The unstoppable rise of the digital investor.

SERIES - MARCH 2021

1

InvestSuite

‘Digital barriers are being broken. Forever. That behaviour will not change anymore’.

– Steven van Belleghem, Partner & Co-founder of Nexxworks

2020 witnessed the massive rise worldwide of a new generation of self-directed investors. There has been an acceleration of existing increasing tendencies in numbers of retail online investors.

Going forward, there will be a regular update of highlights or trends we see in the world of online self-directed investing. This new series builds upon the Perspective we issued end 2020: ‘The Unstoppable Rise of the Digital Investor’.

HIGHLIGHT 1: THE UNSTOPPABLE RISE OF THE RETAIL INVESTOR – SOME NUMBERS

Goldman Sach’s Scott Rubner (Global Markets Division), said in a recent podcast (29th January 2021) that **“retail investors’ trading activity has been the largest story of 2020. Period.”.** Hereby some very interesting numbers he quotes based upon research from the Federal Reserve Board in the USA:

1. **US Households own 36% of the $57 trillion US equities market.**
2. **Which is 12 times more market cap than hedge funds do.**
3. **“The most active owner of the equity market has become the most active trader.” This was not seen since 1999.**
4. **Goldman Sachs ‘retail trading favorites basket’ (stocks which show up most on message boards, Twitter, trading apps) is up 170% versus March 2020 lows.**
5. **DART (Daily Average Revenue Trades) hit a record of 15 million trades/day in 2021.**
6. **Retail single stock trades make up 25% of the overall market volume compared to just 10% in 2010.**
7. **Small options (50 contracts or less) make up 10% of the overall options market.**

HIGHLIGHT 2: GAMESTOP A ‘GAMECHANGER’?

Although GameStop was a Fortune 500 company, it seldom appeared on the front pages of the financial newspapers. It had stumbled down the rankings from place 255 in 2010 to place 464 in 2020, although it was still making $6,4bn in revenues and had more than 30,000 employees in 14 countries. The sudden resurrection of the company, and explosion in its stock price despite its obsolete business model, was caused not because of the intrinsic merit or promise of the company itself, but because of a large-scale popular action to protest against the controversial practices of powerful hedge funds. The campaign stimulated much debate about the ethics of hedge funds’ practices.

It was merely a coincidence that GameStop became the focus: the company just happened to represent a massive opportunity to create another short squeeze.

The campaigners, based on Reddit, had carried out some ‘warm-up’ exercises with Nokia and other companies. By the time GameStop came into the centre the ideas of the ‘Main Street masses’ had gained such a wide following that Wall Street and regulators could no longer afford to neglect it: they were witnessing billions of dollars moving in unexpected directions, and supposedly untouchable professional hedge funds were losing out to simple retail investors.

Of course, GameStop was not really worth all these billions of dollars. Some of the self-organising retail army won, but many lost out due to the sharp decline in the company's share price after the peak of the campaign.

Retail investors are informing themselves more and more through the internet. Reporting by Redesign for Finance, a thinktank based in Zurich, Switzerland, confirms that investors are increasingly going online for investment advice:

... although most investors still rely on advisors, the group of investors stating that they rely on the internet to make their decision has grown threefold since 2001 to 45%, according to data collected by the Fed. ... This trend has important implications. Enormous communities have formed on social media sites such as Twitter and Reddit, with millions of users sharing investment tips. As a result, numerous investment firms have tried to capture these sentiments and incorporate them into their investment decisions.

HIGHLIGHT 3: MORE ATTENTION FOR THE REVENUE MODEL OF BROKERS

The Reddit army was permitted to act as it did thanks to zero-cost transactions; however, they soon learned that, in a zero-cost environment, they were the product. The GameStop saga revealed that there is more to the 'zero cost' model of neobrokers than meets the eye. Zero-commission transactions certainly helped a lot to democratise access to stock markets; but shortcomings, or at least 'points to think about', become more and more apparent.

How many 'normal retail customers' (in particular outside the USA) have heard of 'pay-for-order flows' (PFOF)? Revenue streams like PFOF are critical for US brokers, essentially allowing players like Robinhood to offer 'free trades'. In the aftermath of the GameStop affair, the CEO of Robinhood had to testify to the US Congress to explain how PFOF works and what it means for the broker business.

In the aftermath of the Robinhood congressional hearing, the EU markets watchdog stated that it would scrutinise the business models of the many neobrokers that had been set up online in recent years to offer commission-free trading. In the US, brokers earned almost $3bn via PFOF (Financial Times, February 26th).

HIGHLIGHT 4: RETAIL BANKS GOING AFTER THE ONLINE BROKERS

Self-directed retail trading has been in the hands of online brokers for a long time. There is, however, a significant opportunity for retail banks to offer solutions to self-directed investors, leverage their existing customer base, activate their balance sheets and avoid losing customers to online brokers. We notice more and more retail banks considering and launching trading platforms for self-directed customers. This was clearly not the case even a year or two ago. Within two to three years, many more retail banks worldwide will be offering self-directed platforms targeted at less active investors.

The untapped potential in Europe is huge. The percentage of adults in the $100k–$1000k bracket is 50% higher than in the US, but the percentage of digital investors is still far lower. The online brokerage market is still immature and has huge potential.

Another sign of the relative immaturity of the European online brokerage market is the concentration index: the top-5 US brokers control 80% or more of the online investing market, against 60% in Europe.

With such a massive inflow of new self-investors (both young and middle-aged), a larger bank building on its existing client base and customer confidence can easily reach the breakeven less than a year. There is no need for expensive marketing; banks need only use their existing internal client communication channels for cross-selling.

Previously, advisory and discretionary business models were the most profitable. But this has changed:

- MIFID has brought cost transparency: fees are under pressure.
- (Self)-investing has become the new 'saving', since deposit rates are close to zero if not already negative.
- Zero-cost brokers threaten the once-loyal investing client base of retail banks.
- Branches have closed, depriving and mass affluent customers are deprived from their personal advisor.

This has increased the need for banks to install their own execution-only solutions, rather than giving online brokers 'red-carpet access' to their premium and private client segments.

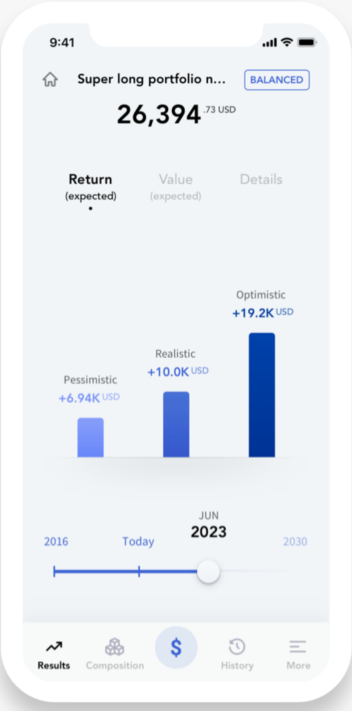
HIGHLIGHT 5: INCREASED APPETITE FOR FRACTIONAL SHARE TRADING

The advantage of buying a fractional share is that investors can buy part of a stock even if a full share is too expensive. Fractional shares allow an investor to build their portfolio even without significant amounts to invest. As more and more younger people flock to the stock markets, there is an increased appetite for fractional share (and ETF) trading. Some popular stocks' share prices are just too high for people with lower budgets. Fractional share trading offers a way out.

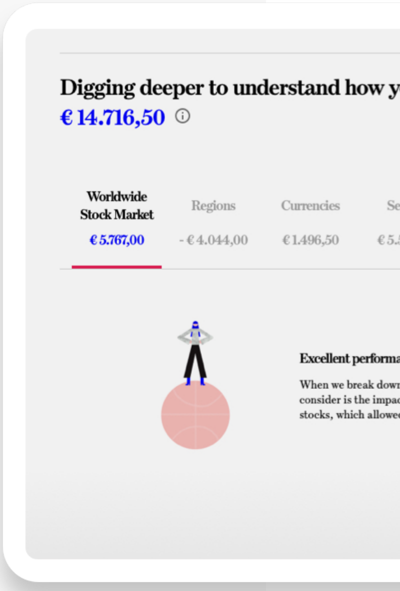
HIGHLIGHT 6: CONVERGING OFFERS OF ROBO-ADVISORY AND SELF-DIRECTED SERVICES

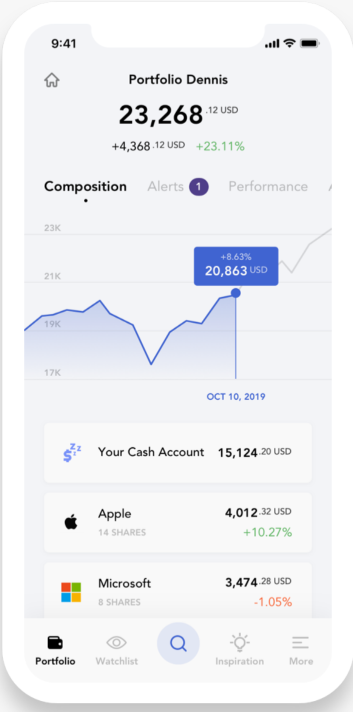
There is a recent trend for retail banks to offer separate solutions for self-directed clients and clients seeking a (robo-)advisory solution. Previously, advisory and self-directed services were strongly differentiated (in most cases, they still are). Online brokers introduced advisory services much earlier (Charles Schwab was a pioneer, for example), and started offering robo-advisory services in particular long before most other players. For instance, in Europe, somewhere between 20 and 30% of online brokers also offer some sort of robo-advisory services. That percentage is much lower with retail banks. But there is a clear trend – at least with the larger retail banks – towards combined offers. The goal is to activate the balance sheet in a digitally enabled way.

Discover our suite of products:

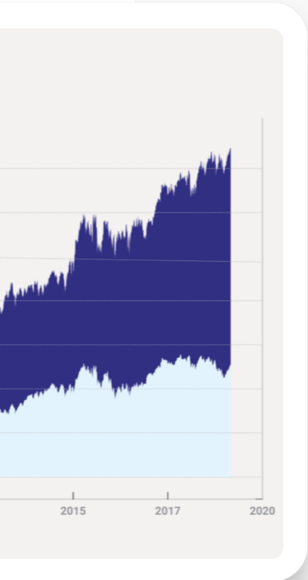


Robo Advisor
A low-cost, customisable digital wealth management tool that can deliver hyper personalised portfolios for Goal Based Investing





StoryTeller
A worldwide first new way to tell the story on portfolio performance



Portfolio Optimizer
The next-generation quant tools that provide cost-effective solutions for more efficient portfolio management

Self Investor
A best-in-class powerful white-label execution-only platform for easy investing

InvestSuite