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Aggressive Defence: profiting from financial collapse

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Aggressive Defence: how to profit from turmoil in the financial system... from within

Nick Hubble

Financial markets are fragile.

Stockmarkets crash. Banks fail. Property prices slump. And commodity prices collapse.

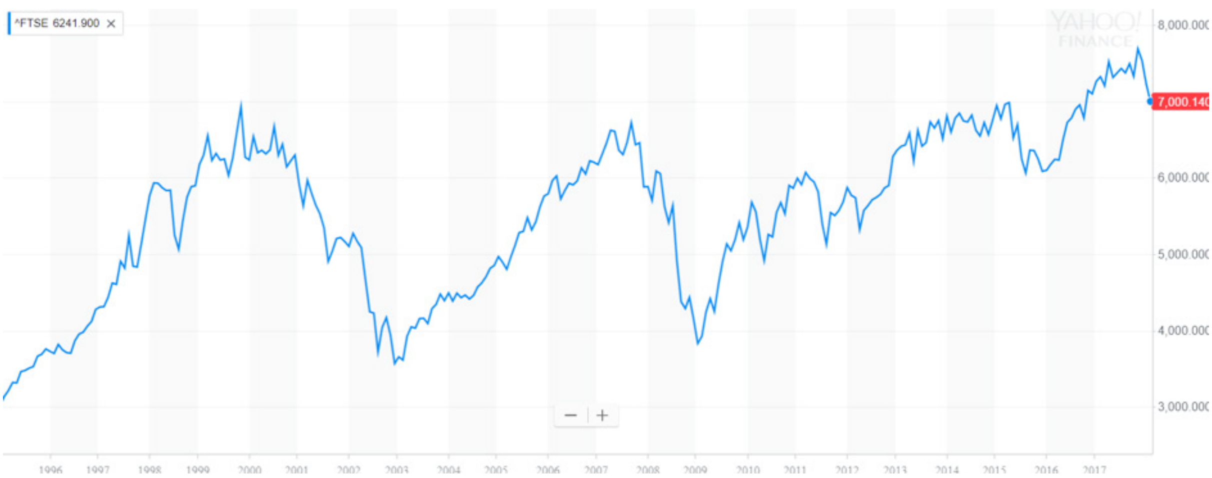
Crises in financial markets are as old as financial markets. Perhaps even older. And yet, most people don't know how to profit from them. Or think it's too hard and arcane to do so.

Perhaps that was true once. But the last 20 years have changed things in two ways. First, they made it convenient and cost efficient to profit from falling markets. And second, they demonstrated why you can no longer ignore these opportunities if you want to grow your wealth.

The FTSE is back where it was 18 years ago. I bet you're furious when you hear the mantra "stockmarkets go up in the long run."

Two major stockmarket crashes delivered devastating setbacks for investors. Why not turn these crashes into moments you can profit or protect yourself from?

FTSE 100 going nowhere



Source: Yahoo Finance

In our last report, "Stealth Wealth: how to unplug your wealth from the financial system", we looked at how you can "unplug" your money from the traditional financial system. We'll be continuing to research and share ideas like that with you in your monthly The Fleet Street Letter Monthly Alert letters.

But you needn't stop there.

If you're concerned about the fragility of the financial system, you don't need to run for the hills. Not with all your capital, anyway.

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We'd also like to show you how you can turn the weakness of the financial system to your advantage using traditional financial investments. There are always ways of profiting from big moves in the market – either up or down. It generally involves thinking ahead and being smart about what your options are.

That starts today.

Keep in mind: the ideas outlined in this report AREN'T LIVE RECOMMENDATIONS.

I simply want to talk you through some options and introduce you to the types of ideas we may recommend when the time is right. I'll use examples to demonstrate this, but these examples are not intended as advice. Some of the ideas are speculative vehicles and are high risk. You should always do full risk analysis before embarking on similar investment ideas.

To be clear: when we actively recommend you do something we will be 100% clear.

Timing will be key here. That's why we'll write to you specifically to activate an Aggressive Defence position.

Another point to remember: we're not building a full management portfolio here. We're introducing you to specific, individual ideas that help you potentially profit from our analysis. You can follow some, all or none of our advice. It's up to you.

With that bit of housekeeping out of the way, let's dive in.

There's something I want you to realise about financial markets. They weren't originally designed to grow savings, raise capital or enable speculation. They were designed specifically for the goal this report is about.

Financial markets were once about reducing risk

Financial markets came into being to allow people to protect themselves against a crisis.

Olive oil futures during Aristotle's time helped farmers match supply and demand at a decent price before they incurred the costs of a harvest.

Fur trappers in colonial America used financial markets to secure a fair price before they took to the wilderness. Reducing price risk in this way ensured hard work and initial investment would pay off. Less animals died needlessly each season.

Wine futures allowed vineyards during the Napoleonic era to transfer the risk of their harvest to wine merchants. Instead of vineyards going broke because of a bad harvest, investors did. This provided the certainty and continuity that allowed vineyards to develop the best wine in the world today.

Insurance markets hosted in coffee houses like Lloyd's, protected merchants at the mercy of the sea from financial ruin. Stockmarkets in Holland and London allowed people to diversify their wealth and savings across industries and countries to protect them from a shock.

The entire hedge fund industry is based around the idea of reducing risk too. By making bets both ways, overall positions are "hedged" and therefore less risky. Hedge fund managers have often forgotten this basic principle, or turned their funds into speculative bets that are hedge funds in name only. But if you adhere to the perfectly valid principle of hedging your bets, the benefits are still yours to claim.

Making a bet that profits from financial turmoil is usually not about profit in the end. It's about protection from the losses your other positions experience. It's a type of insurance or hedge, as described above.

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This report is about using financial markets to reduce the risk financial markets pose to you. After all, a great deal of your wealth is invested in those markets. So, although we'll look into profiting from decline, don't forget that profit is primarily designed to offset your losses.

In other words, we're making it possible for you to hedge your risks. I call this...

Aggressive Defence

Thanks to modern financial markets, you don't need to be an olive oil farmer to deal in futures, or a hedge fund manager to protect yourself against a bear market.

These days, it's possible to profit from falling asset prices almost as easily as rising ones. This report shows you how you can trade the turmoil of the financial system from within.

But never forget, these instruments are speculative by nature. They're designed to be part of a well-balanced portfolio, or only to be used as a short-term trade. With that in mind, let's take a look at what they are:

1. Short selling

Short selling is a very simple idea. But it's hard to get your head around because it sounds odd. It also gets a bad rap. But that's politically motivated.

People don't like short sellers because they have a knack of exposing accounting fraud and other scandals . They're the private detectives and vigilantes of the investment world. In my opinion, holding people to account keeps them more honest. You can think of short sellers as whistle-blowers with inbuilt incentives.

But what is short selling? Usually, investors buy an asset and then sell it later. If the price has gone up in the meantime, they make a profit.

Short sellers sell an investment and then buy it later. If the price has gone down in the meantime, they make a profit. That's because price they sold at is higher than the price they bought at. Their inflow is greater than their outlay.

But how can you sell something and buy it back later? The secret to short selling is to simply accept that it's possible. Buying and selling in financial markets are far more abstract concepts than you might think. In the end, your broker will handle the details.

You still need to know the basics of how it works though. There are many ways to sell before you buy. The obvious one is to borrow what you're selling from someone else. This allows you to sell that item and, as long as you buy it back later, you can return it to the person you borrowed it from. If the price falls in the meantime, you've made a profit. You sold the stock when it was high and bought it back when it was low.

The mechanics of short selling aren't worth getting into for investors. The rules and method will be whatever your broker has on offer for you. And I can't detail that. It varies a great deal between brokerages. Be sure to examine their costs and terms closely. Especially the fees, which usually reflect the cost of borrowing the investments you want to short sell.

The point is, you can use short selling to profit during a market crash. You'll have to get set up with your broker to do so. That takes time, so if you'd like to use this method in the future, get started now.

Your broker will likely require you to keep a certain amount of cash on deposit with them. This is called the "margin" and it's used to ensure you can pay up if the short sale goes against you and the investment rises in price instead of falling.

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A "margin call" is when the broker requests you to increase the amount of money you hold with them. It sounds terrifying, but remember what we discussed at the beginning of this report. You are hedging, or balancing out, your risks. The losses from short selling will be cancelled out to some extent by your rising other investments.

But why short sell as opposed to simply selling your investments? There are many reasons, such as tax and transaction costs. Using the occasional speculative position to hedge your risks can be far more efficient.

Another benefit to short selling is that it enables something called a pair trade. You invest in and short sell two similar investments to isolate the difference between them. You might buy shares in a gold mining company with low debt while short selling a gold company with too much debt. You've isolated debt as the factor that determines the performance of your pair trade.

In a crisis, no matter how the gold price trades, the company with too much debt is likely to perform worse than the company with low debt. Regardless whether both stocks fall or rise, the underperformance of the stock you shorted delivers you a profit between the two positions. It's a great example of how to use short selling as a way to profit from a crisis without it being a simple speculative bet.

Why not explore the short selling option with your broker? It would allow you to protect yourself from a plunging market.

2. Short/inverse ETFs

Short selling is the original way to profit from falling markets. But it's probably not the most convenient these days.

The easiest way to bet on falling investment prices is investing in an exchange-traded fund (ETF) designed for just that purpose. There are all sorts listed on the UK market. You can bet on falling currencies like the euro, indices like the FTSE, commodities like oil and more.

I've listed some that might be of interest. But how do they work?

There are various ways an ETF might try to deliver its promise. It could use futures or other derivatives, or it might hold the underlying assets it's trying to mimic.

It's important to understand that, especially if you throw in management fees, the returns will diverge from the investment you're trying to mimic over time. Holding ETFs for a long period will deliver sub-par results. This is especially true of short/inverse ETFs. But trading them over the medium term allows you to get access to investment trends that would otherwise be difficult.

Thanks to the flexibility of ETFs, there are many different kinds.

Examples of ETFs designed to profit from a falling market

Short stockmarket ETFs
ETFX FTSE 100 Super Short Strategy ETF (SUK2-LSE)
ETFX DAX 2X Short ETF (Sterling) (DS2P-LSE)
ETFS 3x Daily Short EURO STOXX 50 – EUR (UES3-LSE)
Boost EURO STOXX Banks 3x Short Daily ETP – EUR (3BAS-LSE)
Boost EURO STOXX 50 3x Short Daily ETP – EUR (3EUS-LSE)
Boost FTSE MIB 3x Short Daily ETP – EUR (3ITSm-LSE)
Boost S&P 500 3x Short Daily ETP – USD (3USS-LSE)
Boost NASDAQ 100 3x Short Daily ETP – USD (QQQS-LSE)

Short commodity ETFs
ETFS Short All Commodities ETF (SALL-LSE)
ETFS Short Copper ETF (SCOP-LSE)
ETFS Short Crude Oil ETF (SOIL-LSE)
ETFS Short Energy ETF (SNRG-LSE)
ETFS Short Gasoline ETF (SGAS-LSE)
ETFS Short Industrial Metals ETF (SIME-LSE)
ETFS Short Natural Gas ETF (SNGA-LSE)
ETFS Short Petroleum ETF (SPET-LSE)

Bond ETFs
Boost BTP 10Y 3x Short Daily ETP – EUR (3BTS-LSE)
Boost US Treasuries 10Y 3x Leverage Daily ETP – USD (3TYS-LSE)

Currency ETFs
ETFS Short Australian Dollar Long US Dollar ETC (Sterling) ETF (SAUP-LSE)
ETFS Short British Pound Long US Dollar ETC (Sterling) ETF (USD2-LSE)
ETFS Short Euro Long US Dollar ETC (Sterling) ETF (SEUP-LSE)

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The first factor to look for is the currency they trade in. Some ETFs take out currency risk by offering the "sterling" option instead of the US dollar or local currency option. Usually, the currency denomination will be in the name.

The currency can be very important. A US dollar gold ETF might not rise as much as a sterling gold ETF during a crisis, for example. That's what happened during the 2008 financial crisis.

Perhaps the key feature you'll be looking for given the nature of this report is "inverse" ETFs. These bet on the falling value of the underlying asset. An inverse oil ETF should go up as the price of oil falls. On the London Stock Exchange, inverse ETFs usually have the word "short" instead of inverse in their name, a reference to short selling .

The third feature to look out for is leverage. Below we look into an ETF that delivers triple the return of the underlying investment. So if the pound falls 1%, the ETF should gain about 3%.

Inverse and leverage ETFs are riskier than ordinary ones because they are more difficult to manage and use more extreme bets. We'll look into how that went spectacularly wrong for inverse volatility ETFs in February 2018 in a different section below. If you use a leveraged ETF, you can expect the performance to diverge a little more than for ordinary ETFs.

Most ETFs use fairly reliable futures trading positions to deliver their aims. But don't think that these products are riskless in terms of their management teams or ability to actually deliver the performance they claim. Those risks are real, even if they're fairly small.

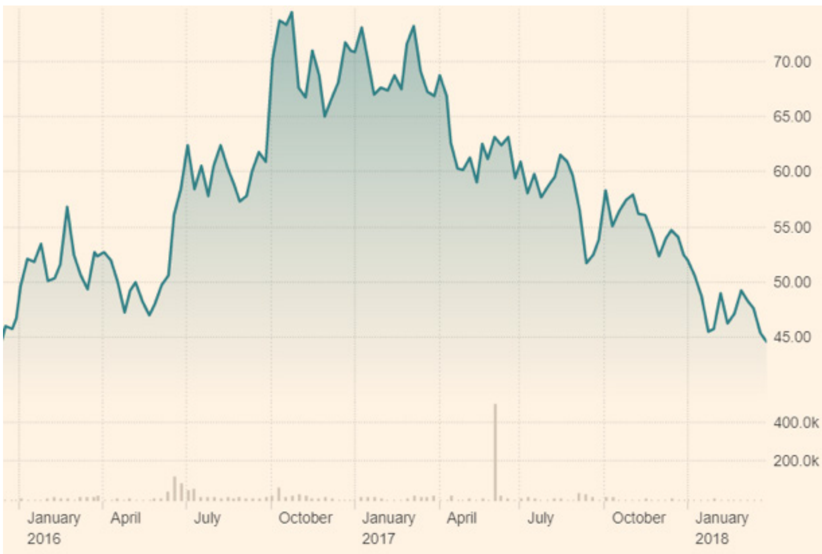
But do these ETFs actually deliver on their promises at all?

Let's take a look at an example. If you had bet on a plunging pound in anticipation of the Brexit referendum, you might've bought the following **ETF: ETFS 3x Short GBP Long USD [SGB3:LSE:USD].** That looks confusing, so let's break it down.

ETFS is the company which provides the ETF. 3x suggests it's triple leverage, as mentioned above. Short GBP Long USD means the ETF is betting on the pound going down against the US dollar.

If you'd bought this ETF just before the Brexit referendum, you would've promptly doubled your money within four months while the pound was hammered.

ETFS 3x Short GBP Long USD after Brexit



Source: Financial Times

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As the pound recovered, the ETF lost value again. It's not a bad reflection of the currency market. Although the ETF has fallen further than the pound has recovered. A good example why you shouldn't hold such an investment too long.

If you're expecting a hard Brexit to trigger new trouble in the currency market, this could be a great investment.

To summarise, ETFs are the convenient way to profit from downward trends in the medium term across a wide variety of investments. They are probably the ideal first step for profiting from a crash in financial markets.

3. Trading volatility itself

Risk and volatility are synonyms to financial market operators. During market turmoil, volatility spikes. Moves in asset prices suddenly become more drastic – measured in per cent rather than the usual tenths of a per cent. Thanks to ETFs, it's possible to trade this surge in volatility itself.

The biggest benefit here is that these ETFs acknowledge a simple truth: a crash isn't a simple tumble in prices. There are plenty of whiplash moments where the market comes roaring back before resuming its plunge.

By betting on volatility rather than the value of an investment, you're more likely to profit from turmoil in general. In other words, you don't have to be right about the direction of the move on a day-to-day basis, just that markets are going to be jumping about all over the place. Which they do in a crisis.

Just as with other ETFs, these are based on an index. The most famous volatility index is called the VIX, which trades in Chicago. It measures the volatility of the S&P 500 index in the US. Since 2013 we have a VIX equivalent for the UK's FTSE 100 too. But there are no ETFs available yet. The US VIX is still the dominant one for VIX investing for now.

One VIX ETF listed on the London Stock Exchange is the Boost S&P VIX Short-Term Futures 2.25x Leverage Daily UCITS ETF (LSE:VIXL). It should give you 2.25 times the return of the original VIX index less an annual charge of 0.99%. It's designed for short-term traders.

Far more popular are the US-listed VIX ETFs. They all use futures to provide their returns.

The iPath S&P 500 VIX short-term futures ETN (NYSE:VXX) holds the first and second month futures contracts on the VIX. It's very liquid and has expenses of about 0.89% per year.

The iPath S&P 500 VIX Mid-Term Futures ETN (NYSE:VXZ) uses the fourth, fifth, sixth and seventh month VIX futures. So it's a longer term bet on volatility. The fees are the same, 0.89%.

As the name suggests, the VelocityShares Daily 2x VIX Short-Term ETN (NYSE:TVIX) doubles the bet on the daily action in the VIX.

Recent research shows that VIX futures move about 50% as much as the VIX index itself. This means the VIX ETFs are less volatile too, because they use these futures. Keep that in mind when considering the size of your investment.

Do these ETFs work? Recent evidence proved they certainly can, and in spectacular fashion too. This chart shows the VIX ETF doubled during the February 2018 10% correction.

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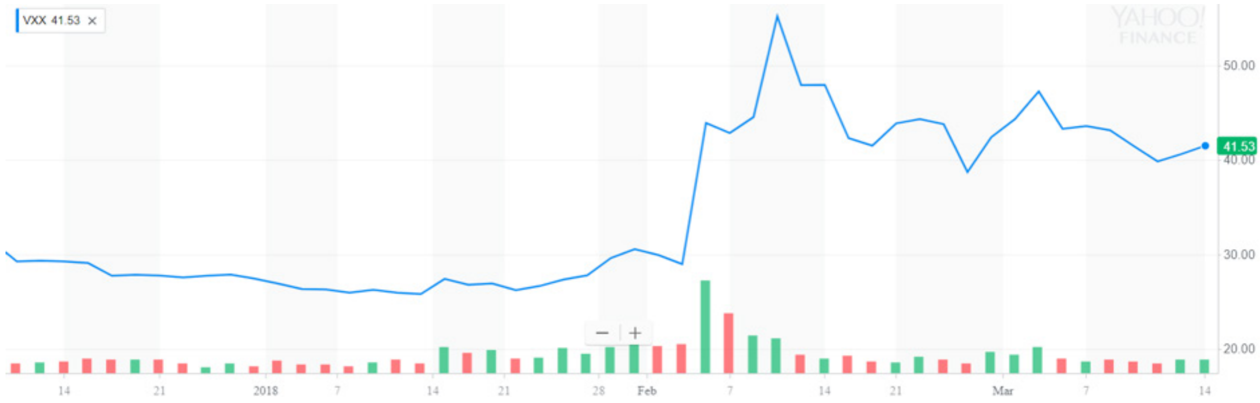
VIX ETF VXX during the February 2018 correction



Source: Yahoo Finance

That's an unusually dramatic jump though. The surge happened from a record low VIX to a recent high. It turned out that many people had been speculating the VIX would fall. But they were caught out. In the end, the dramatic action in the VIX became part of what destabilised the market in February.

Let's take a closer look at what happened. Because volatility had been in a steady downtrend for years, inverse VIX ETFs became popular. They were bets that volatility would continue to decline.

But when the VIX doubled in February as the market got jumpy, these inverse ETFs were effectively wiped out. Because the VIX doubled, a 100% increase, the value of inverse ETFs took a terrible hit – one fell 94%. Their issuers had to redeem them and close the ETF . It's a good example of what can go wrong with inverse ETFs – investors can suffer huge losses within a short time.

The trouble with using a normal VIX ETF to make money from a crisis is that they steadily decline in value until market turmoil hits. Then they surge. But they don't remain high for long. So this is purely a trading opportunity. It's highly unlikely to retain its value over time. Do not forget to sell out once you've made your profits.

4. Gold stocks can profit from rising gold prices in a crash

In the companion to this report, we look into the promise of investing in gold during market crashes. Because gold is tangible and outside the financial system, it's a great investment to hold when the financial system is looking shaky.

We started this report by looking at the FTSE's many crashes and rallies. Over the last 18 years, it's gone nowhere. Over the same timeframe, gold is up fivefold...

But where does this leave gold stocks? These companies dig up the precious metal, but their shares are listed in financial markets. Do they go up or down during a stockmarket rout?

The consensus is that gold stocks can outperform other shares during rough spots. But it's not that simple. This chart shows how three gold stocks outperformed the FTSE 100 index (in red) in 2007 and 2009. But as you can see, 2008 was a bad year for gold stocks too.

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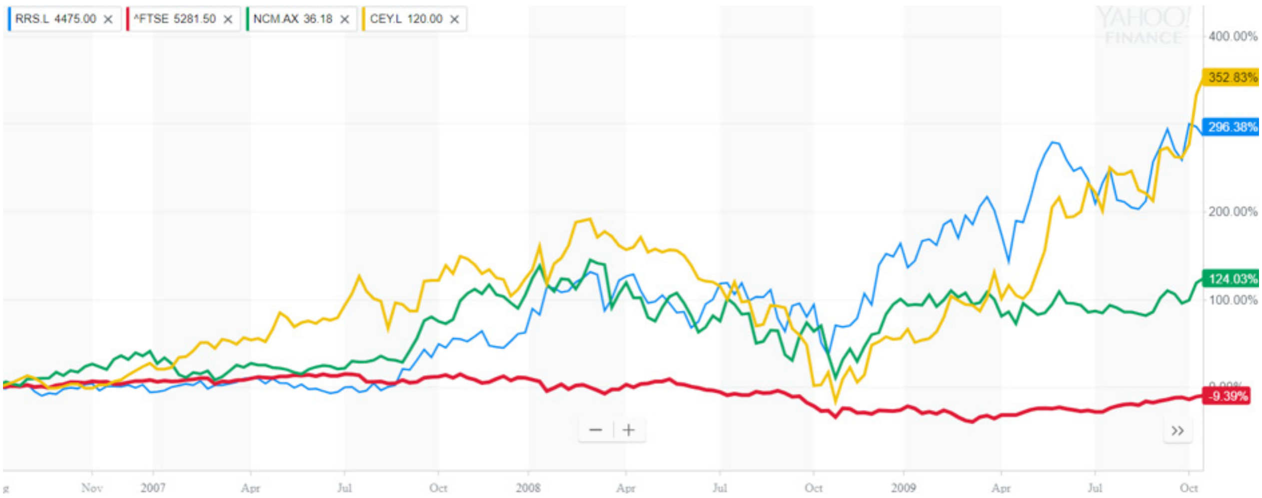

Source: Yahoo Finance

The reasoning is simple. Gold stocks are miners and miners rely on available funding. Their upfront costs are enormous and have to be financed for a long time before the mine becomes viable and there's a payoff. If these companies can't find cheap debt and equity finance, they go broke. And during a financial crisis, that sort of funding disappears. That means gold stocks are at risk during a financial crisis too.

Another important distinction is that there are many different types of gold mining stocks. A speculative gold stock with no reserves isn't going to benefit from a rally in gold because it doesn't have any yet. It's also more prone to financial funding panics.

So if you want to find the right sort of gold stocks to hold during a crash, what do you look for? Companies with large reserves of gold or successfully operating mines that have little debt. You can pay special attention to how much debt they have to refinance, or roll over, in coming years. Companies publish charts of this in their annual reports.

Investing in gold stocks as a crisis hedge is a good idea. But you need to make sure you choose the right ones. In coming monthly issues we'll be working on just that.

5. The investment with the lowest chance of default

Investing in assets that do well during a financial crisis is one way to hedge your risk. But there's another option. You can buy an investment that is highly predictable and comes with extremely low risk. This is only possible at the expense of high returns. But during a crisis, returns are not your priority. Preserving your capital is.

If you agree with this, the investment I'm recommending you buy is a UK government bond, known as a gilt.

Now it might sound absurd to invest in government bonds given the state of government finances and the propensity for central banks to print money. In fact, I think government bonds are a miserable investment in the long term.

But there's a particular way to invest in government bonds that I think you should follow in anticipation of a crisis. It's simple – hold bonds set to mature in the next few years to maturity instead of selling them. I'll explain below. First, let's look into the basics of gilts.

Gilts have two redeeming attributes. They deliver defined cash flows and have extremely low default risk. What do I mean by that?

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Gilts pay out a fixed amount of money on fixed days. There's usually the coupon paid every six months, plus the principal on the day the bond matures. If you hold a gilt to maturity – when it expires and the principal is paid back by the government – then there should be no surprises anywhere along the way. You know exactly what you're getting and when at the time you buy the investment. Compare that to the uncertainty in shares or any other investment and you'll begin to see the benefit. Especially when you're worried about a crash.

It's similar to a term deposit, except banks can fail, like Northern Rock did. It's extraordinarily unlikely that the UK government will ever default on bonds held by the British public. It might print money. It might default on foreign-held bonds. It might cancel debt held by the Bank of England. But defaulting on its debts held with the British public is extremely unlikely. In fact, it has never happened before.

Better still, government bonds tend to rise in value during a stockmarket crash . But not by much. You might want to trade them for this profit. But what I'm arguing for here is that gilts are the most certain investment in financial markets for a British investor. Certain in the sense that they're predictable and have a low default risk. Buying these investments, if you plan to hold them to maturity, is a great way to protect yourself from a crisis.

But why do I emphasise holding the gilts to maturity? Because, if they crash, as they did in the 70s, an investor who holds to maturity is not affected by this crash. They still get their principal back, plus the coupon payments in the meantime. It's an investment you don't have to sell to get your money out. Therefore you have no price risk if you commit to hold to maturity. That's incredibly valuable when falling prices are what's causing all the problems elsewhere in financial markets.

If you want to use gilts in this way, do not invest in bonds that have too many years to maturity. If you are forced to sell during a crisis, you could still lose money on gilts. Or if inflation surges, wiping out the value of the money you get. But inflation tends to take time to emerge. And it's likely to be less of a problem than a market crash.

Remember, buying bonds that have too many years before they mature means you do face price risk, because you might have to sell out at some point. And the risk of inflation eking out your gains rises too. Stick to bonds that will mature in the next few years.

Let me put it this way. Companies tend to keep their spare cash in government bonds because they trust them more than banks. You can easily move cash around via the bond market. I'm suggesting you do the same.

But how do you get your hands on gilts? Let's ignore investing in gilt funds, as these don't deliver the benefits I've just taken you through – they don't mature. You have a few options for buying gilts directly.

The first is the ideal way. You register with the government's Debt Management Office (DMO) as an approved investor, which requires some ID and financial checks carried out by Computershare. Then you can buy gilts on the day they're issued by the DMO.

The problem is, most gilts are long dated, meaning they won't reach maturity for many years from the date they're issued. You probably want to buy them when they're closer to maturity – between one and five years away – if you're trying to achieve the goals above. Otherwise inflation could take too much of a toll.

To buy gilts set to mature in the next few years, you can purchase them in much the same way you do shares with your brokerage account. The downside is the transaction cost, which is £0 for the direct DMO purchases above. But if you consider the side-costs of dealing with the DMO, it might actually be cheaper from the comfort of your own home using an existing system you know well. There's no background check this way either because the brokerage performed it for you already.

Let's take a look at an example of a gilt you might buy. The two-year gilt with the ticker code TMBMKGB-02Y has the following characteristics. It reaches maturity in 22/07/2020, has a coupon rate of 2%, a price of £102.535 and a yield of about 0.9%. Confusingly, gilts are issued in £100 pound units even though their nominal value is £1,000. Each unit is effectively a tenth of an actual gilt.

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The interest, or coupon, is how much you're paid each year in cash. In this case, it's two payments of £1, one every six months. On 22 July, the £100 will be paid, along with the final coupon. This total return, known as the yield, is 0.9% per year. You face a loss of £2.535 because the price is higher than the principal. But you get coupon payments of £1 every six months. In the end, the yield of 0.9% is not much, but it's safer than the bank.

Don't confuse the yield and the coupon. Because the prices of gilts fluctuate, the coupon is not your rate or return. That is partially determined by the price you pay for the gilt.

There are also inflation linked gilts if you prefer to be hedged against that risk.

One of the benefits of gilts is that any capital gain is tax free. So if you do decide to sell for a profit instead of holding to maturity, your gains are tax free. That could happen during a financial crisis, because people flock to government bonds for the reasons I've described above. They bid up the price, no matter how low the yield.

Now that you understand gilts and their benefits, why not try buying one which matures in coming months so you can see how they work. Then, if you suspect a crash, you can secure a chunk of your wealth in the gilt market when the time comes. The returns will be low, but the default risk is tiny. Your wealth will be intact, no matter how much the market crashes.

6. The peer to peer financial system

The internet has made it easy to match buyers and sellers of all sorts of products. eBay is full of anything you can imagine and more. Why not participate in this peer economy? There are two ways I suggest doing so for profit.

The first is lending. Firms like Ratesetter and Zopa allow you to deposit money and lend it out. What makes the idea attractive is the interest rate. It's far higher than the market rate anywhere else.

These systems are so profitable for lenders because they don't have the enormous costs of the branch banking system. They simply match borrower and lender and perform background checks.

Please be aware, the peer to peer lending system is still fairly new. It hasn't really been tested by a recession or financial crisis since it became a big player. When a recession does strike, who knows what it might reveal? Default rates could surge and the support fund could disappear in short order.

So be very careful using platforms like these. But allocating some of your money to them is a great way to profit and diversify away from the traditional financial system.

The second option is CurrencyFair. This Irish firm matches people looking to exchange foreign currencies. Thanks to the way the platform operates, it doesn't feel like you're having to swap with others though – it's actually more convenient than the bank in my experience.

Using CurrencyFair, you can hold foreign currencies without having to get a foreign bank account. It's also very cheap to exchange between them.

But beware the risks! CurrencyFair is not a bank and it is quite new. The company isn't profitable yet either. So we can't be sure it'll survive.

How would you use CurrencyFair? You could've moved your money into US dollars in anticipation of Brexit to profit on the exchange rate's moves, for example.

7. Stockmarket crash insurance

The traditional way to profit from a falling stockmarket is to buy put options. These pay off when stocks fall below a specified level. To understand how to use them, you need to jump into the rabbit hole of how they work.

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Options are the right, but not the obligation, to buy or sell something at a specified price and date in the future. The option buyer pays a premium (like a one-off insurance premium) to the seller of the option for this right.

At the specified date, the option buyer can either execute the agreement and ask the seller of the option to hand over the asset at the price agreed in advance, or they can let the option expire. The seller of the option keeps the premium either way – whether the transaction is completed or not.

Options are popular with savvy investors and larger institutions. One way to use them, and think about them, is like insurance. If you want to protect your portfolio of stocks against a crash, you can buy a put option to do so. You pay the premium. If there is a crash, the value of the option will surge, offsetting your losses in the portfolio. If there is no crash, you do not execute the option and it expires worthless. You lost the premium.

There are actually two types of options. Each of these can be bought and sold, creating four possible positions you can take. Only one is relevant to protecting your portfolio from a market crash by profiting. So let's look at how buying put options works.

Say you own BP shares and are worried they'll crash.

You could buy a put option to sell the shares at £460 in one year, and pay a premium of £1 for this right. If the price doesn't fall below £460, you'll lose your £1 but won't have to sell the shares. If the price tumbles, your option will suddenly be worth a lot of money. It grants you the right to sell your BP shares at £460 even though the price is far lower in the market.

You could wait for the option to expire and sell your BP shares at £460. But many people who use options sell them before they expire and collect the profit or loss on the option itself instead. Using a complex model, the value of that option is calculable.

These days, options tend to settle in cash instead of the underlying asset. So instead of actually selling your BP shares for £460, you'll just receive a cash payment that'll compensate you for the decline in the share price. The compensation will be equal to the amount you would've profited had you carried out the transaction of selling the BP shares above their market price. So it depends on just how far BP shares fall below £460.

There are plenty of options on indices like the FTSE 100 too. These are best for hedging against a market crash.

Just like short selling, each broker has different rules and costs when it comes to options. You need to familiarise yourself with their guides. Don't forget to focus on buying put options – the way to insure yourself against a crash.

8. Become a CFD trader

Contracts for difference (CFDs) have an undeservedly awful reputation. The way the media and regulators portray them is terribly unfair.

The key thing to understand is that they offer you a very efficient and powerful way to trade a market crash. That's because it's just as easy to bet on an investment going down as it is up when it comes to CFDs.

The basic idea of the CFD is that you make a bet on the price of something, rather than investing in it. So it's just as easy to bet on a fall as a surge.

People can be seduced by the power and convenience of CFDs. They make investing as easy as gambling. Next thing you know, you can't tell the difference.

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The danger of CFDs is that you can bet too much money or make a similar mistake when it comes to executing your trade.

But, assuming you can control yourself, and are careful putting on your trades, there is no reason to be so sceptical of CFDs.

In a market crash, having a CFD account you know how to use would allow you to trade the crash for immense profits in a very easy and convenient way.

Keep an eye on the market and your inbox

The challenge of profiting from financial market turmoil is the same as normal investing – timing. That's why I can't make specific investments in this report.

Instead, it's designed to prepare you for the monthly recommendations we make in The Fleet Street Letter Monthly Alert. If we decide to recommend a particular ETF, for example, you'll know where to look for background information on what they are and how they work.

When trying to profit from falling markets, the risks are higher in many ways. For example, options prices can surge or fall far faster than stocks. You need to properly understand how these financial products function. And I hope this report is your first step in doing so.