Financially Speaking

New Investors Can Be Rewarded But Need To Be Careful

Over the last few months I've had five virtual meetings with young adults that are either still finishing college or fairly recently graduated and are getting started with their first full time job. While it is not unusual for clients to ask me to talk to their young adult child as they get started in the world on their own, the conversations this year were quite different than those that I typically experience. To a person, these young adults were all very interested in getting started with investing and were actively looking for information and resources to help them be successful at it.

On a multitude of levels I applaud each of these young people – for recognizing the importance of saving for the future, for wanting to start investing as soon as they can and, perhaps most importantly, for realizing that investing isn't something that they can just do a couple of Google searches to become proficient at.

A worrisome trend that seems to have really accelerated this year is the advent of what I will call the "smartphone trader". Having been a financial advisor for close to 25 years, I remember vividly when day trading was in its prime in the late 1990s and almost everyone knew someone who had become wealthy almost overnight by buying and selling mostly internet related technology stocks. I also remember well the tragic stories of loss, bankruptcy and even worse that followed when the tech bubble burst and many of those stock prices came crashing back to reality. The popularity of day trading crashed as well and seemed to be largely over.

Today's smartphone trader though tends to share many of the same concerning characteristics as the day traders of old and I worry about where that could lead for the people involved.

In a world where more and more can be done virtually or on-line I guess it should come as no surprise that multiple companies have developed apps for smartphones that allow people to literally trade stocks with a couple of taps on their phone. One of the most prevalent, Robinhood, markets fairly aggressively to exactly the demographic that I mentioned – college students and young adults.

Robinhood, and other similar apps, offer very low trading costs, the ability to invest small amounts of money and even the ability to buy fractional shares if you don't have enough in your account to buy a full share of stock in the company you want. All of that, combined with the ease of use and the ability to trade whenever you want throughout the day adds up to quite an appealing package. Right?

Maybe that is the problem.

People have flocked to Robinhood and similar apps in droves, opening literally millions of accounts in 2020 alone. Unfortunately, these apps require no prerequisites to start trading. No mandatory courses to explain the ins and outs of how the investment markets work or even, in the case of more complex investments like options or futures contracts, a primer on the logistics of how the trades will work. Instead the apps provide links to data – lots of charts and graphs and financial reports that can just as easily be found with an on-line search - but no basic course on how to invest.

Without a bigger framework people too often tend to find one or two data points that they frame their investment decisions around, potentially missing the forest for the trees. For example, smartphone traders recently poured money into a stock following a sharp price decline, clearly because they were watching for price drops over a certain percentage as an “opportunity”. What they unfortunately missed was that the reason the price dropped so much was because the company had announced its intention to file for bankruptcy. Ouch.

Even more troubling, is the perception that some develop that investing is just another game to try to win. This can feed the misconception that someone is always “winning” or making money which can lead to little patience with normal stock market volatility because they believe they must be “losing” if their stock price goes down. It certainly doesn’t help to dissuade that notion when the smartphone app they are using is filled with falling confetti and emoji filled trade confirmations.

And in a time when professional sports are limited, I worry when the founder of a website normally focused on sports gambling suddenly shifts his focus, and his social media platforms, to stock trading and acknowledges that he is doing it to fill the gambling void.

The truth is that investing can be very rewarding over time but it takes a lot of discipline and most of the time returns accumulate gradually from owning good quality investments for the long term, not from one lucky purchase or a series of rapid trades. I strongly encourage anyone that is able and interested to invest, but don’t be afraid to get help as you get started.

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