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OUTSIDE THE FLAGS

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The Dangers of DIY Trading

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Many people have taken advantage of the coronavirus lockdown to learn new skills—from baking bread, to knitting, to learning a language. But trading securities, like rewiring the house, is not something you should do without professional advice.

The danger of attempting to 'play' the market through short-term trading and timing strategies was highlighted recently in a warning to retail investors by market watchdog the Australian Securities and Investments Commission.[1]

The regulator said its own analysis of securities markets during the COVID-19 lockdown had revealed a substantial increase in activity by retail investors or 'day traders'—people using now easily accessible software and trading tools to try to time the market.

Not only had trading frequency increased rapidly during the pandemic, but the duration of people holding securities had fallen significantly. In short, it looks like folks in isolation at home have been trying to generate quick windfalls from market volatility.

"Even market professionals find it hard to 'time' the market in a turbulent environment, and the risk of significant losses is a regular challenge," ASIC said. "For retail investors to attempt the same is particularly dangerous, and likely to lead to heavy losses—losses that could not happen at a worse time for many families."

Of course, a common reaction to these sorts of warnings is for people to say to themselves: "It's true there are a lot of naïve day traders out there with no experience. But the difference is that I'm extra careful and I know what I'm doing."

Unfortunately, there is little evidence that there is a burgeoning industry of successful home-based stock traders out there. ASIC says its analysis found retail investors chasing quick profits traditionally perform poorly in good times and bad and even in relatively stable, less volatile market conditions.

Using its market surveillance data based on trading through retail brokers, ASIC focused on activity in the period from 24 February to 3 April.

1. 'Retail Investors at Risk in Volatile Markets', ASIC, 6 May 2020

It found that on more than two thirds of the days on which retail investors were net *buyers* in this period, the prices of their targeted shares declined the next day. Conversely, the study found that on days in this period where retail investors were net *sellers*, the shares they sold more likely increased the next day.

In other words, the regulator says its detailed research over this focus period found little evidence that home-bound DIY traders were proficient in predicting short-term market movements, either on the way down or the way up.

"While markets generally recover over the long run and tend to grow with economic fundamentals, short-term trading and poor market timing can be a major risk for investors in volatile markets," ASIC said. "Therefore, retail investors should be wary of trying to 'play the market' for short-term price movements by day trading."

Furthermore, the regulator warned that the probability and impact of unpredictable news and events in offshore markets overnight only magnified this danger.

On top of failed timing attempts and short-term holding periods, ASIC also expressed concern that unsophisticated investors are increasingly trading in complex, often high-risk investment products like highly-geared 'contracts for difference' (CFDs).

"Leverage inherent in CFDs magnifies investment exposure and sensitivity to market volatility, so retail clients should be particularly cautious about investing in leveraged products at this time," the regulator said.

In previous statements, ASIC has said while some people may be drawn to the sense of control they feel in investing for themselves and the opportunity to save money, the risk is that they overrate their own expertise and fail to diversify sufficiently.

"A financial advisor can help you set financial goals, understand your risk tolerance and find the right investments," the regulator says on its popular 'MoneySmart' site.

In summary, while the COVID-19 isolation period has encouraged many of us to become more self-sufficient, short-term trading in stocks and derivatives may be a bridge too far for the do-it-yourself brigade.

After all, global financial markets are highly competitive and full of smart people with sophisticated trading and analytical tools. News is quickly built into prices. While amateurs may feel they have an edge, there is little evidence that this is the case.

Rather than trying to generate quick profits through hazardous trading, a better approach is to think about your goals and build a diversified portfolio aimed at achieving them—a portfolio that is made for you and that allows you to sleep at night.

All that is best done with advisor who knows you and what you can live with.

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