

A Guide to Online Trading in Shares etc.

Expert knowledge means success

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Note: This publication has not been updated since it was last published. Some of the hyperlinks may have changed and may need updating. In addition, some of the information in this publication may be out of date.

Introduction

The Internet has opened up market trading in stocks, shares and other investments to anyone who has a computer and sufficient capital to open an account. A variety of financial instruments can now be traded in this way across the UK and, through some brokers, across the world.

The markets have become more accessible, but that doesn't mean you should take online trading lightly. Online trading is really no different than offline trading: it carries the same amount of risk and requires the same amount of research and discipline. However, it can be both enjoyable and provide a residual income to supplement your regular income.

Most personal online trading centres on the buying and selling of shares. This publication therefore primarily considers share trading although other online investments are touched upon.

Online Investments

Shares

A company incorporates with an authorised share capital. It can choose to issue some or all of these shares up to the authorised amount. Any issued shares can be traded on an exchange where they are listed or can be traded privately. The price of a share will be set according to supply and demand; hence it will vary according to economic conditions, the performance of the company and investors' attitudes.

Shareholders make money if they sell shares when the share price has risen past the price they paid for their shares plus any associated fees. They also benefit from any dividend payments made by the company out of profits. Shareholders lose money if they sell when the share price falls below the price they paid for their shares plus any associated fees.

Other Investments

In addition to buying and selling shares listed on UK markets you can make a number of other investments online, depending on what your online broker offers. For example, you may be able to invest in:

- Overseas shares, e.g. European, Asian, Australian and US shares. Some brokers offer dealing in all overseas shares where they are settled in £ sterling through the CREST (UK share electronic registry) system.
- Investment Trusts
- Unit trusts
- Open-Ended Investment Companies (OEICs)
- Mutual Funds
- Exchange Traded Funds (ETFs)
- UK Corporate Bonds
- Covered Warrants
- Warrants
- Options
- Futures

Your broker may also offer a spread-betting service. For more information on spread-betting see our publication IP372 – *Spread Betting*.

Choosing a Broker

Before you can trade shares and other instruments online, you need to select an online broker who will execute trades on your behalf and store your money and shares in an account.

Different brokers offer different levels of advice, account types and other services. They also have different cost structures which may include commission on trades, account charges, inactivity charges and other fees.

Some brokers offer online tutorials and practice accounts so you can have a go at investing without actually risking your winnings. They may also offer research tools and professional advice.

Consider the following:

- How much money do you plan to invest? Some brokers may require you to have a certain amount of money to open an account. You may also need to maintain a minimum account balance although this will usually be small.
- How frequently do you plan to trade? If you plan to buy shares and hold on to them you may want to choose a broker that doesn't charge a fee for account inactivity. If you plan to make lots of trades, look for a broker that charges a low fee per trade or offers a discount to active traders.
- What is your level of trading experience? The brokers with the lowest fees are unlikely to offer research and advice facilities. If you need help, look for a broker that offers market analysis, articles on successful trading and other advice.
- What other services do you want? Some brokers offer a basic share dealing service in the UK; others may offer trading in a wide range of financial instruments across multiple countries. Some brokers may offer an ISA account wrapper to shelter your tax gains.
- What security measures do they have in place? All brokers should offer automatic logouts and transmission encryption but some may have more sophisticated security measures than others.

If you expect to have different trading patterns for different investments then you may wish to consider using more than one online broker if it will reduce your overall trading fees.

Opening an account

When you open an account with an online broker you will be asked for some personal information including your National Insurance Number (to open an Individual Savings Account (ISA)), addresses for the past 3 years and details of your UK bank account. You will also need to provide proofs of your identity. If you wish to benefit from the advice of the broker you will also need to provide information relating to your financial standing, investment objectives and attitude to risk.

Opening an account online is easy and quick – it can take as little as 15 minutes for the necessary processing to be completed. Your account can then be funded using either a debit or a credit card or by a transfer from a current account. Any shares you already hold with another broker or as share certificates can usually be transferred to your new

account. However, the transferring-out broker may charge a fee for the transfer.

Online accounts are generally set up as nominee accounts. That means that any shares you buy through a nominee account with a broker are held in the broker's name at CREST – the UK's share electronic registry. The broker is responsible for recording which client is the 'beneficial owner' of a share. However, whether you get sent company documents or are given the opportunity to vote at shareholder meetings depends on your broker.

You can choose to set up a personal Crest account for a fee, in which case the shares you buy will be held in your name at CREST. However, CREST cannot be used for most overseas shares or shares held in an ISA.

Broker list

Some of the popular brokers are listed below.

- Barclays Stockbrokers
www.stockbrokers.barclays.co.uk/
- Charles Stanley Fastrade
<https://www.fastrade.co.uk/wps/portal>
- E*Trade Financial
www.etrade.co.uk
- Hargreaves Lansdown
www.h-l.co.uk
- iDealing.com
www.idealing.com
- Interactive Investor
www.iii.co.uk
- Internaxx
www.internaxx.lu
- Iweb
www.iwebsharedealing.co.uk
- NatWest Stockbrokers
<http://www.natweststockbrokers.com/nw/products-and-services.ashx>
- Selftrade
www.selftrade.co.uk
- The Share Centre
www.share.com
- Sharecrazy
www.sharecrazy.com
- Sucden
www.sucden-smart.co.uk
- TD Waterhouse
www.tdwaterhouse.co.uk

Making a Trade

Once you've opened and funded your account, you can buy and sell shares. You will therefore need to monitor the price of the share you are interested in. Most brokers provide real-time quotes as part of their service. You can also check the website of an exchange on which the relevant share is listed. Many free financial news sites also offer delayed quotes; however these will be behind the market and therefore in volatile times could be substantially different from the real trading price. Be aware that media sources typically only show a 'mid' price for a share. However, there are two market prices - the 'offer' price at which shares are sold to you, and the 'bid' price at which shares are bought from you. (The difference between them is known as the spread).

Buying shares

Once you've got a quote and decided you want to buy some shares, you can place a market order to execute the trade at the current market price of the share.

Alternatively, if you want to wait until the price of a particular share falls your broker may offer a buy limit facility:

- Buy Limit – You can set a buy limit if you want to make sure you only pay up to your selected price for a share. You place a buy order on your account that sets a buy limit for a period of time, e.g. 30 days. If during that period the 'offer' price for the shares drops to or below your target price, the trade will be executed. If the price doesn't fall to your target price within the specified period the order is cancelled.

Selling shares

Similarly, if you decide you want to sell some of your shares, you can place a market order to execute the trade at the current market price of the share. Alternatively, if you want to wait until the price of a particular share rises your broker may offer a sell limit facility:

- Sell Limit – You can set a sell limit if you want to make sure you get at least the price you want when selling shares. You place a sell order on your account that sets a sell limit for a period of time, e.g. 30 days. If during that period the 'bid' price for the shares rises to, or above, your target price, the trade will be executed. If the price doesn't rise to your target price within the specified period the order is cancelled.

You may also be offered the following limits:

- Stop-loss Limit - When you buy a share you need to consider that it may lose value. If it does you can limit that loss by using a stop limit. If the share price falls to or below the price you've set the shares will be sold.
- Tracking Stop-loss Limit – As the name suggests the stop-loss limit follows a share price as it rises. That way you can lock in gains on shares you buy but sell when the price starts to fall back.

Overseas Investments

If you want to invest in overseas shares you can set up an account with a UK broker that provides access to non-UK platforms. Most UK brokers offer trades in the most popular large-cap overseas companies. In addition, certain brokers offer access to particular markets, the most popular being Europe, America and Canada.

Alternatively, you can open an account with a non-UK broker. However, these brokers will not be regulated and supervised by the Financial Services Authority.

Another way to access the potential of overseas companies is to buy an ETF that tracks overseas markets.

Online Fraud

Although by its nature online traders are not subject to unsolicited phone calls from fraudulent share sellers ('boiler rooms'), there are still fraudulent practices designed to trip up online traders.

- 'Pump-and-dump' - Online message boards, online newsletters, e-mails etc. are used to spread the word about a particular share so as to drive up its price. The scheme organisers then sell their shares for a huge profit and stop promoting it. The price falls, and investors lose money.
- Fraudulent shares – Similar methods are used to spread the word about stock in companies that do not exist. The fraudsters then abscond with the money.
- Fraudulent IPOs – Fraudsters may promote a forthcoming Initial Public Offering (IPO) for a company that either doesn't exist or has no plans to go public. Again the organisers then flee with investors' money.

- Fraudulent company information - Overstating or misrepresenting a company's financial performance can drive up the stock price.

Note that a survey conducted for the Financial Services Authority (FSA) found that 81% of victims of 'boiler room' scams were male, 64% of whom were over 50, and most were experienced investors.

Always do your own research into a company that you wish to invest in. If you want to check that a company exists, check for its name on the Company Register. If you have any doubts whether a company is a listed company check on the exchange on which it purports to be listed.

Financial Services Compensation Scheme

With regard to brokers the Financial Services Compensation Scheme (FSCS) covers two kinds of investment loss:

- When an authorised broker goes out of business and cannot return your investments or money.
- Loss arising from bad investment advice or poor investment management

The maximum level of compensation for claims against firms declared in default *on or after* 1 January 2010 is £50,000 per person per firm. The maximum level of compensation for claims against firms declared in default *before* 1 January 2010 is 100% of the first £30,000 and 90% of the next £20,000 up to £48,000 per person per firm.

Note that an individual dealing with an unregulated firm such as a 'boiler room' is not covered by the FSCS. Additionally, the FSCS only covers the issuer of an instrument, not the backer. Therefore for instruments such as ETFs that include a counterparty, if the counterparty goes bust (as happened in the case of Lehman Brothers who acted as a counterparty to ETFs and other structured products) but the broker is still solvent compensation may need to be sought through the liquidator.

Tax and Online Trading

Shares (and other investments)

Gains made from selling shares (and most other traded assets) are liable for Capital

Gains Tax (CGT) which is charged at 18%. Any losses can be offset against profits.

Gilts (UK Government bonds) are exempt from CGT. Any income generated by bonds will be liable to income tax.

Dividends

Companies pay dividends out of profits on which they have already paid - or are due to pay - tax. The dividend you are paid represents 90% of your 'dividend income' with the remaining 10% of the dividend income being a tax credit. Basic rate taxpayers therefore have no further tax to pay in dividend income. Higher rate taxpayers have an additional 22.5% tax to pay on dividend income.

Stamp Duty Reserve Tax

SDRT of 0.5% is levied on paperless purchases of UK listed shares. You don't have to pay SDRT if you buy foreign shares but there may be foreign taxes that you'll have to pay.

Individual Savings Accounts

Shares held in an equity-ISA are sheltered from both CGT and higher rate tax on dividends. SDRT is still payable.

Recommended Reading

A Beginner's Guide to Day Trading Online by Toni Turner; published by Adams Media Corporation; Mar 2007
ISBN-10: 1593376863
ISBN-13: 978-1593376864

The Complete Guide to Online Stock Market Investing: The Definitive 20-day Guide by Alexander Davidson; published by Kogan Page Ltd; Dec 2006
ISBN-10: 0749447478
ISBN-13: 978-0749447472

Investing Online for Dummies by Matt Krantz; published by John Wiley & Sons; Jan 2008
ISBN-10: 0470228024
ISBN-13: 978-0470228029

What Works in Online Trading by Mark Etzkorn; published by John Wiley & Sons; April 2001
ISBN-10: 0471372889
ISBN-13: 978-0471372882

Technical Trading Online by Jerold Roth; published by John Wiley & Sons; Jan 2001
ISBN-10: 0471394211
ISBN-13: 978-0471394211

Further Information

This guide is for general interest - it is always essential to take advice on specific issues.

We believe that the facts are correct as at the date of publication, but there may be certain errors and omissions for which we cannot be responsible.

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