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TESTING THE LIMITS OF SOCIAL CAPITAL

By Joe Bestwick, Senior Digital Marketing Manager, Spectrum Markets

The emerging trend for online peer-to-peer investment advice doesn't represent the democratisation of financial markets, it is actually a symptom of the lack of transparency of legacy systems, according to our Senior Digital Marketing Manager, Joe Bestwick.

At the turn of the millennium, web 1.0 existed in an era of optimism. Many predicted the web would usher in an age of increased democratisation as access to social capital; the ability to connect with the networks that shape society, became decentralised. Instead, power became concentrated, through network effects, into the hands of a few social networks.

Financial capital is not identical to social capital, and its disruption via digitalisation has not followed precisely the same trajectory. Digitalisation has decreased transaction costs and reduced friction, old paper-based systems have been replaced by more efficient online services. Digitalisation has democratised access to the markets through round-the-clock online retail trading. However, the fundamental nature of the customer/service provider relationship between retail investors and brokers has gone unchallenged. Retail investors can more easily than ever take a position on a stock, and hopefully make a profit from it. But they have not been viewed as a force with the ability to shape the market. That is, until recently. Through coordinated effort, orchestrated on social media, retail investors (in instances limited to the price of individual stocks) have been able to force major shifts in financial markets.

Retail investors are building online communities for exchanging investment advice. To some, this phenomenon is reminiscent of the early optimistic days of web 1.0, a sign of necessary disruption and democratisation of the markets. But to others, the unregulated exchange of investment advice, between unqualified amateurs, often acting pseudonymously on chaotic online forums, is a dangerous new development.

At the very least, the existence of these online communities demonstrates that retail investors have an unfulfilled desire for unbiased information to guide them in making investment decisions. And even the most cursory look at these forums will reveal that the nature of the advice given, its informality and accessibility, is what makes it both high-risk and appealing to a new generation of fully-online investors.

The most high-profile episode arising from retail investor social media is the GameStop short squeeze. Plenty has already been written about these events in which users of a Reddit forum caused short sellers to take major losses. Retail investors who continued to hold their long positions on the stock as the price began to decline again also suffered significant losses. However, many of these retail investors claimed at the time not to be motivated by mitigating their losses, but by a desire to harm the short sellers, who had come to represent a villain against which their online community could unite.

There are several ways to interpret this reaction; unchecked bravado, an attempt by influential forum users to manipulate the behaviour of others in order to stem their own losses or merely an illustration of the irrationality of the advice to be found on such online forums. Either way, from this isolated incident involving the price of a single stock, it is hard to argue that retail investors coordinating their efforts on social media now wield significant power in the financial markets. In retrospect, the GameStop short squeeze is less a demonstration of the rise of a new form of decentralised people power so much as a viral episode of internet trolling, albeit one with significant real-world impact. However, from a regulatory standpoint, the integrity of markets and investor protection, go hand in hand. Leaving cases such as GameStop unscrutinised would foster what regulators claim a "gamification of trading"; an amplification of potential damage – however systemic or local – that is fostered by the fact that the opportunity to take immense risk is now at retail investors' fingertips.

It is clear that a lack of transparency contributed not just to the initial market volatility, but also to a loss of trust in trading platforms on the part of retail investors. Lack of transparency in how the market operates pushed retail investors towards accepting unregulated amateur financial advice from online strangers in an attempt to circumvent more established and better regulated systems. Lack of transparency also led many of those investors to believe that their brokers were guilty of foul play. It all serves to demonstrate the importance of promoting the use of safe, trusted marketplaces.

Spectrum Markets was created with transparency as a core operating principle. It is inevitable that digitalisation will continue to disrupt legacy systems but, through transparency, these disruptions can be of the positive kind. And through transparency, retail investors' requirement for unbiased information can be met safely and equitably.

Get in touch today to discuss how the seamless market access that our venue provides, can help to grow your retail client business.

Please don't hesitate to get in touch if you wish to receive further detail. spectrum-markets.com

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