SharesExplained.com

your step by step guide to trading shares

10 COSTLY mistakes novice stock market investors make

by Matthew Merriman | SharesExplained.com

10 COSTLY mistakes novice stock market investors make.

In October 2008, it was clear for everyone to see that huge losses had been inflicted upon the stock market worldwide. This resulted in an increase in a number of people (novice traders) opening brokerage accounts, with the aim of taking advantage of stocks whilst they were low. However this could lead to these people making COSTLY novice errors.

If you are a novice trader, an unsuccessful trader or just want to be aware of the 10 COSTLY errors beginners make then read on...

1. Lack of stop loss awareness

Anyone who trades knows that the hardest part of trading is cutting your losses short. It is vital you set a point at which you are no longer willing to stay in the trade, otherwise the mentality of *"if I keep my trade for a bit longer I can regain some of my losses"* is very likely to creep in and consequently lose you even more money. Stop losses enable you to set a cut off point. Before you enter a trade brokers will allow you to set a fixed price at which you are withdrawn from a trade. If your broker doesn't allow you do this, ditch them.

Recommendation – Get a broker that allows stop losses and read up on stop losses and how they will benefit you.

2. Accidentally executing trades incorrectly

It's easy for beginner traders to execute trades incorrectly because they are new to ordering a stock. It is easy to mistype information/numbers or click on the wrong box, especially when you want to get in to a trade quickly and are under pressure (yes I have shorted a trade when meaning to go long before!).

Recommendation - Making a few practice trades first will help you get to grips with executing trades. For a free practice account check out Wall Street Survivor.

3. No strategies

New traders are unlikely to have developed, let alone tested, any successful strategies. A lot of people enter the market because of a tip from a friend. Ok so they've bought a share, how long are they going to keep it for? What is their stop loss and target point? What's their risk:reward ratio on the share? If they are planning to buy multiple stocks frequently, this could end up in them losing a lot of money quickly. There is no success without strategies!

I developed my strategies by attending a stock market course in London with WinInvest. The course was good and the teacher was excellent, however I ended up paying £2000 for this course, which, at the time converted to $3700. However there is a company now, Wall Street Survivor, that has produced and investing101 course. In the e-book is all the information I received and more for a lot less money!! Check it out Investing101

Recommendation - spend a little time and money on some solid stock market education.

4. Little knowledge about stock market psychology

New traders are often unaware of the ridiculous/senseless/greedy/fearful actions that losing trades can make traders do! Remember 'traders that lose cut their winnings short and let their losses run!' this is an easy psychological state to get into after having a few losing trades.

Recommendation - reading up on stock market psychology before trading and perhaps getting used to trading using a practice account.

5. Not knowing about stock liquidity/volume

Stocks with high liquidity, UK volume 1,000,000+ US volume 5,000,000+, do not need worrying about. However, low volume shares should be avoided when picking shares as they could come across liquidity problems. This is because when you come to get rid of the share and no one on the other end wants to acquire it (because there are not many buyers or sellers) then the price can easily drop 0.5-2% (or even more, panic time!) before you can get rid of it.

Recommendation – stick with shares with a volume of 1,000,000+ at least.

6. Not knowing the difference between limit & market orders

In volatile times such as late 2008, depending on how much capital is invested, the difference between a limit and market order could mean you start the trade with a significant loss! This is because when you place market orders you get the worst possible price available. Market orders are used just to get into the market quickly. In volatile times (like at the very start of the day), prices move up and down a lot and very quickly so the chances of getting a market order at the price you wanted is slim!

Recommendation – use limit orders. Limit orders are orders where you set the price and your order can only get filled at that price.

7. Not knowing when to exit a trade.

Many people who invest for the first time do not know when to exit a trade - and more importantly do not know how much money they want to make from a trade. This could result in the investor getting impatient and exiting a trade at completely the wrong time (often way to early when in profit and way to late when in loss!).

Recommendation – before you enter a trade know what price your cut off point (aka stop loss) is and know what price your profit take point is. This is called risk:reward.

8. Following tips from your mates/bloke in the pub.

New traders on the stock market often follow tips from their mates or tips from people who they think have stock market knowledge - this can so easily lead to disaster. You don't know how experienced they are, if they're really telling the truth about their profit/loss from trading or if the one winning stock they picked was beginners luck.

Recommendation - Do you own research or seek professional advice! How many times have you taken a tip on the horses and lost? (I know I've done it!) You can research companies by signing up to ADVFN.com.

9. Lack of research

Linking on from the last point, novice traders often do not research a company's key financial information, they often just go on big company names they know - this means they do not know how much a company is forecasted to grow, how much debt it's in etc. This stuff is worth knowing if you want to make a trade on which way the share price is going to go!

Recommendation – Look at companies' key financial information and compare it with other companies in their sector. As I said before, this can be done easily and for free at ADVFN.com.

10. Choosing the right brokerage account

New traders will often sign up to any brokerage account - this means they will not have taken into account if a broker charges

- Inactivity fees for not trading - not ideal if their plan is to buy and hold a small number of stocks for months and months!
- Withdrawal fees –could be costly if the investor is looking for a wage from his/her shares and makes regular withdrawals.

- Data fees – Brokers will often give free data for stock in their own country but can charge for data of foreign stocks. Watch out for this if you are looking to trade stocks in multiple countries.
- Trading fees – These average around $3-7 per buy and sell in the U.S. ($6-14 flat fee) and from £4-£7 in the U.K (£8-14 flat fee) If you are going to trade regularly use a broker with low fees.

Recommendation – Use optionshouse.com to trade US stocks (US citizens only) as fees are only $3.95 flat fee, there is no inactivity fee and only a $1000 minimum account deposit. For UK citizens the cheapest broker is TD Waterhouse.

So there you go people, take all these points into account when entering the stock market and you will definitely save some money – take it from me, I've lost money doing most of the things above!

NB. I don't want to put you off trading but I do want to put you off losing your hard earned money!

Most of all guys enjoying trading as there is nothing better when you're making money from it!

Matthew Merriman | SharesExplained.com