



**New joiners in the club: characterizing and
analysing the new actors and players of the
investment community.**

CAPSTONE PROJECT SUMMARY
By Máté Kalapos

Introduction

The Capstone Project was done for a Hungarian investment bank and they proposed the topic of new joiners in the investment community based on the current environment in the financial markets. The company wanted to understand more deeply what is behind the current surge of retail traders in the financial markets and whether it will be a lasting trend or something that is over within a few months or perhaps as the pandemic ends. Retail traders were present in the financial markets for quite some time, and they had impact on the markets previously as well, for example during the Dotcom bubble of the early 2000s, but what has started in 2020 and developed and grew in 2021 is unprecedented. The main task was to understand and discover the cultural and social roots of this phenomenon and to present the trading behaviour of this new generation of retail traders. The outcome of the project can be an important input on the ongoing strategy of the firm and provide more transparency into one of the most recent trading booms.

The project was started by analysing this “new generation” of traders, their characteristics, demographics, and psychological behaviour. It is very important to understand the people behind this movement as there are some key characteristics such as their mindset that made this trading boom possible. Generally, these retail traders are Generation Y (the so-called Millennials) and Generation Z. The life of these two generations involved living through the Dotcom crisis and 2008 financial crisis. If they didn't live through it, their parents did and this had a big impact on how they see financial markets and how they think about their investments. The above mentioned was also solidified by a survey done by Deutsche Bank on retail traders: the survey found that most of the participants only joined financial markets in the past year (2020), mostly under 34 and have aggressive trading practices. One of the main causes of this situation are the US stimulus checks that many people from the above generation received. Many of the survey respondents said that they will invest their stimulus money into the financial markets. According to Deutsche Bank as much as \$170bn can go into the stock market from the stimulus checks. As it was mentioned previously this generation has a different mindset, they are not investing in the financial markets to save for retirement but to sometimes take immense risks and spend their savings or stimulus money recklessly on speculative trades that do not rely on any fundamental or technical analysis.

Behavioural Finance Implications

Behavioural finance found that retail traders and millennials in general are prone to many biases that can affect their decision on the stock market. The two most important biases are conservatism, and availability bias. Understanding biases and implementing them into market research will be very important for financial institution moving forward as the decisions of these retail traders is something that cannot be understood through traditional means.

To understand further implications and behaviour of retail traders a survey was analysed. The survey was originally conducted by Rena Hope Hooker of Appalachian State University. The survey was studying the determinants and implications of millennials' stock market investment habits and opinions. The survey consisted of 28 questions and was distributed among 106 students at the university campus. To highlight some of the key findings of the survey it can be learnt that millennial students are likely and willing to invest their money in the stock market. Business education was also measured in the survey, and it was found that students who do not have financial education tend to use in-person brokers more often, probably to compensate for their lack of knowledge and experience. On the other hand, it was observed that students without business education are also very likely to use smartphone applications to invest in the financial markets. The reason can be that these apps are easy to use and are easily accessible. This can lead to the above-mentioned behavioural biases as these people do not have enough experience to use these software effectively.

Another important term from behavioural finance is herding. This means people following actions of other people, mostly because of peer pressure, while thinking that others know what they are doing. This can have many dangers as most people do not do their own research on certain topics, which would be especially important in the financial markets. The implication on the topic is that this behaviour can be observed on the social media site of Reddit. This is the website from where most the recent trading surges originate.

The biggest forum for retail traders on Reddit is r/WallStreetBets that has reached 10 million subscribers recently. Stocks and option trades are mostly based on other's opinion or behaviour and not on the fundamental values. The likelihood of persuasion increases as an individual is exposed to more and more discussions on a given topic, which is something observable on Reddit. This is how some of the biggest trading surges spread in regards of GameStop or AMC.

Analysis

Some of the key retail trader fuelled market movements were analysed during the project. The first analysed was a trading frenzy affecting Apple stocks. The surge was driven by a four-to-one stock split which made the otherwise more expensive apple stock accessible to more retail traders. This increase in price can show the impact retail traders can have on a share's price they jump on. The next event that was analysed is the one that happened with GameStop's stock. This is the most significant retail trader fuelled surge in the recent years. It originates from the previously mentioned subreddit r/WallStreetBets. It started in early 2021 after retail traders realised that the stock of GameStop was heavily shorted by institutional traders, mostly because of the bad situation the company was in during the pandemic and because their retail business was also less successful in the recent years. As a result, more and more retail traders started to buy GME stocks to pump up the price and try to force a short-squeeze. This situation is still ongoing, currently in June 2021 the price of

GME is above \$200, for comparison in June 2020 the price was around \$4. This trading surge turned into a movement against financial institutions, as this new generation did not trust banks after experiencing 2008 financial crisis themselves or through their parents. The price of GME is still rising and although numerous gamma squeezes happened that pumped the price higher retail traders are not letting go. This can also be seen from the previously mentioned herd behaviour as these social media forums pressure people into holding their stocks or buying more, fear of missing out on a good investment is something that drives these people.

Lastly AMC trading surge was analysed which is a similar situation to the GME craze as it happened at the same time. AMC was a struggling company during the pandemic and the trading craze saved the company from bankruptcy as they could issue new shares when the price was high. This trading surge is also far from over as the price of AMC jumped by 96% in May 2021.

Cryptocurrencies were also discussed in detail for the project. Bitcoin, Dogecoin, and Non-Fungible Tokens (NFTs) were analysed. Bitcoin has a very volatile price history but saw a surge in price in recent months especially after institutional buyers such as Tesla pumped the price higher. It is important to note that Bitcoin is used more as a store of value than a day-to-day currency. Dogecoin is an altcoin that started as a joke but surged in price in early 2021. This surge is also related to retail traders and herding and shows the dangers of pump and dump. This craze was driven by celebrities such as Elon Musk who pumped the price of Dogecoin through tweets. NFTs are a new kind of technology mostly used for distributing digital arts, this saw rise in popularity in 2021 as some NFTs were sold for millions of dollars.

The future of cryptos was analysed in relation of crypto exchanges such as Coinbase that went public recently while being valued at \$79bn and having 56 million retail customers and \$90bn in assets. The future of cryptocurrency in day-to-day transactions is something that is still far away as cryptos have many inherent problems that need to be fixed and many regulators to agree with.

Summary

In conclusion it can be seen that retail traders have a big impact on financial markets, and this is just the start. Social media and trading apps are not going away. More and more people are downloading these apps and start trading with no prior experience. Looking at the analysed trading surges it is easy to see how big impact retail traders can have on the market and these also show the ill-effect of such behaviour. That is why behavioural finance and financial literacy will be crucial in the future.

Cryptocurrencies may not be the currency of the future yet, but they are definitely a technology of many possibilities. Many retail trading surges are based in the crypto markets, so it is worth to keep an eye on these new financial assets. The future of retail trader's impact is not clear as they will never have the money of big institutions, but social media can lead to similar possibilities that can be dangerous in the future as these speculative trades may lead to crashes in the financial markets.