl	Change US$/bbl
Sept WTI Futures – long	67.40	64.00	- 3.40
Oct WTI Futures short	(69.65)	(66.75)	+ 2.90
You Paid	+ 2.25	- 2.75	- 0.50
			$ 500 loss on 1,000 barrels ($ - 0.50 x 1,000)

In both cases, the prices of both contracts fell.

In this scenario, an outright September WTI long contract would have lost US$ 3.40/bbl or US$ 3,400 whereas an outright short contract would have gained US$ 2,900. However, a calendar spread would have had a profit/loss range of US$ 500.

Some Useful Links

www.investopedia.com
www.tradingmarkets.com
www.spread-trading.com
www.allbusiness.com
www.tradejuice.com
www.ezinearticles.com
www.futuresource.com
www.tradingeducators.com
www.finance-strategy.com

Further Information

Full details on all DGCX products and news can be found at www.dgcx.ae.
Alternatively, if you would like to speak with a Relationship Manager, please contact us on the details below.

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