Brainy's Articles on

Share Trading

Strategy considerations
Volume and liquidity

Introduction

Many share market investors and traders fall for a number of traps in the early days of their investing/trading experience. One of these is to do with stock *liquidity*. It doesn't matter whether you are buying shares for shorter term profits, or for longer-term investments, it is very important to be able to sell the shares at a time that suits you. To do this, it is important to have buyers available to take your stock at the point in time when you want to sell it.

It is important to realise that with many stocks, there are times when there is a shortage of buyers. So to sell a stock you might have to wait for hours to find a willing buyer, or even days, and then sell at a price which is well below your desired sell-price.

This article in Brainy's series on Share Trading (number ST-6210) talks about the concept of stock *liquidity*, and provides some considerations to help avoid thinly traded stock. By avoiding thinly traded stocks you should be able to hang on to more profits, and minimise losses. Conversely, by ignoring the issue of *liquidity*, you might end up seeing profits slip away, and losses grow before your very eyes. And it is very easy for this to happen — and it can result in a gut-wrenching feeling.

Readers should also refer to the further details on this topic included in eBook (PDF) Article:

- ***ST-6215, "Strategy considerations — Finding liquid stocks"***.

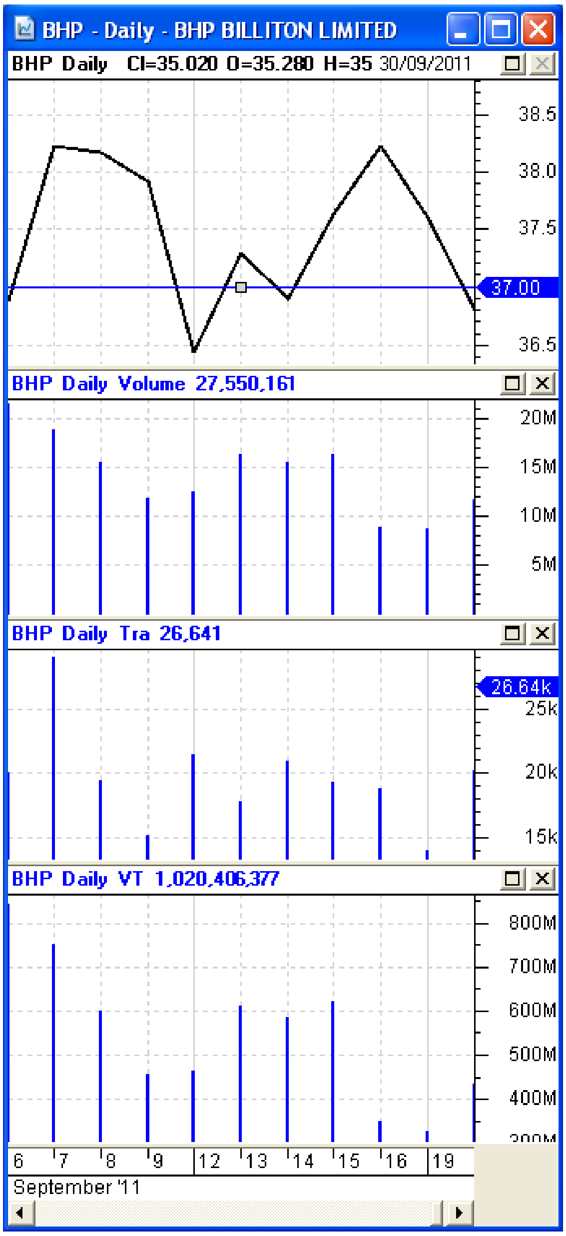

Figure 1: BHP (Sept 2011), showing Volume, Trades, Value.

Quick sample

As a quick example, with reference to Figure 1 at right, BHP traded for a few days at around $37 (the upper pane of the chart), and in any one day there was a *volume* of about 15 million shares in 20,000 *trades* (the next two panes down in the chart) In this case the *total value* was basically 15 million times $37, or $555 million (the bottom chart pane). These concepts are explained in more detail below.

Liquidity — overview

The concept of *liquidity* in relation to buying and selling shares is a very important one. It basically refers to the "amount" of a stock that is available for purchase, or the numbers of willing buyers who might buy the shares from a seller.

A serious share trader will tend not to trade in the shares of any company where the *liquidity* is too low. This is to avoid being stuck with a stock, or needing to sell a stock for a price that is too low. Having said that, some serious share traders do trade in illiquid stocks; but they are very mindful of this. In some cases, it is the thinly traded stocks where a lot of money can be won (and lost); but at significant risk. Some people might call this type of trading speculating, or even gambling.

Note: This information cannot be relied upon. It is only a guide. There is no guarantee of success.

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