



CAPITAL  
STREET|FX

INTRODUCTION TO  
COMMODITY TRADING  
CAPADEMY TUTORIAL SERIES



Capital Street FX

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Commodities are the raw ingredients or components of almost everything we consume or use in our everyday life. Commodities as an asset class/investment product means tangible physical produce, that can be described as "products and/or by-products of natural resources that are directly extracted/processed and/or synthesized from their naturally occurring state, for consumption by society for e.g. crude oil (which is refined into petroleum, diesel, kerosene, heating oil and many other by-products), food grains, livestock, metals etc.

The distinctive characteristic about commodities is that they can be of different types, based on their end use such as industrial commodities (for e.g. copper), investment commodities (for e.g. gold), edible commodities (such as wheat or coffee) or consumer commodities (for e.g. cotton). Yet, they all form one asset class referred to as commodities.

It is due to this feature that they are traded on different exchanges and on electronic communication networks after being split into different groups. A commodity is a tangible physical product that can be bought or sold unlike shares of a company, or a bond issued by a government/private entity or a paper currency of any nation/group of nations.

While commodities are actual, and physically present assets, that are traded, many other instruments such as currencies or stocks or bonds are paper based investments that are generally backed up by a “promise to reimburse the holder” or a “claim to pro-rated ownership of the net value” in case of a currency/bond or the stock/share of an entity respectively.

The primary categories of commodities are “softs”, “grains”, “livestock”, “energy” and “metals”. Other classification conventions may be used to provide finer grouping of similar commodities such as precious metals, base metals, meats, fats and oils, livestock, fibres and textiles etc.

Traders and Investors must decide what type of commodity they want to trade. Long term traders tend to focus on primary and soft commodities like livestock, grains, metals and energy. Commodities are also a great way for traders to diversify their portfolios. Precious metals for example, are considered a safe haven investment and are always a good asset in any portfolio.

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Commodity trades are done in 5 common ways: Spot trading, Futures trading, Forward Trading, CFD Trading, or using Commodity Options.

A Commodity spot trade occurs “on the spot” and is done for immediate delivery at the prevailing cash market price at any given instant.

Futures trading is based on trading a financial exchange based contract with standardized terms and conditions such as quality, quantity and date of expiry. The trading price of a futures contract at any given instant is the market estimated price for that commodity at or around the futures expiry date.

A forward contract is an agreement between two parties to exchange at some fixed future date a given quantity of a commodity for a price defined today. The fixed price today is known as the forward price.

A CFD (Contract For Difference) is a financial contract that defines standardized terms and conditions for trading a given commodity. The primary advantage of the contract is that it is always settled in cash, and is non-deliverable. Further, it is free of possible restrictions such as position limits or high deposit requirements that can sometimes occur when trading commodities using other formats. CFD's may be exchange traded or traded Over The Counter(OTC).

Commodity Options are another instrument that is used to invest/trade in the commodity markets. Commodity Options are standardized contracts that allow a trader “the right, but not the obligation” to “buy or sell” a “specific quantity” of a given commodity at a “specified price” at or before a specified “date of expiry”.

Some of the top traded commodities are: crude oil, coffee, natural gas, gold, silver, copper, sugar, corn, wheat and cotton to name a few.

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Commodities count as extremely lucrative investment opportunities due to their liquidity, high leverage (sometimes more than 1:100) and the fact that investors and traders do not necessarily have to hold onto them physically. However, risk management strategies are important for commodity trading as with all trading ventures.

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