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Reimagine Financial Services: Customer Journey

The Rise of the Retail Trader

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Reimagining Capital Markets

By Saanya Sarin

The surge in retail trading is heralded by advocates as the triumph of the 'little guy' over financial giants - and by its detractors as a dot.com bubble waiting to burst. But love it or loathe it, retail trading is now so prevalent that it can't be ignored.

In January 2021, the growing power of digitally-enabled small investors hit the headlines, following the spectacular rise and fall of shares in the US video game retailer GameStop.

The retail traders' actions defied professional experts. Commentators speaking out against the subsequent restrictions on platform trading include Tesla CEO Elon Musk and one-time Wolf of Wall Street, Jordan Belfort, who went so far as to herald this a "radical change" in the market. "Information travels instantly now...so the little guy finally has the ability to play the same game [as the big guys], at least somewhat," he said.

Case for caution

Others including regulators see risks ahead, especially if people with little or no money to spare experience severe losses. Moreover, while some believe that retail trading opens the way towards a fairer and more democratised market, others worry that the 'big guys' will always have more experience, analysis and financial clout at their disposal. Even the so-called 'Reddit rebellion' that was thought to have fuelled the rise in GameStop's share price may not have been quite as impactful as it first appeared. Research carried out by JP Morgan suggests that the market movements owed more to institutional money than small investors.

Further controversy centres on the ultra-low or even zero commissions used to attract investors. These provide welcome price competition in the equity trading market. The internet has also made it easier to compare fees and shop around. However, there are concerns that, once in, investors could be encouraged to buy riskier securities such as contracts for difference (CFDs). In response, sale of CFDs have been severely restricted by the FCA.

Embracing a new reality

Welcome or not, this phenomenon is here to say. According to analysis carried out by Bloomberg for the Financial Times, retail trading now accounts for almost as much US equity trading volume as mutual funds and hedge funds combined. It's therefore an important channel for sourcing and directing capital.

Rather than combating, curtailing or even prohibiting retail trading, a more sensible course would therefore be to accept it as one of the realities of a market being transformed by digitisation, manage the risks and embrace the opportunities. This is certainly the view of many banks and brokers, who are launching new investment portals to take advantage of the trend.

Setting up your own retail trading platform not only provides access to a new pool of investors, but would also enable you to directly influence this increasingly important area of the share dealing market. It can also be aligned with robo-advice, digital profiling and other tech-enabled capabilities to create low cost, customised financial guidance and solutions.

How can your business capitalise while sustaining effective protection for small investors and control over market risks?

Five priorities stand out:

Understand the landscape

The starting point for balancing the risks and rewards is to understand why retail trading is taking off.

Retail trading is an opportunity – albeit a risky one – to reap more returns than are offered by today's meagre interest rates. This is also a time when many young people in the UK now despair of ever being able to get on the property ladder. Many are therefore channelling their surplus cash into another currently rising asset class – equities.

The young digital native demographic means that some investors adopt a 'gamer's instinct' as they move from one hot stock to another. Much of the focus is also driven by dedicated social media influencers, who may have many more followers than their mainstream analyst rivals. Yet, far from the slavish followers of viral trends or the bored millennials looking to fill time during lockdown that are so often portrayed in the media, retail traders are a varied and often savvy group of investors. It's perhaps telling that despite all the social media frenzy over GameStop in January, it wasn't even in the top ten of most traded stocks by small investors.

Both from a commercial and risk management perspective, it's important to recognise these motivations and the dynamics of how shares are profiled, bought and sold within this segment of the market.

Monitor the influencers

Social media isn't regulated in the same way as professional financial analysis or advice. Therefore, one of the biggest concerns for regulators is what information retail traders are receiving, how much of the trade flows are being driven by a small selection of star influencers and what impact this has on potentially vulnerable investors or the market as a whole. What new rules might transpire as a result remains to be seen. However, regulation of social media is notoriously difficult to agree, let alone enforce across a borderless virtual universe.

That means that the onus is very much on you as a bank, broker or market maker to closely monitor what is being said, its influence, its validity and the potential risks. Clearly this includes the impact on share prices and any potential distortions.

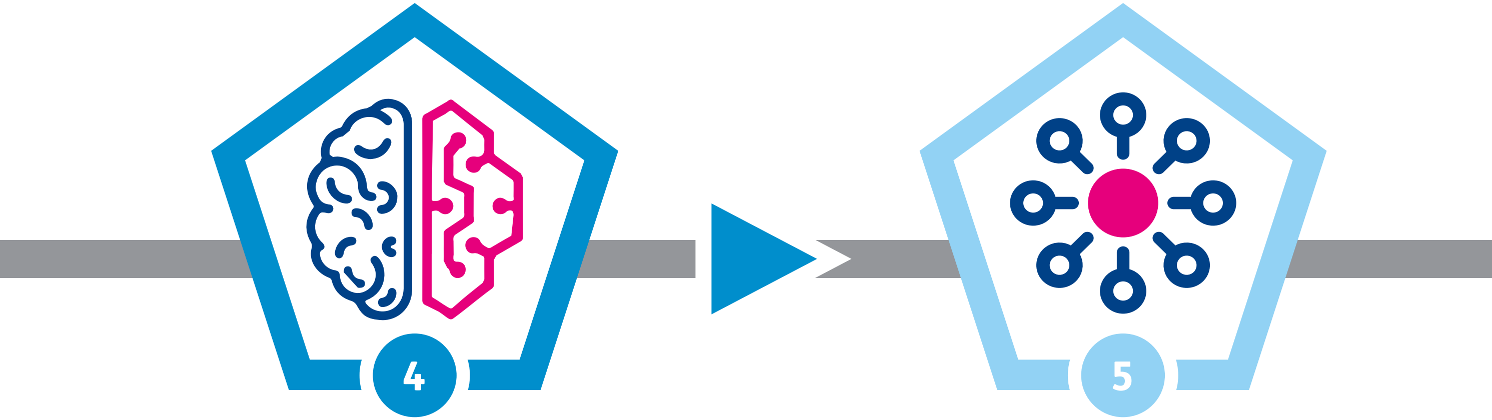
Traditional investor relations, market reporting and financial PR remain important. But your social media monitoring and engagement should now get equal billing. As companies in other spheres of commerce have found, the big danger is treating social media as a sideshow, only to find themselves engulfed in a wildfire of bad publicity. The digital savvy of many of these young retail traders heightens this risk.

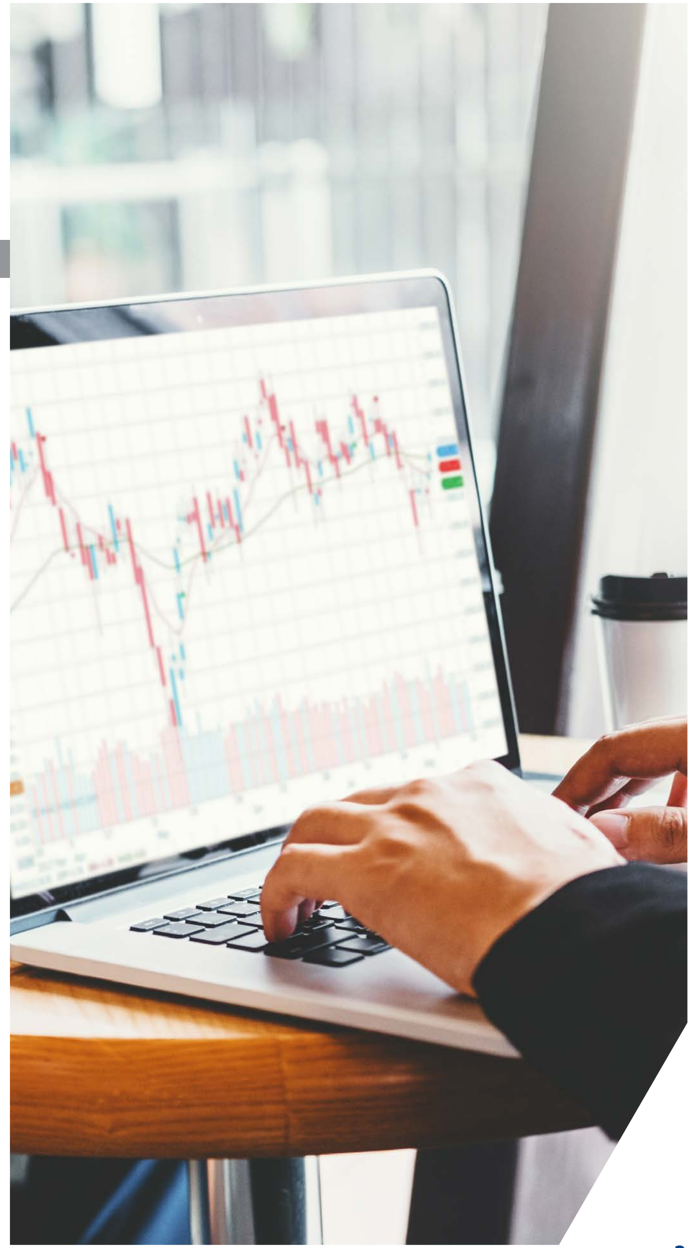
Put in controls

As your investment portal presence grows, it's important to assess and actively address the potential market, conduct and reputational risks.

Terms, conditions and disclaimers aren't enough, especially as investors may not read or understand them. Moreover, even if the disclaimers stand up in court, they might fall foul of regulatory scrutiny or lose out in the court of public opinion.

That's why protections such as behavioural analysis and possible trading/loss-bearing limits are so important. To help inform investors and differentiate from digital-only services, it's also possible to combine robo-advice and self-service dealing with analysis from your expert teams.





Properly educate

Education is clearly critical in raising awareness of the risks and how retail traders can protect themselves. But this needs to be geared to the demographic and delivered on the channels they most use and trust. This underlines the need for an active and relevant social media presence. It's also important to stress the potential for volatility and encourage investors to be clear about how much they can afford to lose.

Put ESG at the centre of your offering

This is a demographic with heightened environmental, social and governance (ESG) awareness and expectations. Look for opportunities to promote ESG-supporting investment opportunities. Build this into your social media engagement. Learn from the social media traffic about what shares are favoured from an ESG-perspective and what aren't.

Managing Threats and Opportunities

Like all disruptive trends, retail trading can't be wished away. Winners will embrace the increased pool of investors, while boosting risk awareness and control. We will continue to see them building retail trading into their wider push to attract digital natives and integrate ESG into investment strategies.

An example of this is the Robinhood IPO, which will allocate as much as 35 percent (an unusually large amount) of the 55m shares it plans to sell to investors buying directly through its app, but is also facing increased volatility and regulatory scrutiny.

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