2 Mistakes Every New Investor Makes When Trading Their 1st Stock

Description

You’ve finally done it. You’ve signed up for an account at one of Canada’s many brokerages, booted up their app, and are ready to buy your very first stock. Visions of upwards trending green charts, fat dividend payments, and good earnings reports fill your mind.

Fast forward a year later, and you’re wondering why your carefully chosen stock portfolio is underperforming an index fund. Why aren’t you making the big sums of money you initially envisioned?

It turns out that there are a few common mistakes every new investor (including me back in 2017) makes when starting out. If uncorrected, these mistakes can really ding your returns over time. Let’s learn how to recognize and avoid them!

Be patient: Don’t use market orders!

A market order is an instruction for your broker to fill your order immediately. This type of order guarantees that the order will be executed but does not guarantee the execution price. For a buy order, it will execute at the current ask price. For a sell order, it will execute at the current bid price.

You want to avoid market orders because of the possibility of sudden, volatile movements in the stock (such as a flash crash). Imagine you’re holding 10 shares of ABC at $10, and the price when you check the bid is currently $11. Cool; you can make a $1 profit per share.

You submit a market order to sell your 10 shares. However, the bid price of ABC suddenly crashes to $8 per share. Because you used a market order, you would have sold your 10 shares at a $3 loss! To avoid this, make sure you use a limit order, which will only execute at a price you specify.

Be careful: Watch the spread!

Buying and selling stocks is a two-way street — there has to be a buyer and seller. Some stocks aren’t very popular though and may lack a tonne of buyers. When this occurs, the stock is said to be illiquid, with a low volume being traded.

The lack of liquidity can affect the bid-ask spread, which is the difference between what someone wants to buy a stock for versus what someone wants to sell a stock for. A stock with liquidity will have a lower spread, which is good.

Let’s say you want to buy shares of XYZ. XYZ is a company with low liquidity, with not many people trading it. The current bid price of XYZ is $10, and the current ask is $11.

If you’d bought XYZ at the market price, you would be paying the ask of $11. However, if you turned around and sold it immediately, you would only receive the bid of $10. That’s a 10% loss on the spread alone!

The Foolish takeaway

New investors should beware of using market orders, especially if they’re trading an illiquid stock. Committing these mistakes can leave you with losses to overcome from sudden price movements or a wide spread.

You can avoid these follies by setting carefully thought-out limit orders, sticking to liquid stocks with a high volume and low spread, and holding for the long term.

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