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INTRODUCTION TO ONLINE TRADING

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Introduction

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Risk Warning: Trading Contracts for Difference (CFDs) on margin carries a high level of risk and may not be suitable for all investors. Before deciding to trade Contracts for Difference (CFDs), you should carefully consider your trading objectives, level of experience and risk appetite. It is possible for you to sustain losses that exceed your invested capital and therefore you should not deposit money that you cannot afford to lose. Please ensure you fully understand the risks and take appropriate care to manage your risk.

What is Online Trading?

Online trading is simply buying and selling assets through a brokerage's internet-based proprietary trading platforms. The use of online trading increased dramatically in the mid- to late-'90s with the introduction of affordable high-speed computers and internet connections. Stocks, bonds, mutual funds, ETFs, options, futures, and currencies can all be traded online. Also known as e-trading or self-directed investing.

Traditionally, investors and traders have to call their brokerage firms to make a trade for them. If John wanted to purchase 50 shares of Intel, he would call his broker with a buy order request. The broker would let John know the market price and confirm the purchase order. If the investor is making a limit order, the broker has to confirm the limit price, how long to keep the order open for, what account to purchase the shares in (if John has multiple investment accounts), etc. The investment representative must also confirm the commission costs for making the trade. When all has been established, the broker would place the trade in the system which is linked to trading floors and exchanges, such as the New York Stock Exchange (NYSE) or the NASDAQ. The client would receive a trade confirmation by mail and a monthly or quarterly statement of account showing a list of his investments. If John wanted to transfer some cash from his trading account to his checking account, and vice versa, he would also have to call in to make that transaction request.

Today, with the advent of the internet in the digital era, more and more investors are using online trading platforms offered by their brokers for DIY (do-it-yourself) investing. The online trading platforms serve as a hub with multiple tools for the investor or trader. The investor can place buy and sell orders; place market, limit, stop, stop-loss, and stop-limit orders; check the status of an order; view real-time stock quotes; read news on companies; view the list of securities currently held through the dashboard; etc. An investor can also access his or her investment statements, confirmation statements, and investment tax forms using the online system. Most discount brokerages that are affiliated with banks also provide added convenience for their digital clients by linking their bank accounts to their investment accounts. This way, an investor can easily initiate a transfer between accounts held under the same financial institution.

The advent of online trading has reduced costs for both investors and discount brokers. To encourage people to do their investing themselves, brokers have lower commissions for trades placed online than for trades placed over the phone with a representative. It is not uncommon to pay somewhere between $4.95 to $9.99 for an online trade; same trade which would cost about $29.99 if made over the phone. The lower fees have also made the capital markets accessible to a wider range of people who may not have been able to afford the higher commission fees of a personal advisor or over-the-phone trade. As brokers transition into automated trading, they save costs on their ends from hiring fewer human representatives.

Another benefit of online trading is the improvement in the speed of which transactions can be executed and settled, because there is no need for paper-based documents to be copied, filed and entered into an electronic format. When an investor enters an order online, the order is placed in a database which checks for the best price by searching all the market exchanges that trade the stock in the investor's preferred currency. The exchange with the best price matches the buyer with a seller and sends the confirmation to both the buyer’s broker and the seller’s broker. All this is done within seconds of placing a trade, compared to making a phone call which has to go through several confirmation steps before the rep can enter the order.

It is up to an investor or trader to do his due diligence on a broker before opening an online trading account with the company. Before an account is opened, the client will be asked to fill out a questionnaire about his or her investment and financial history to determine what type of trading account is suitable for the client. If the investor has little knowledge about the different types of securities and trading strategies in the financial world, a simple cash account will be opened for him for doing simple buy and sell orders on stocks, mutual funds, bonds, and ETFs. On the other hand, a sophisticated trader who would like to implement various trading techniques will be given a margin account in which he can buy, short, and write securities such as stocks, options, futures, and currencies.

Not all securities are available to be traded online, depending on your broker. Some brokers require that you call them to place a trade on any stocks trading on the pink sheets and select stocks trading over-the-counter. Also, not all brokers facilitate derivatives trading in commodities and currencies through their online platforms. For this reason, it is important that the trader understands what a broker offers before signing up with the trading platform.

Traditional Trading VS Online Trading

In the past, investors would call their broker to make a trade for them. They could either visit or telephone their broker. In fact, there was no other choice.

In the 1970s, for example, if I wanted to buy 100 IBM shares, I would call my broker. I would then place an order request. The broker would let me know what the IBM share market price was, and confirm the order to buy.

In the past, the whole procedure was relatively lengthy. The broker would confirm how long to keep the order open, which account to withdraw money from, etc.

Today, with online trading, it is a do-it-yourself world. In other words, online traders can buy and sell financial securities on their own. In fact, they can even carry out multiple trades with nobody else's help.

Most importantly, the modern online trader can do all these things rapidly. In fact, almost instantly.

5 Benefits of Online Trading

1. Lower fees

One of the clearest advantages of online trading is the reduction in transaction costs and high fees associated with traditional brick-and-mortar brokerage firms. Typically, you'll pay between $5 and $10 to buy and sell stocks and exchange-traded funds at online brokerages.

2. More control and flexibility

Time is often of the essence when you trade stocks, so the speed of using online trading portals is a benefit to many investors. With online trading, you can execute a trade almost immediately. Traditional brick-and-mortar brokers might require appointments, either online, over the phone or in person, just to initiate a trade. Which is a job of your personal broker.

3. Ability to avoid brokerage bias

By taking trading into your own hands, you can eliminate brokerage bias. Bias sometimes occurs when a broker gives financial advice that benefits the broker — such as in the form of a commission for selling specific mutual funds and other products.

4. Access to online tools

In the world of online trading, a lower cost does not necessarily mean a shoddy product. Many of today's online trading companies offer customers an impressive suite of tools providing valuable information and helping optimize trades.

5. Option to monitor investments in real time

Many online trading sites offer stock quotes and trade information that make it easy for people to see how their investments are doing in real time.

Profit Whether the Value Goes Up or Down

Anybody who knows about trading shares on the stock market understands that it is not possible to sell shares that you do not own, so you must buy before you can sell. That restricts options for traders to profit from their skill at predicting. Online trading plug that gap. It enables traders to profit on rising and falling values because they do not own the assets of the underlying market but only trade the price movement.

Leveraging

Online trading enables the investor to trade on margin, which is called leveraging and is a major benefit. The effect is that where, for example, an investor wants to open a position in the S&P 500 worth $5,000 and the broker requires a 10% margin, then only $500 is needed to create the trade.

If the price moves favorably for the trader, then the profit is calculated on the full $5,000 position. On the other hand, losing trades also have the loss calculated on the full amount. You can see why great care must be exercised when applying leveraged trading.

Hedging

Online Trading is ideally suited to provide a form of insurance for trades in the underlying market, known as hedging. Say, for example, you buy shares on the stock market in Company A and the share price drops, meaning your investment is showing a loss. You can limit your losses by opening a trade selling (going short) the price. That will return a profit if the price continues to fall.

A Wide Range Of Contract Sizes

Being able to invest amounts that match your appetite for risk is a cornerstone of successful long-term trading. Therefore, be sure to select a broker that offers a good range of contract sizes. That enables novice traders to begin with mini contracts that offer minimal exposure and risk. As you grow in confidence, you can gradually choose larger contract sizes, as experienced traders do.

In that way, less experienced traders can begin with mini contracts and lower exposure to the markets, whereas seasoned traders can still trade in larger volumes.

The Bottom Line

You don't need to engage in online trading to accumulate a nest egg. The best way to build wealth is by saving early and often, then investing that money in a diversified portfolio that takes an appropriate amount of risk for your age. But if you're keen to trade, go into it slowly with a base of knowledge and awareness of potential risks.