December 3, 2012
With addendum dated June 27, 2015

Trading futures- and forex-related ETFs is a foolish way to manage trading capital

Why trade an ETF when the underlying future contract can be traded

Note: This post will no doubt create some level of controversy and disagreement. This is my intent. I will stand by my position that trading an ETF tied to an underlying futures or forex market is a very foolish way to manage trading capital. I have no idea why a trader would ever trade a futures or forex-related ETF if he or she can handle the risk of the futures and forex markets. Let the facts of this document speak for themselves.

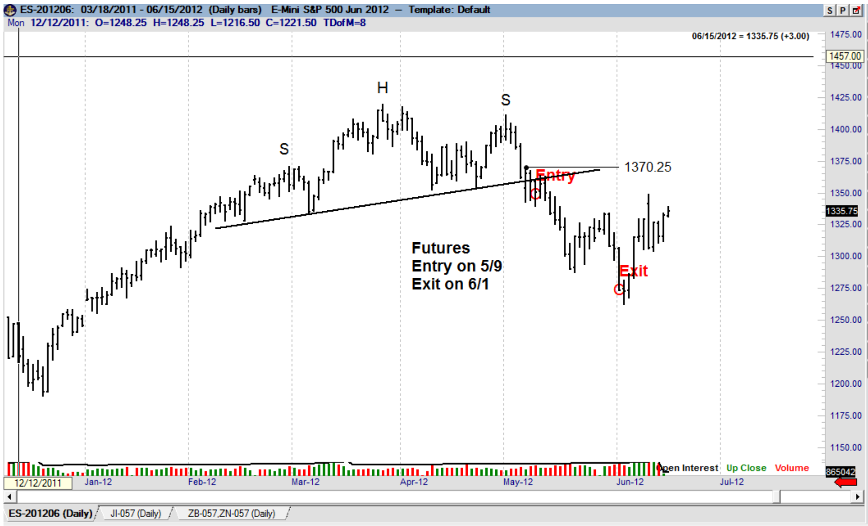
Trading an ETF tied to an underlying futures or forex market requires far more capital with less profit potential at the exact same level of risk as directly trading the underlying futures or forex contract. Five examples are provided to make my point.

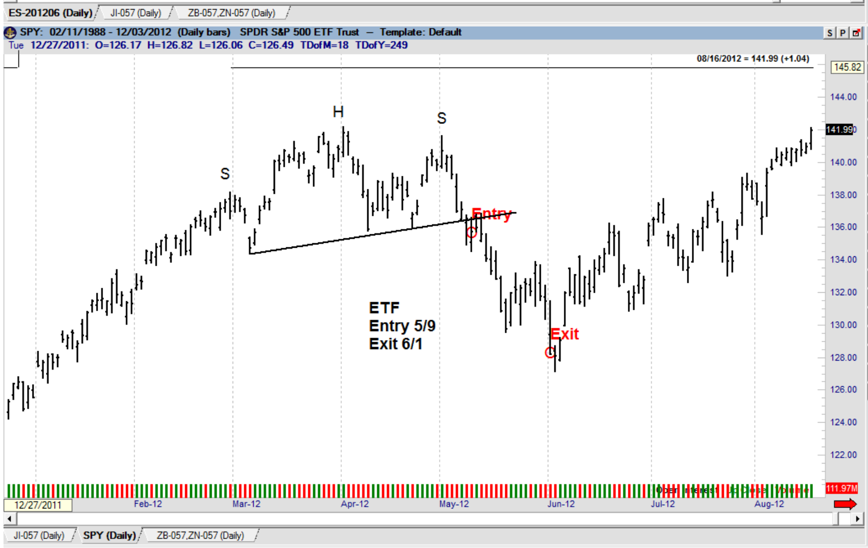
- S&P futures vs. SPY
- S&P futures vs. SH (inverted SPY)
- British Pounds futures vs. FXB
- Gold futures vs. GLD
- Copper futures vs. JJC

Assumptions:

- An ETF represents a specific futures or forex market
- A loss of $10,000 is risked per trade – in both the futures/forex and ETF expressions of a trade. A risk of $1,000 would simply require dividing the key numbers by 10
- The entry and exit for each trade (futures/forex vs. the ETF) are made simultaneously – same date and time
- The corresponding charts for each trade set up are shown

S&P 500 – Shorting the H&S top in May 2012

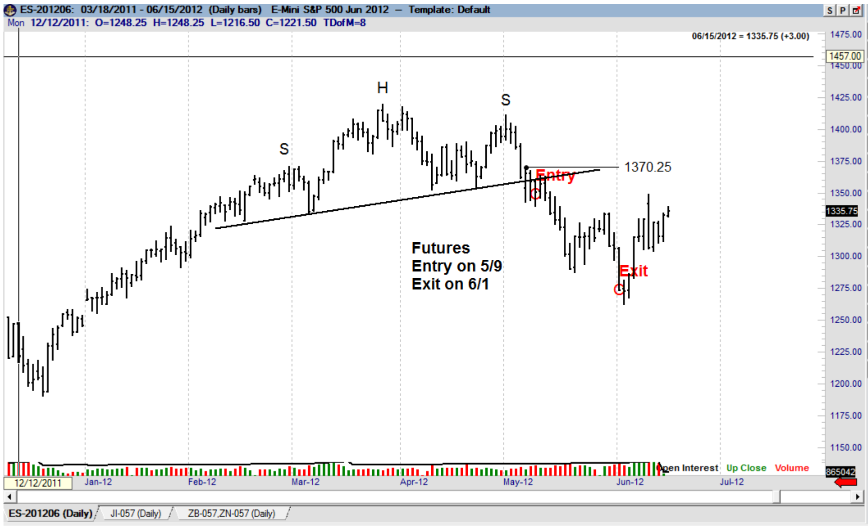


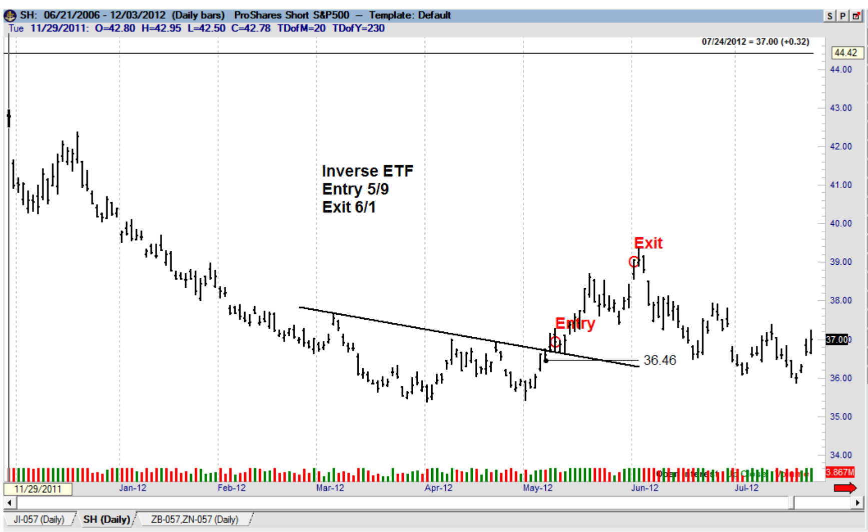


	Futures (ES)	ETF (SPY)
Entry	Short at 1351 on 5/9	Short at 135.74 on 5/9
Risk	5/7 high at 1370.25	5/7 high at 137.56
Risk per unit	19.25 or $963 per contract	$1.82 per share
Margin	$4,400 per contract	50% margin
Position size	10 contracts	5,300 shares
Total risk (goal = $10,000)	$9,630 (10*$963)	$9,646 ($1.82*5,300)
Cost to carry trade	$44,000	$359,710 at 50% margin
Target	1274 met on 6/1	128.16 met on 6/1
Profit per unit	$3,850 per contract	$7.58 per share
Total profit	$38,500	$40,174
Bang per $ factor (Profit ÷ Cost to carry trade)	$.87	$.11

Summary: Trading SPY ties up eight times more capital in a trade with a near-identical risk to reward profile. FOOLISH!

S&P 500 – Shorting the S&P top in May 2012 with an inverse ETF

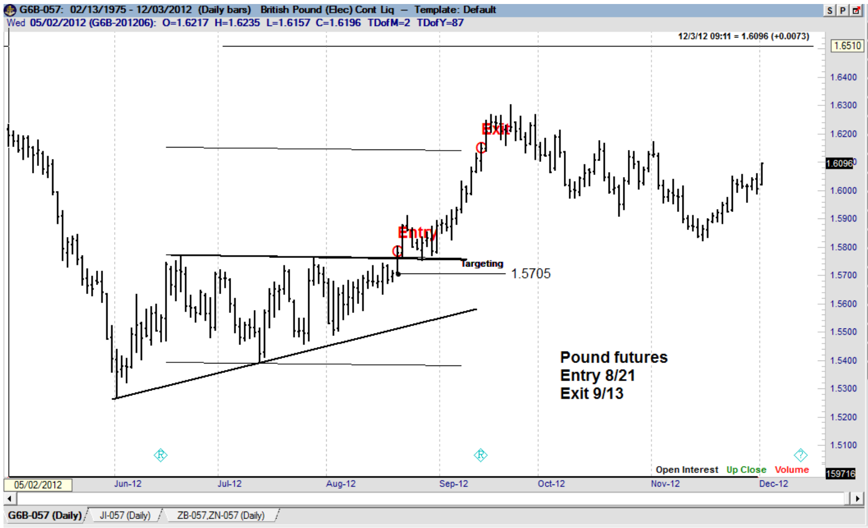


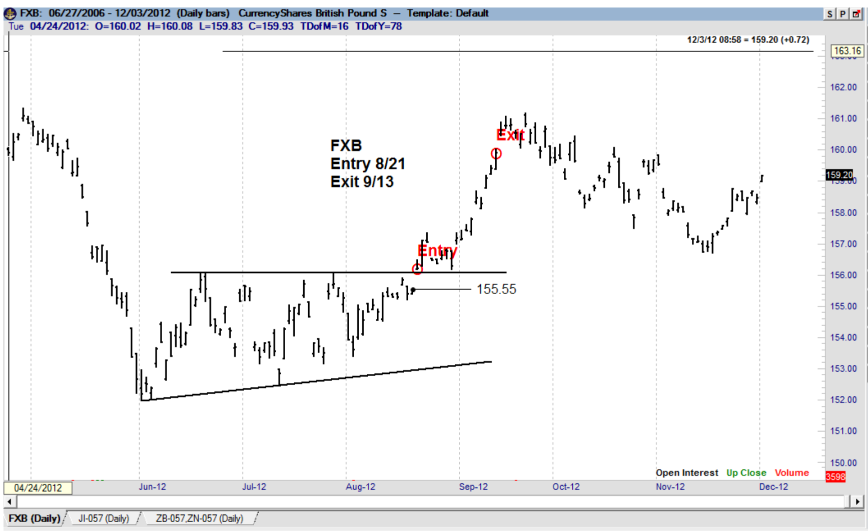


	Futures (ES)	Inverse ETF (SH)
Entry	Short at 1351 on 5/9	Long at 36.94 on 5/9
Risk	5/7 high at 1370.25	5/7 low at 36.46
Risk per unit	19.25 or $963 per contract	$.48 per share
Margin	$4,400 per contract	50% margin
Position size	10 contracts	20,000 shares
Total risk (goal = $10,000)	$9,630 (10*$963)	$9,600 ($.48*20,000)
Cost to carry trade	$44,000	$369,400 at 50% margin
Target	1274 met on 6/1	39.05 met on 6/1
Profit per unit	$3,850 per contract	$2.11 per share
Total profit	$38,500	$42,200
Bang per $ factor (Profit ÷ Cost to carry trade)	$.87	$.11

Summary: Trading an inverse S&P ETF (SH) ties up eight times more capital in a trade with a near-identical risk to reward profile. FOOLISH!

British Pound – Buying the descending triangle bottom in August

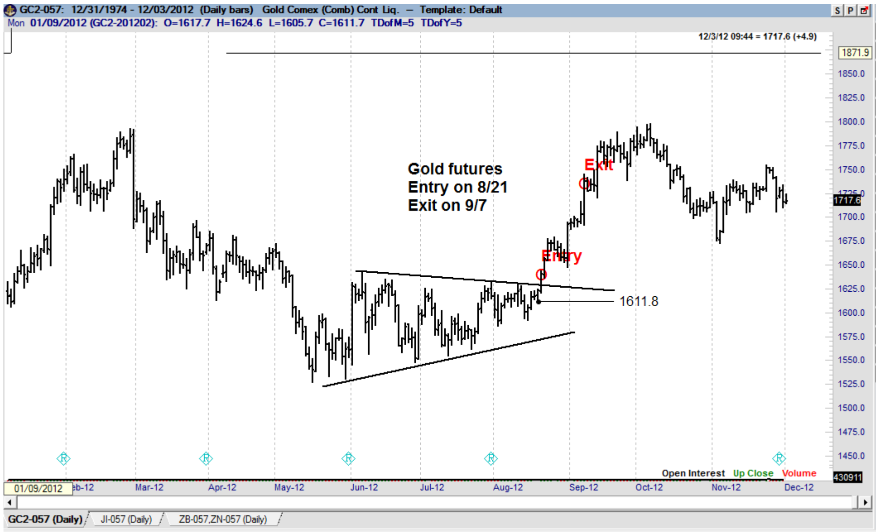


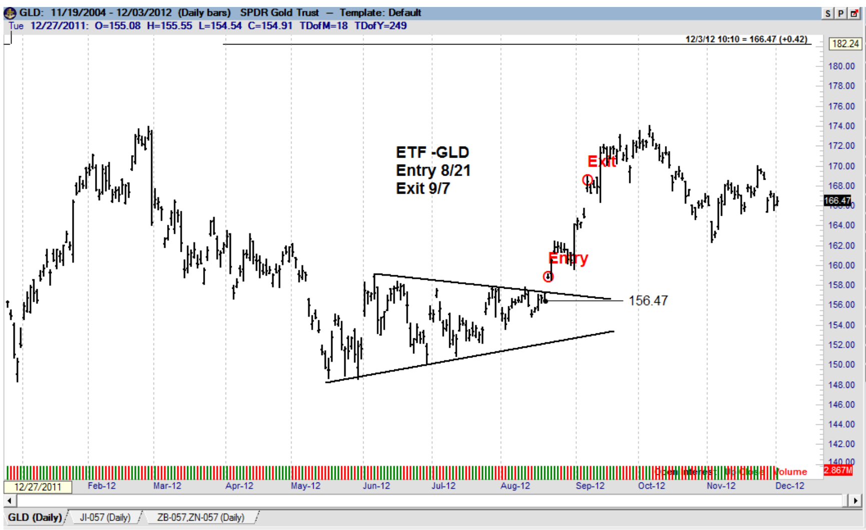


	Futures (GBP)	ETF (FXB)
Entry	Long at 1.5781 on 8/21	Long at 156.22 on 8/21
Risk	8/21 low at 1.5705	8/20 close at 155.55
Risk per unit	76 pts or $475 per contract	$.67 per share
Margin	$1,900 per contract	50% margin
Position size	20 contracts	14,000 shares
Total risk (goal = $10,000)	$9,500 (20*$475)	$9,380 ($.67*14,000)
Cost to carry trade	$38,000	$1,093,540 at 50% margin
Target	1.6149 met on 9/13	159.92 met on 9/13
Profit per unit	$2,300 per contract	$3.70 per share
Total profit	$46,000	$51,800
Bang per $ factor (Profit ÷ Cost to carry trade)	$1.21	$.05

Summary: Trading a long British Pound ETF (FXB) ties up 24-times more capital in a trade with a near-identical risk to reward profile. FOOLISH! REALLY FOOLISH! JUST PLAIN STUPID!

Gold – Buying the symmetrical triangle in August 2012





	Futures (GC)	ETF (GLD)
Entry	Long at 1640.6 on 8/21	Long at 158.45 on 8/21
Risk	8/20 low at 1611.8	8/20 low at 156.47
Risk per unit	\$28.80 /oz. or \$2,880 per contract	\$1.98 per share
Margin	\$8,440 per contract	50% margin
Position size	3.33 contracts (inc. a mini)	5,000 shares
Total risk (goal = \$10,000)	\$9,590 (3.33*\$2,880)	\$9,900 (\$1.98*5,000)
Cost to carry trade	\$28,105	\$396,125 at 50% margin
Target	1737.6 met on 9/7	168.45 met on 9/7
Profit per unit	\$9,700 per contract	\$10.00 per share
Total profit	\$32,010	\$50,000
Bang per \$ factor (Profit ÷ Cost to carry trade)	\$1.15	\$.13

Summary: Trading a long Gold ETF (GLD) ties up nine times more capital in a trade with a near-identical risk to reward profile. FOOLISH!

Copper – Buying the 3-month -compound fulcrum bottom in September 2012

	Futures (HG)	ETF (JJC)
Entry	Long at 3.5180 on 9/5	Long at 44.55 on 9/5
Risk	9/4 low at 3.4465	9/4 low at 43.85
Risk per unit	$1,787 per contract	$.70 per share
Margin	$4,600 per contract	50% margin
Position size	5 contracts	13,000 shares
Total risk (goal = $10,000)	$8,935	$9,100 ($.70*13,000)
Cost to carry trade	$23,000	$289,575 at 50% margin
Target	3.8280 met on 9/14	48.50 met on 9/14
Profit per unit	$7,750 per contract	$3.95 per share
Total profit	$38,750	$51,350
Bang per $ factor (Profit ÷ Cost to carry trade)	$1.68	$.18

Summary: Trading a long Copper ETF (JJC) offered 25% more profit potential, but tied up eight times more capital in a trade with a near-identical risk profile. FOOLISH!

Addendum dated June 27, 2015

This past week the Wheat market completed a large chart bottom – and provides another example of the lunacy of using commodity-related ETFs when futures contracts are available. For this example I am assuming that a long position was taken at the June 26 breakout.

	Futures (ZW)	ETF (WEAT)
Entry	Long at 5.52 on 9/26	Long at 11.29 on 9/26
Risk	6/24 low at 5.17	6/24 low at 10.49
Risk per unit	$1,750 per contract	$.80 per share
Margin	$4,600 per contract	50% margin
Position size	5 contracts	11,000 shares
Total risk (goal = $10,000)	$8,750	$8,800 ($.80*11,000)
Cost to carry trade	$8,250	$62,095 at 50% margin
Target	Dec high at $6.77	Dec high at $14.07
Profit per unit at target	$6,250 per contract	$2.78 per share
Total profit at target	$31,250	$30,580
Bang per $ factor (Profit ÷ Cost to carry trade)	$3.78	$.49

Summary: Trading a long Wheat ETF (WEAT) ties up 7.7 times more capital than a futures trade with the same profit and risk profile. What an absolutely FOOLISH utilization of speculative capital!

Summary

I could go on and on with these examples -- to interest rate markets, grains, energy, food and fiber, every conceivable forex pair.

No matter how you stack it, using ETFs when underlying futures or forex contracts are available is an absolutely foolish utilization of trading capital.

With the sole of exceptions of having an account with too little capital to trade futures or an IRA or Roth account unable to use futures, why a person would trade GLD or SLV or SPY or any number of futures/forex-related ETFs in beyond my comprehension?

For the same risk per trade (expressed in dollars or as a percent of a trading account), futures/forex provide the following advantages:

- More liquidity
- Fewer overnight gaps
- 24-hour trading access (in most cases)
- Ability to hold far more different trades at the same time
- Great punch per dollar employed to hold a trade – in fact, capital in futures is about eight to 10 times more efficient at an equal-risk level
- Shorts in futures cannot be called back (as is the case with a short ETF position)

If you are a properly capitalized trader (I would saying anything north of $100,000 of non-IRA trading assets) you need to seriously challenge your use of ETFs instead of the underlying futures contract or forex cross.

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