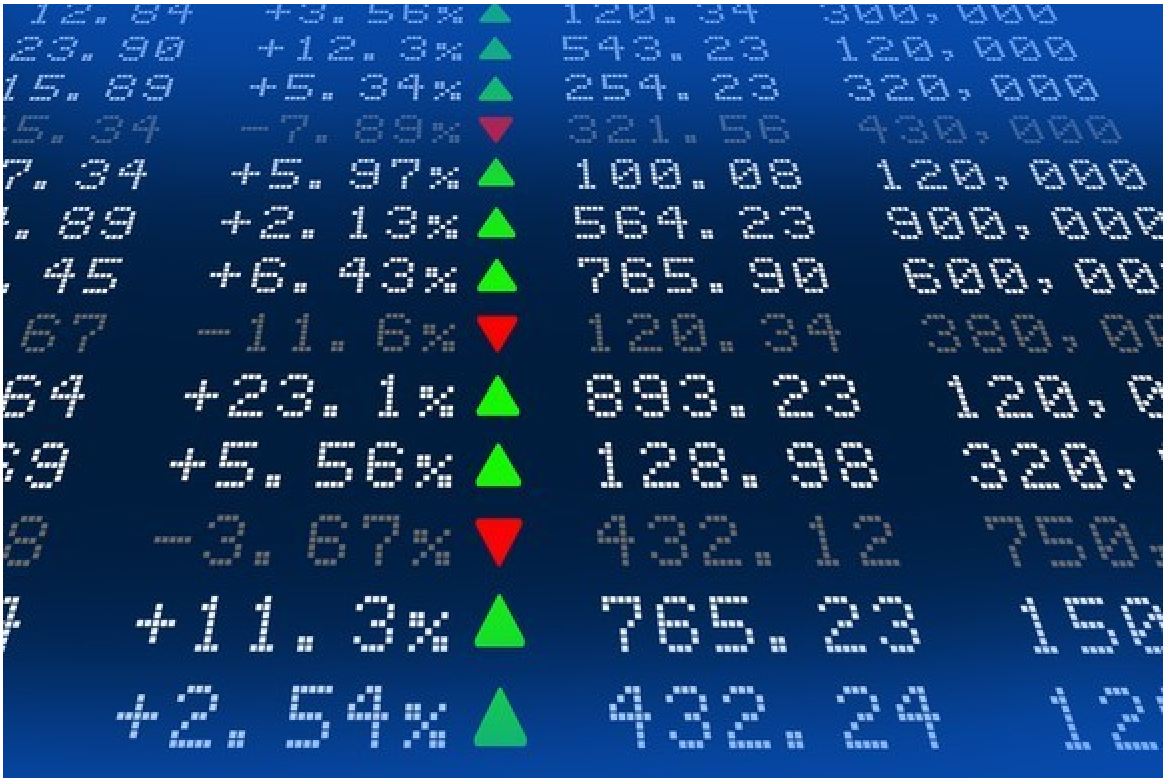
What Makes a Good Candidate for Trading on the JSE?



Background

The Jamaica Stock Exchange is a far way off from being all it can be, BUT it is steadily evolving. I foresee the day when the JSE is on par with such notorious exchanges such as the New York Stock Exchange (NYSE), the Tokyo Stock Exchange, the London Stock Exchange and the NASDAQ. I also foresee many Hedge Funds being formed along with other Private Equity firms. That time will be one of tremendous opportunity, more so than those that exist today. We must appreciate that the JSE is still relatively young, being just over 48 years old (in 2017). However, the market has already seen it's own share of Bear and Bull Markets. Furthermore, based on the fact that only 5% of Jamaicans invest on the stock market, it is fair to say we have a few more to go.

This article seems to establish a checklist for those persons who have been involved in the market for a while and have exercised the tenets of fundamental/value investing but are interested in trying their hand at a more active style of capital management, ie Trading. I will assume that the reader fully understands the difference between investing and trading. If however you require a refresher, as we often do, I recommend this short but insightful article from Investopedia on the topic.

To the Jamaican seeking to actively trade stocks on the Jamaica Stock Exchange, this article is for you. I have been involved with the JSE since 2013 and I have still not had my fair share of lessons (that's a whole other article) but there are a few markers I have noted that may help you to be a more successful trader than I was. Note that I said **was.** This is because I feel I am more suited to a systematic way of buying stocks. Having become more self aware, I finally admit to myself that my temperance is more that of an Investor, than of a Trader. That being said, the three primary characteristics of any good candidate for Trading are:

- **Volatility in Price**
- **Consistency in Volumes and**
- **Activity by Institutional Investors, Directors or Big Money Investors.**

Volatility in Price:

A good candidate for day trading will exercise reasonable volatility in price. The ideal day trading stock will be one that has it's price varying within 8 – 15 percent on any given trading day. These are rare on the JSE at the time of this publication but they do exist.
The questions to ask in regard to price volatility are:

- What is the typical price movement? Or said another way,
- Within what range does the price tend to change during the hours of trading on any given day?
- What was the change in price over the last three days? Week? Month?

An important note:
At the time of this writing, it takes three business days for a trade on the JSE to clear so it is useful to look at how the price of the stock you are interested in moved over the past three days. It does not make much sense to look at the price beyond one month prior unless you intend to hold the stock for a longer period. For example, a quarter or six months.

Bid and Closing Prices

In evaluating the possibility for making a profitable trade within a few days on the JSE, we must look at what the current market price of the stock and what buyers are willing to pay for it. The latter is known as the Bid Price. Typically, if the bid price is higher than the previous close price, this stock has potential to go up. Note also that the upward movement may not always happen on the day immediately after you make the observation. However, if sufficiently large volumes moved at a noticeably lower price than the average trading price of the stock, it is likely to go back up. This is called a recovery or a rebound.

The main questions to ask as it relates to bid and closing prices are:

- What price did the stock close at?
- What is the closing ask price?
- What was the closing bid price?
- Is the closing bid higher than the closing ask?
- What was the highest it traded at today?
- What was the lowest it traded at today?

Consistency in Volumes

Volumes are extremely important to the day trader. In fact, volume is possibly more important than price and volatility. **It makes no sense for the day trader to buy 100,000 units of a stock that has fallen by 15% when the average daily volume traded for that stock is 5000 units**. In order for him to capture the full reward of the capital gain he needs someone to buy 100,000 units of the stock 15% higher and in one go. If the average daily volume traded for the the stock is 5000 and someone (or some institution) buys 100,000 units at a 15% discount, don't buy more than 5000 units to day trade. The rule here is, **Don't buy more than you can comfortably sell off in a single day of trading**. To hope that 20 trades (of 5000 units each) will occur on the same day for such a stock, and at the desired price to allow you to claim the maximum gain can be considered naïve at best.
The question to ask yourself regarding volume are:

- What is the daily average volume over the last week or month?
- What volume traded yesterday?
- Was there a significant volume movement on this day?
- If I got X amount of units, would I be able to sell all of them at once on a typical trading day?
- How long would it take me to get rid of X units if I were to buy more than the average amount traded over the last month?

Institutional Activity, Director Trading and Big Money Investors:

Generally speaking, institutional activity, director trading and high profile investors create opportunities for the small individual day trader. Why? Because they normally control large volumes and will often sell or buy blocks at discounted prices.

Think of it like this, a farmer who is the owner of a tomato farm can sell hundred of tomatoes. He can sell then at a much lower price than the corner store or even the wholesale (typically who he is selling to) and still realize a decent profit. On the other hand, the wholesale, which is buying from that farmer in orders of hundreds can “negotiate” price down to a level he prefers to pay. The Stocks are the Tomatoes, The Directors are the Farmers and the Big Institutional Investors are the Supermarkets. You and I are the corner stores.

Now imagine that the market price of a share is $1.00, if a big institutional investor negotiates the price down to $0.85 per share and the market closes the shares will officially be at a discount when the market reopens. We will be able to purchase the shares at the opening of the market at $0.85. Additionally, and favourably so to us, the other small investors trying to get the shares are still bidding at, or above, $1.00 in order to secure their purchases. We could also view this from the Director's stand point. If, for instance a director who got in on the stock at inception of the business wishes to exit, he can afford to sell his shares at a remarkable discount and still exit with a handsome profit. **The key is to observe the volume movement and rationalize the possible reasons behind whatever volume trades.**

The questions to consider here are drawn from two aspects previously discussed:

- What volumes traded?
- What price did they trade at?
- Based on the volumes and the prices who is possibly trading the shares?

Margin:

This consideration is closely related to price. As a day trader, our margins determine our profit. We have to closely monitor the possible returns on our capital in the short term.
The questions one must ask pertaining to margin are:

- How much can you expect the stock to move up by in the short term (within a few days)?
- What is the most you expect it to move by?
- What is the least you expect it to move by?
- If it is to go up by your lowest approximation, would it be profitable to sell?

Time Frame:

Day Trading is actually not a real possibility in Jamaica as yet. Strictly speaking, **Day Trading** means that a block of stocks are bought then sold later, by the same person or institution that bought the, within the few hours that the market is open. Currently, the JSE doesn't facilitate such transactions since it takes 3 business days to process a trade. Therefore, when I speak of “Day Trading on the JSE” I am really talking about short term trading, i.e. buying a block of stock and selling it within a few days or weeks of the purchase date.

Since this is the case, we must therefore give ample consideration to how long we expect it will take to realise gains on our purchases.
What is the shortest time frame?
What is the foreseeable longest time frame?
How do I respond if my expectation do not play out in the time frame I expected?

Having considered all these factors, we can now look at my recommended reactions to certain market activities. For this section I will present a simple scenario then pose some of the more common questions that the Day Trader should ask himself. I will then propose certain reactions to different cases. There are really only three possibilities, the Day Trader will either BUY, SELL or HOLD. The aim of this section is to help you in determining when to do each. See you in Part 2:

Endorsement

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