



ASIC
Australian Securities &
Investments Commission

Retail investor trading during COVID-19 volatility

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Summary

This paper outlines some early observations by ASIC staff on trading in securities and contracts for difference (CFDs) during the volatility caused by the COVID-19 pandemic (COVID-19 volatility).

It was produced to inform our work in managing the impact of the COVID-19 pandemic and is published to raise awareness and provide detail on recent retail investor trading activity and issues of concern.

The paper highlights a range of potential retail investor harms. It is divided into three parts:

- (a) Section A sets out the changes we observed in retail trading activity in securities markets;
- (b) Section B sets out the potential retail investor harm in securities markets; and
- (c) Section C discusses CFDs and market volatility.

Examples in this paper are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

Time periods covered in this paper

The securities market analysis in Sections A and B is derived from ASIC's exchange market surveillance data, using trading through retail brokers. We use this as a proxy for retail investor activity, but we note that not all trading through these brokers is 'retail' within the context of the *Corporations Act 2001* (Corporations Act). The 'focus period' is from 24 February 2020 (the first trading day after the market peak) to 3 April 2020, and the 'benchmark period' used for comparison is the six months prior (22 August 2019 to 21 February 2020).

The CFD analysis in Section C is based on over-the-counter (OTC) derivatives trade repository data and separate data provided by a sample of 12 Australian licensed CFD providers for the seven days from 16 to 22 March 2020.

A Changes in retail investor trading activity in securities markets

Changes in turnover and market share

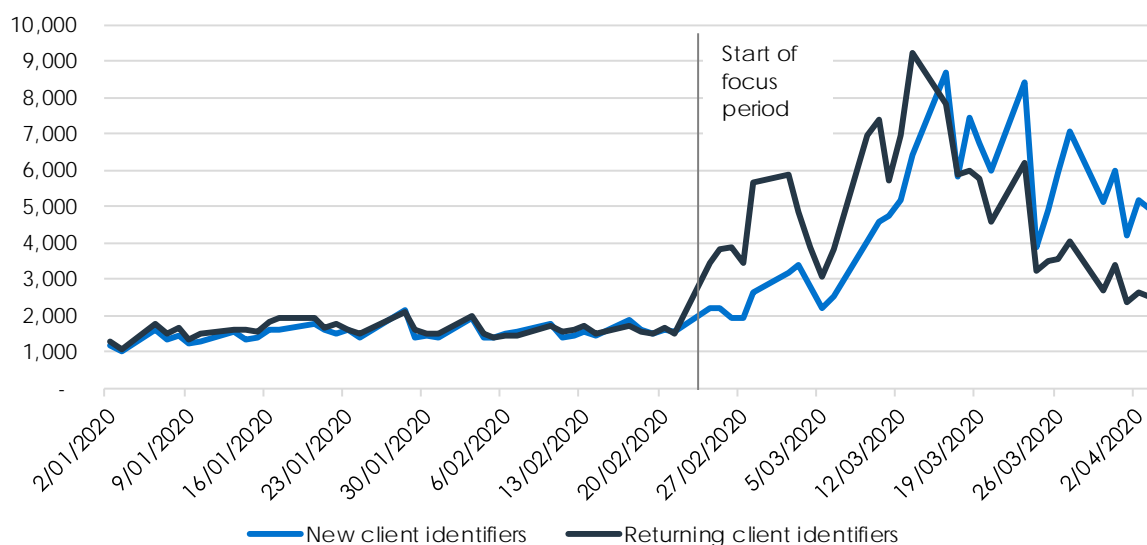
The average daily securities market turnover by retail brokers increased from \$1.6 billion in the benchmark period to \$3.3 billion in the focus period. Retail trading as a proportion of total trading increased marginally, from 10.62% to 11.88%, when benchmarked against the backdrop of total average daily securities market turnover—which increased from \$15 billion to \$28 billion (counting both sides of each trade, consistent with retail numbers).

Retail brokers were net buyers of securities over the focus period, buying \$53.4 billion and selling \$48.4 billion.

Trading by new and dormant accounts

There has been a sharp increase in the daily number of unique client identifiers (indicative of new client accounts) associated with retail brokers that are appearing for the first time in ASIC's trade surveillance data. An average of 4,675 new identifiers appeared per day in the focus period. This made up a total of 140,241 identifiers we had previously not observed. In the benchmark period, we observed 1,369 new identifiers per day and an average of 34,502 new identifiers appearing in a period of the same length. See Figure 1 for the increase in activity by new and dormant accounts during the focus period.

The rate of creation of new accounts (as indicated by their identifiers) is roughly 3.4 times higher during the focus period (compared to the benchmark period). In the focus period, new accounts represented 21.36% of all active accounts. New account made up 3.65% of all active accounts in the benchmark period.

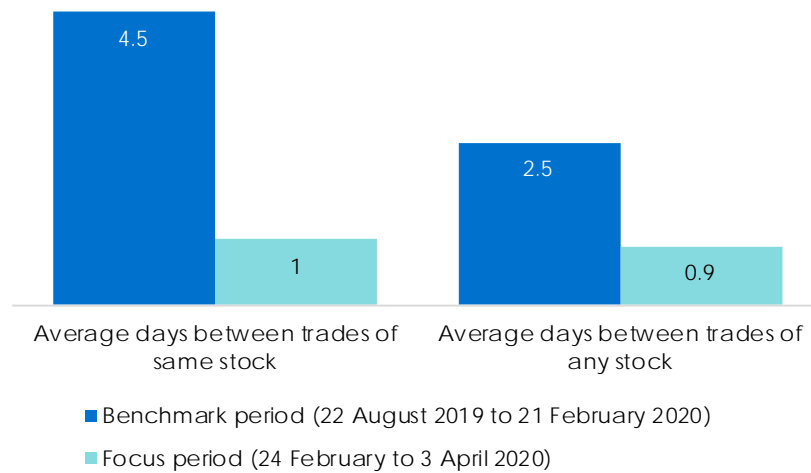
Figure 1: Increase in new accounts and dormant accounts re-entering the market

A large number of ‘dormant’ client identifiers from retail brokers, which had not traded during the preceding six months, started trading again in the focus period. A total of 142,022 ‘dormant’ retail broker client identifiers did not trade during the benchmark period, but recommenced trading during the focus period. In the focus period, these dormant identifiers accounted for 21.63% of all active accounts.

Trading frequency and day trading

Retail investors have been trading more frequently. For client identifiers that were active during the focus and benchmark periods, there has been a substantial decline in the average time between trades by the same investor in a particular stock. On average, this was 4.5 days in the benchmark period and one day in the focus period.

This may indicate either investors building up positions more frequently over time or attempting to profit from buying and selling around short-term price movements. For trading in any stock, the average time between trades by the same investor has decreased from 2.5 days to less than one day: see Figure 2.

Figure 2: Retail investor trading activity and frequency

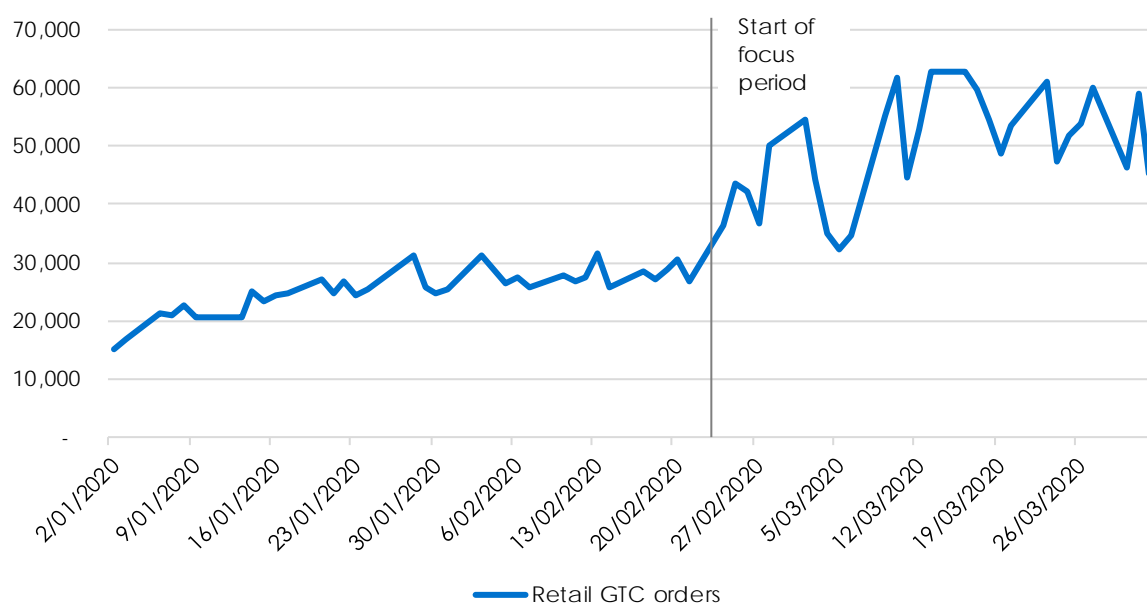
Exchange traded products

The average daily turnover in exchange traded products (ETPs), like exchange traded funds (ETFs) and managed funds, has increased from \$703 million in the benchmark period to \$1.88 billion in the focus period (counting both sides of each trade, consistent with retail numbers). In relative terms, this is an increase of 159%, which compares with the increase in turnover of 86% across the broader securities market.

However, the proportion of turnover in ETPs that retail brokers were a party to increased marginally—from 58% in the benchmark period to 61% in the focus period. A significant proportion of the non-retail activity in these products is typically conducted by market-makers as opposed to institutional investors.

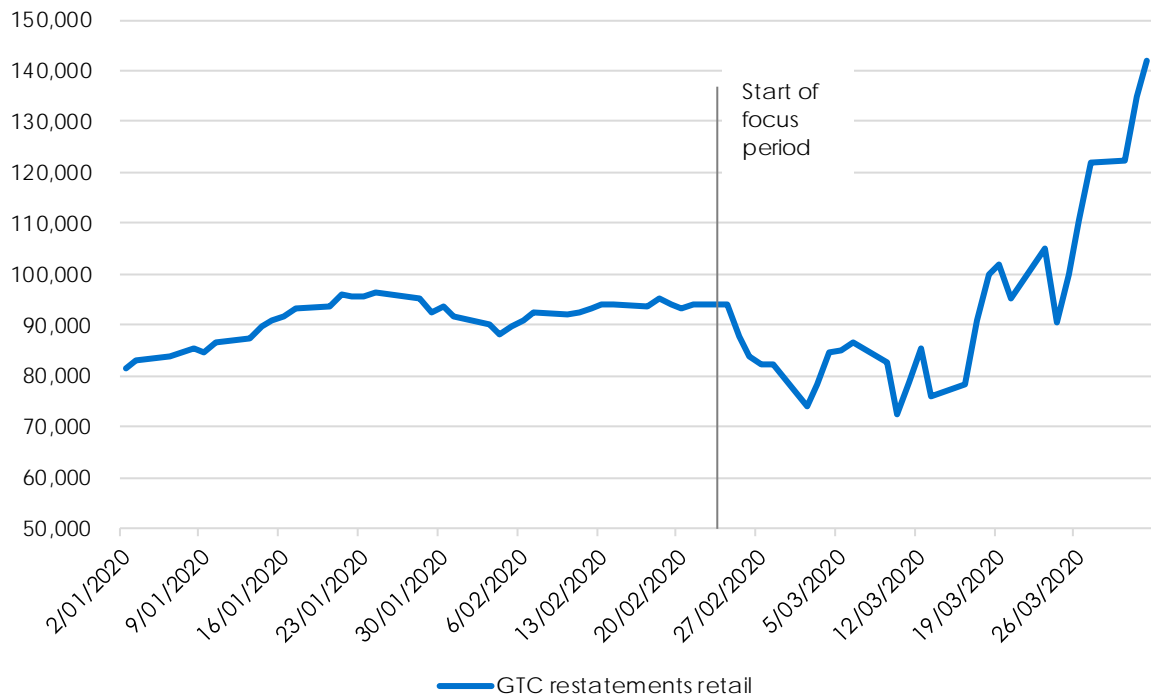
Changes in order characteristics

Increases in new retail trading have also seen changes in order characteristics, including the use of orders that remain open until cancelled (i.e. ‘good til cancelled’ or GTC). GTC orders provide the benefit of order queue priority and the possibility of orders away from current market prices being hit if there are overnight price moves. But they are exposed to significant price swings in response to overnight international news and market performance, and may expose retail investors to unexpected losses.

Figure 3: Number of GTC orders submitted by clients of retail brokers

In the period from 1 January to 1 April 2020, usage of GTC orders by clients of retail brokers increased dramatically: see Figure 3. These clients were also responsible for the vast majority of GTC orders.

Figure 4 shows the number of accumulated GTC orders that did not execute intraday, and hence were restated at the beginning of the next trading day. As volatility and retail trading increased, initially the accumulated restatements dipped even as the use of GTC orders increased. This could be because many GTC limit orders far away from current market prices were able to execute intraday due to extreme volatility. As volatility tempered recently, we started to see a build-up of GTC orders that were not hit intraday, and hence were restated at the start of the next trading day.

Figure 4: Number of GTC orders restated for clients of retail brokers

B Potential retail investor harm in securities markets

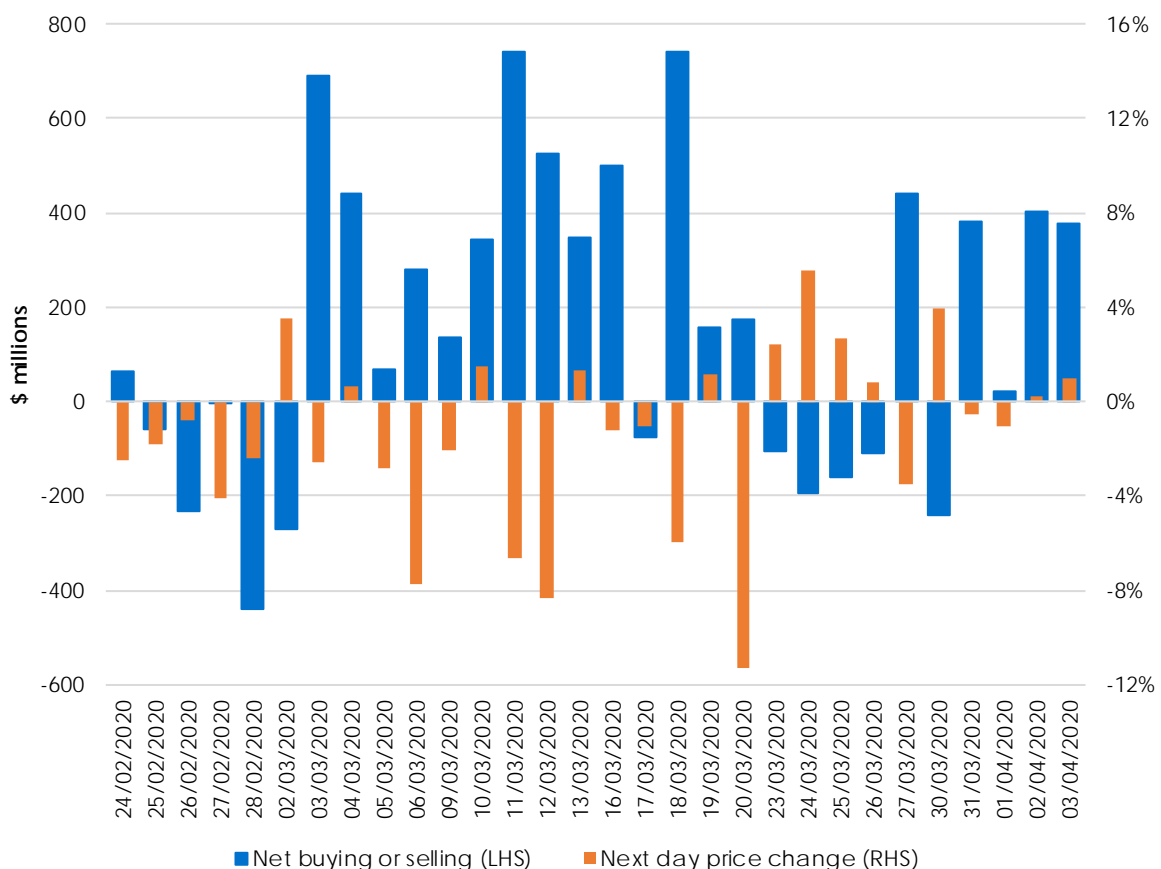
Poor market timing

The average retail investor was not proficient at predicting short-term market movements over the focus period.

Figure 5 compares the daily net buying or selling activity across all retail investors with the change in price over the next day for the shares that they traded. For more than two thirds of the days on which retail investors were net buyers, their share prices declined over the next day. For more than half of the days on which retail investors were net sellers, their share prices increased over the next day. If all retail investors held their positions for only one day, total losses would have amounted to over \$230 million.

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. Therefore, retail investors should be wary of trying to ‘play the market’ for short-term price movements by day trading.

Figure 5: Net buying and selling activity and next day percentage price change—Focus period (24 February to 3 April 2020)



Trading in complex and high-risk products

Geared ETPs

Over the focus period, there has been a significant increase in trading activity in ETPs that have geared exposures in the same or opposite direction to market movements.

Gearing magnifies the risk of these ETPs, by increasing profits from favourable market movements but also increasing losses from unfavourable market movements.

Additionally, geared ETPs are complex because they are actively managed to periodically reset the level of gearing, to ensure that it remains within a specified range after large market movements.

Geared ETPs should not be traded by investors who do not have appetite for this risk or understand the complexity. We saw trading volumes for one geared ETP increase by 16 times the normal volume to become the second most traded ETP. Retail investors were on at least one side of 75% of turnover in this fund during the focus period.

Oil-related securities

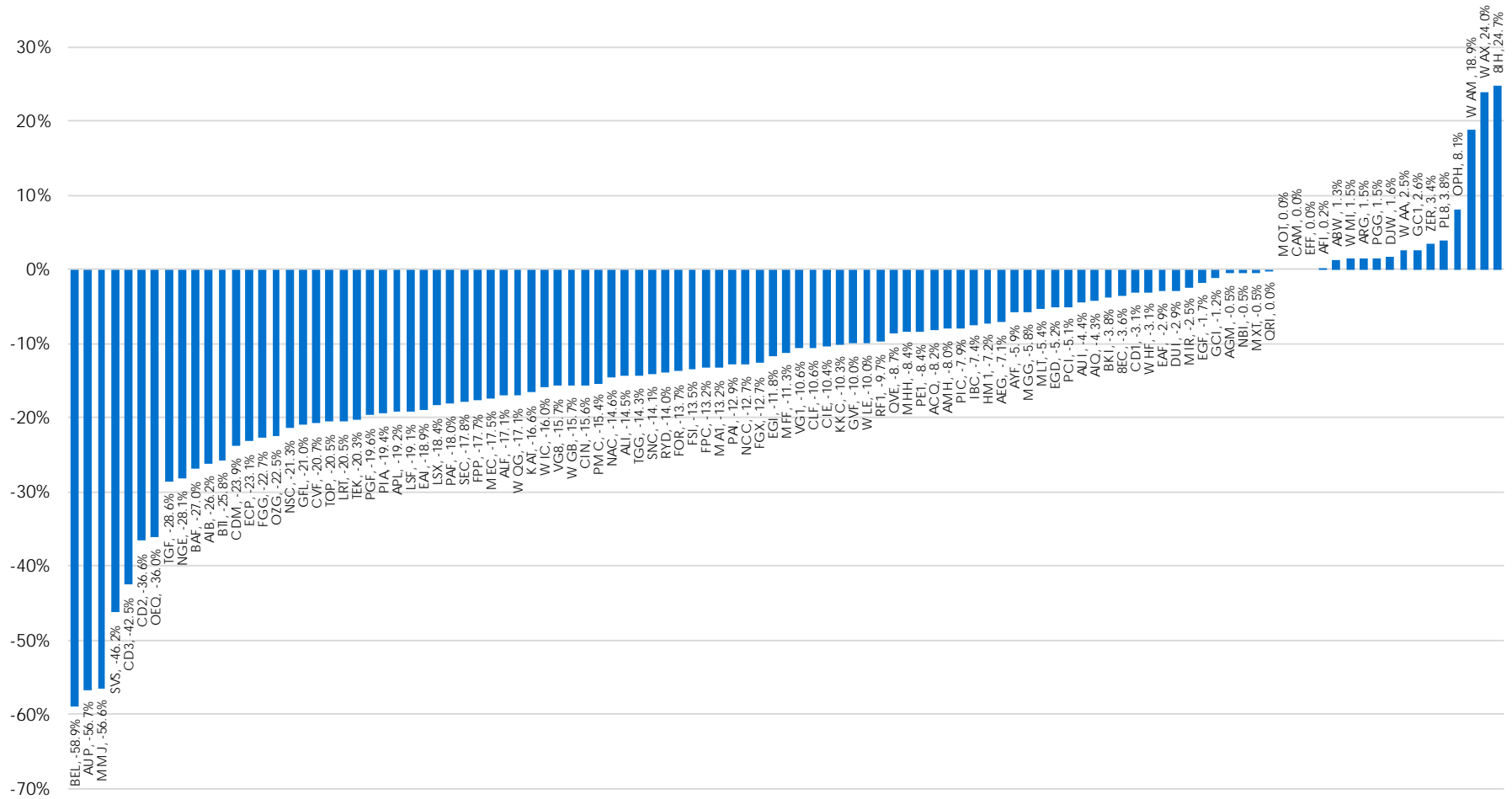
The global oversupply and storage issues with oil are impacting Australian financial products that are heavily invested in by retail investors. ETPs and other unlisted managed investment schemes that are exposed to oil futures have seen significant price volatility in response to unprecedented negative oil futures prices. Some saw prices decline over 80% between 24 February and 22 April. It highlights a risk for funds that have exposure to physically delivered commodities, where many investors in the futures contract have no intention of taking physical delivery of the oil.

Listed investment companies and listed investment trusts

Low interest rates and the search for yield have led to increased risk taking by investors in the fixed income space in recent times. Even before the COVID-19 volatility, we saw an increasing trend of high-yield issuances and retail investor interest in listed investment companies and listed investment trusts. The constituent underlying securities can fall outside the investment-grade credit ratings and bear significant risks in periods of economic stress. We saw the price of some fall by 50% during the focus period.

Overall, we have also seen an increasing proportion of listed investment companies and listed investment trusts trading at greater discounts to their net tangible assets: see Figure 6. This trend pre-dates the COVID-19 pandemic.

Figure 6: Distribution of premiums and discounts of listed investment companies as at 28 February 2020

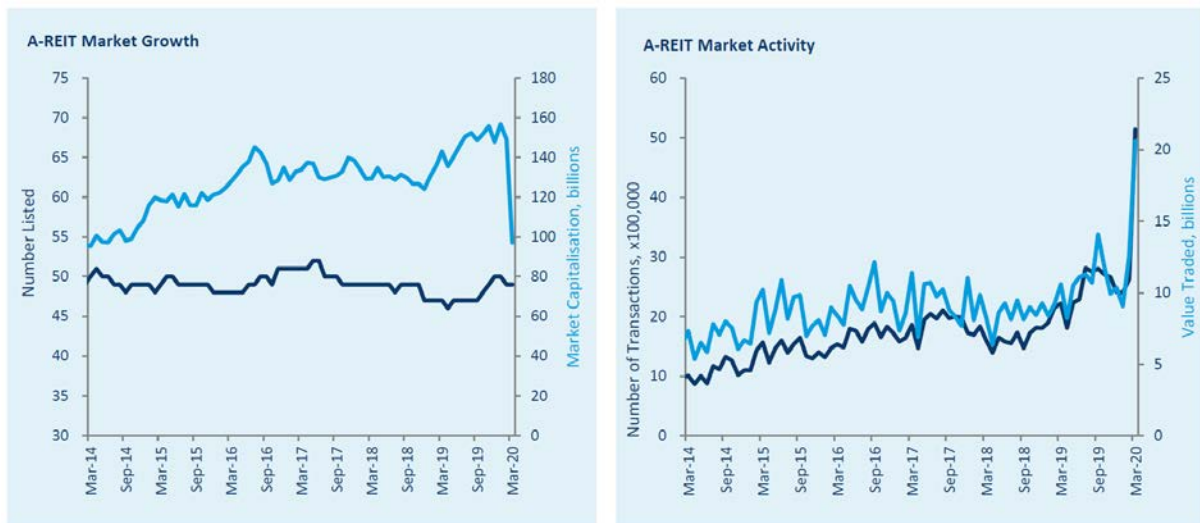


Source: Based on data from ASX. See the original figure in [ASX Monthly Investment Products Report March 2020](#) (PDF 2.23 MB).

Australian real estate investment trusts

The impacts of the COVID-19 pandemic have been keenly felt by tenants and real estate investors. Discounts and suspensions of rental payments may indirectly impact Australian real estate investment trusts (A-REITs). We are seeing a sharp fall in A-REITs prices and total market capitalisation, while trading volumes in these products has increased: see Figure 7.

Figure 7: A-REITs market size versus market activity



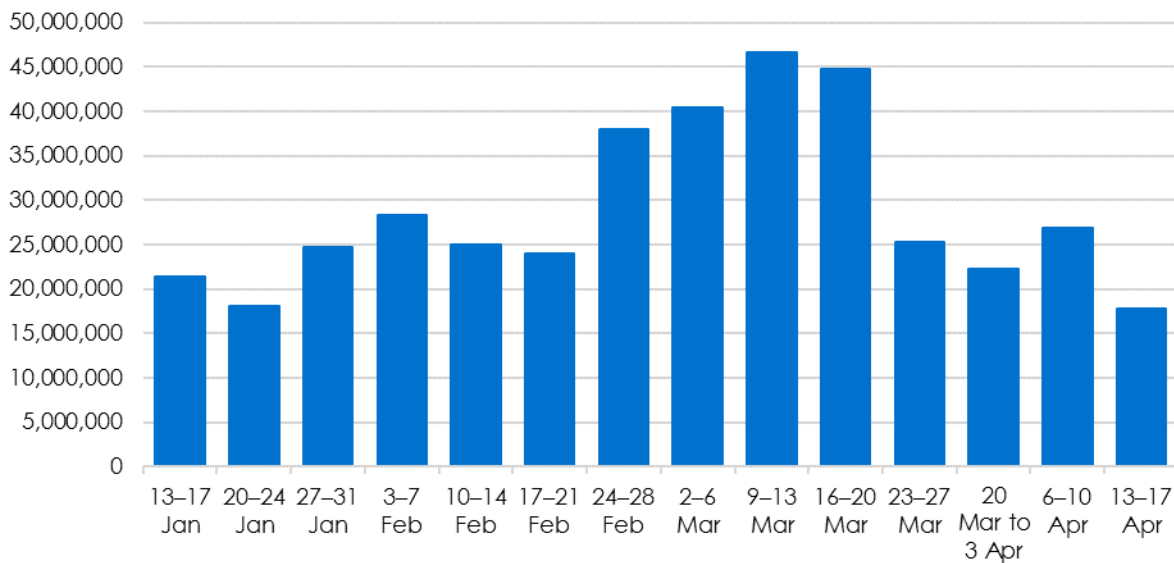
Source: [ASX Monthly Investment Products Report March 2020](#) (PDF 2.23 MB).

C Contracts for difference and market volatility

Large spike in CFD trading activity

ASIC OTC derivatives trade repository data indicates a significant increase in trading activity during the peak of COVID-19 volatility: see Figure 8.

Figure 8: CFD messages per week: Total messages reported to the Depository Trust and Clearing Corporation (DTCC)



Leverage and volatility magnify risk

Compared with unleveraged investment in securities like shares and ETFs, CFD leverage magnifies investment exposure and sensitivity to market volatility. For example, on a \$1,000 initial investment in shares, a 5% fall in a share price results in a \$50 loss. For a \$1,000 investment in a CFD over shares with a leverage ratio of 20:1 (i.e. providing \$20,000 exposure), the loss is \$1,000—100% of the initial investment amount.

We commonly see CFD leverage ratios of up to 200:1 for CFDs over securities market indices, and up to 500:1 for CFDs over currency pairs. This means that, for example, at a leverage ratio of 500:1 a retail client with an initial investment of \$1,000 may open a CFD position with exposure of \$500,000. Between 16–20 March 2020, the Australian–US dollar fix rate (WM/Reuters) fell 5.2%, the equivalent of 26 times the minimum initial margin for a currency CFD with 500:1 leverage (a \$26,000 fall in the example).

We have observed some CFD issuers reducing the maximum leverage that they offer on CFDs during this period of significant market volatility.

Retail client losses trading CFDs during 16–22 March 2020

In the week 16–22 March 2020, based on a sample of 12 Australian licensed CFD providers, retail client losses were just over \$428 million gross (or \$234 million net). The 12 providers account for around 84% market share, so the aggregate retail client losses across the industry for this single week may be higher.

CFD losses may exceed initial investment amount

In fast-moving markets, prices can gap and losses can exceed the initial investment. Many retail client accounts went into negative balance in the week commencing 16 March. 5,448 retail client accounts of the 12 providers in the sample (or 2% of their retail client accounts that traded during that week) went into negative balance to the value of over -\$4 million in aggregate. That is, they lost their initial investment and owed a further \$4 million to the CFD providers. Some of the providers absorbed the losses themselves.

Overnight funding costs may erode initial investment amount

Overnight funding costs can increase significantly during times of volatility and can quickly erode a retail client's initial investment, even before accounting for price movements. For example, we have seen very significant increases in the cost of holding oil CFDs overnight (up to 220% per annum). For a hypothetical \$100,000 exposure to oil CFDs (\$1,000 initial investment at 100:1 leverage), overnight funding costs of 220% per annum would amount to around \$600 per night—around 60% of the initial investment in fees alone in one night.