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DISRUPTION: A RAPID CHANGE IN AN INDUSTRY'S WORKING PRACTICES AS THE DIRECT RESULT OF A RADICAL NEW SERVICE, BUSINESS MODEL OR TECHNOLOGY.

Retail trading has grown in popularity and influence, to the point that it is fundamentally changing the financial industry. **Enrique Marti, CEO of iBroker**, explores how this happened.

1994, if you're old enough to remember, was a remarkable year. It was the year Nelson Mandela became South Africa's first black president. It was the founding year of the WTO[1], too. It has also gone down to history as the year Sony presented the PlayStation. And it was the year when a man who had just turned 30 founded a garage start-up now worth around $1tn. Most people will have realised I'm talking about Jeffrey Preston "Jeff" Bezos and his company, Amazon.

I'm aware that Amazon is a well-worn example to start a tech-related story with. Then again, it is hard to find a more illustrative example for the phenomenon we refer to as "disruption". Many will want to argue that, from a technical standpoint, creating a digital marketplace and a logistics giant wasn't that disruptive and that other tech entrepreneurs deserve more recognition for their achievements. Well, maybe we can agree on an observation that Victor Hugo[2] once made: "Nothing is more powerful than an idea whose time has come". The wisdom of these words, in my view, comes from the fact that it's always a combination of factors that lead to an idea defying the gravity of reproducibility, insignificance or just unsuccessfulness. Sometimes it doesn't even take a new 'killer app' to spark a disruption: a combination of otherwise unremarkable factors, met by one black swan event, can make the difference.

The Covid-19 pandemic and its impact on retail trading patterns has been such an example. The story about hyped trading apps such 'Robinhood' and the Meme Stock Mania has been told many times already. However, what culminated in a guerrilla-style run on GameStop shares, pushing their price to almost $500, thus producing a loss for hedge fund short sellers of an aggregate $6bn, generated somewhat one-sided takeaways. Most notably, the notion has been that the surge in trading activity is random, i.e., attributable to a hype, something such as a seasonal trend or fashion that will recede as quickly as it arose.

However, considering the context is important. First, investors shared their views – opinions, information, or rumours – via social media platforms. Second, they flocked together to appear as an activist group of investors. Third, they were a group of investors allegedly lured by the ease of on-the-go investing via barrier-free, fancily-designed trading apps.

Meanwhile, regulators are explicitly warning retail investors of the risks associated with information gathering via social media – rightly arguing that social media platforms aren't yet subject to sufficient supervision, not constituting sources of neutral, sufficiently unbiased information. In combination with easy trading access via mobile devices, they consider this a "gamification of trading", exposing an ever younger and often inexperienced target audience to risks they're not able to consider adequately. While this concern for vulnerable groups is appropriate, it doesn't explain the massive increase in retail trading interest, nor does it lead to the right conclusions about the phenomenon's sustainability.

As the European Securities and Markets Authority (ESMA) noted in 2021[3], "The sharp drop in valuations and the surge in volatility following the onset of the pandemic in March 2020, corresponded to large increases in stock buying and volume traded by retail investors, a trend confirmed by studies in different countries". The potential reasons ESMA identified for this surge in trading activity were increased household savings as a result of a prior period of refraining from consumption (savings which were suddenly seeking a destination for being invested into), more time available to be spent online during lockdowns, periods of high volatility encouraging speculative trading and, finally, long-term investors trying to benefit from attractive valuations following the initial sharp downturn.

The key message, however, comes at the beginning of ESMA's note. The combination of sharp drops in valuations and massive volatility – that, according to ESMA, corresponded to significantly higher retail trading volumes – had never been considered as an opportunity by the retail sector before. The fact it appeared inviting this time allows just one conclusion: something must have enabled retail investors to navigate through an unfriendly, demanding environment, allowing them to make profits where this, until recently, was reserved to the professional investor. An additional trend we can confirm at iBroker is the increase in overall trading activity; a large number of new investors, higher trading activity by existing investors and a particularly strong increase in younger investors. So, demand is an additional dimension that must be looked into.

On the demand side, there is a cultural shift towards a stronger capital markets engagement. More than a decade of ultra-low interest rates made many people rethink their savings approach. This does not necessarily change their overall savings ratio – which is finally determined by the amount an individual is able to put aside – but it has affected the way they save. Strictly speaking, today, people invest. Even if this is passive through ETF savings plans, it provokes their interest into what happens on capital markets, how they work and how they interact with the broader economy. This latter aspect is particularly important as people's understanding of economic contexts is growing in line with their growing awareness for more self-responsibility, or vice versa. Where older generations look to protect their pension savings, younger generations know there will not be much of a pay-as-you-go pension scheme left by the time they reach retirement age. This process towards more autonomy for individuals regarding their wealth creation and their acceptance of this challenge may still be slow, but it's irreversible and it's a huge factor.

The other important element of the paradigm change in investment behaviour is obviously driven by the supply side where developments have been no less ground-breaking. The emergence of neobrokers has clearly propelled retail investor participation with user-friendly apps and tailored offerings attracting younger and more experienced traders alike.

Brands such as Trade Republic, Scalable Capital, eToro and flatexDEGIRO have revolutionised the European trading landscape, offering negligible trading costs for the retail investor, made possible by modern IT infrastructures and efficient order routing models – a setup that we have chosen for iBroker as well.

Exchanges such as Spectrum Markets have emerged to roll-up the venue landscape with permanent innovation, lean processes and an ultra-resilient infrastructure, kept up and running throughout periods of severest market stress. Through connecting to Spectrum Markets, we'll enable retail investors in Spain and Italy to trade leveraged instruments listed there, available for 24 hours a day, 5 days per week. As the main Spanish derivatives broker for the retail sector, we add a market with a population of almost 50 million to the Spectrum Markets single-ISIN-pan-European franchise.

Finally, I would like to share an interesting fact that you may not have heard of. According to research from Bloomberg Intelligence cited by the Wall Street Journal (WSJ) earlier this year[4], 85% of hedge funds and 42% of asset managers are now monitoring retail-trading message boards. The WSJ report also noted that JPMorgan Chase has introduced a new data product in September of last year indicating which securities retail investors will most likely buy and sell.

We are living in an environment that is characterised by a mutually-reinforcing upwards spiral of regulation and technology with a strong trend towards industry specialisation and where the role of the retail investor is growing more and more important. Access and availability, the key to any change of behavioural patterns, have democratised trading. This is the beginning of an era that people, in retrospect, will remember as a change for the better.

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[1] World Trade Organisation
[2] Victor-Marie Vicomte Hugo (1802 – 1882) was a French writer and politician
[3] https://www.esma.europa.eu/sites/default/files/library/esma50-165-1524_trv_1_2021.pdf
[4] https://www.wsj.com/articles/fund-managers-pay-attention-to-retail-day-traders-11642132135?mod=hp_lead_pos7

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