Traders still play in the shallow end

The Australian index has been giving some hope, although the market is still 35 per cent off 2007 highs. Photo: Andrew Quilty

by Gayle Bryant

The Australian sharemarket has been in an upswing over the past couple of months, bringing renewed confidence to investors and traders about returning to the market. But volumes remain subdued and while they stay low, opportunities are limited.

E*Trade’s head of online and direct markets, Matthew Loughnan, says the trading environment is still subdued, although July to September were better months.

“It was seasonal reporting time which tends to bring people into the market," Loughnan says.

“But there are a lot still sitting on cash or coming back into the market with smaller positions."

Loughnan says investors are continuing to take a conservative view. “There is strong interest in hybrids, which may be driven by the SMSF [self-managed superannuation fund] sector," he says. “There is also strong interest in global shares, especially in the names you read about every day such as Apple, Google and Bank of America."

LCG Markets head sales trader, Ashley Jessen, says traders like higher volatility so at this point they are seeking out different markets. “In this case they are trading indices and foreign exchange but any time there is a fall back in volatility they look elsewhere," he says.

Jessen says commodities like gold are more favourable at the moment, as well as silver and oil.

“A lot of leveraged traders are focusing on shorter time frames and so gravitate towards more volatile products," he says.

“Professional traders, whether they are using leverage or not, tend to keep their risk levels constant – usually around 1 or 2 per cent.

“Even in a bull market, traders keep their risk at constant levels although a bull market provides more opportunities."

Jessen says that by using leverage traders are able to access more opportunities. “In a down market, there may be only three opportunities per day for a trader, but in a bull market there may be considerably more," he says.

“Leverage enables a trader to allocate risk on more opportunities, although in a down market the trader’s mindset and strategies need to be different."

Loughnan says people aren’t using leverage like they used to, but there has been interest from certain segments of E*Trade’s client base. “They are quite conservative with their leveraging though," he says. “They are only leveraging around 45 to 55 per cent and again only taking out small investments."

Jessen says the market is going through a consolidation phase. “There was a breakout across all markets on the upside," he says. “The Aussie dollar went up, the euro-US dollar had a good run.

“But this appears to have capped out and markets are now waiting for decisions such as those coming out of Spain, and the impact of QE3 [third quantitative easing in the US]. Traders are waiting for these global macro issues to play out."

Still, he says markets are more favourable to the upside and the mindset of traders is positive.

“Anytime there is a move to the upside, confidence returns," he says. “The markets have been positive: gold has rallied since August, the Australian dollar has rallied from May to August and the Aussie index has been up from around mid-June. This is giving investors a lot of hope, especially as our market is still 35 per cent off its 2007 highs."

But he says the resources sector has taken a beating.

“There has been a lot of divergence on the local market, with banks and other sectors outside resources in an uptrend," he says.

“Traders need to be proactive and rebalance their portfolios towards good-performing sectors."

While the markets have been volatile, Jessen says smart traders tend to allocate small amounts of risk to each trade so if it goes against them they can walk away without losing too much.

“But nervous investors, if they take a number of hits, they tend to walk away altogether, especially if they have not allocated risk in a responsible manner," he says. “Leverage allows traders to spread their risk further and with sentiment more favourable and giving investors hope, confidence is returning. Traders find it easier to make profits when markets are bullish."

CMC head of research, David Land, says while the market has been going up, for the bears it has been a death by a thousand cuts.

“It has been rallying but in an incremental way," he says.

“There has been no big consistent jumps but it has been positive. It just hasn’t been enough to draw out the people who are bearish."

Land says this is hardly surprising given the news flow that appears each day, especially out of Europe. “At the same time we are getting to the stage where people are interested in buying the dips on things that are performing well," he says. “There is growing interest and levels of activities but it is not as good as it has ever been. You only have to look at the volumes to see that."

For markets to improve and more traders to come back in, Land says there needs to be more consistency.

“The market may rally before this stage but a roaring bull market is later down the track," he says.

“I don’t know when. There are a number of things hanging over the market, especially overseas, say with Spain and the expectations of a bailout there, so there is still an air of uncertainty."

Land believes any bull market will be slow-moving, even though Australia has been sheltered from the rest of the problems around the globe in terms of economic performance.

When it comes to leveraging their investments, Land believes people will be relatively conservative.

“CFDs, for example, are a product that have built-in leverage and I expect traders will take smaller position sizes rather than avoid them altogether," he says. “As CFDs become more mainstream, CFD traders may look at other asset classes such as commodities and forex and focus on things that are trending more consistently."

Land says there is a lot of interest in gold and larger currency pairs at the moment. “With the stockmarket being less consistent and with the higher uncertainty, investors and traders are looking to alternative markets," he says.

The head of Australian Unity Investments, David Bryant, believes the best part of the investment cycle to use leverage is now.

“If there are any dips in the market they are buying opportunities," he says. “The best time to use leverage is when a company is coming off a low base."

Bryant says investors are beginning to get their nerve back. “While they may have missed the 10 per cent or so that the market has rallied recently, any opportunities that come up now will be the time to transact," he says.

“However, saying that, we are not seeing many investors coming back to the market; they tend to come back slowly. Over the next year, the market may lift 200 or 400 points and it’s likely only then investors will return. However, by then they will have missed out on 10 to 20 per cent of the gains."

Bryant believes it’s a good time to use leverage because interest rates are low and dividends are good. “If an investor is sensible about their leverage level, then it is a good time to start coming back," he says.

“If there are stocks they like and they are familiar with them then they could use leverage gradually. However, they need to keep an eye on the level; this is a lesson learned from five years ago. You should be in a position where you use dips to buy rather than be forced to sell."

Trader and director of Trading Lounge, Peter Mathers, says he watches price and volume flow as support and resistance when he trades. “All technical indicators are based off the price and the volume," he says. “Volumes have been low on the Australian Stock Exchange in September over August,which is an indication of a corrective pattern.

“We are not interested in the fundamentals as they are too broad for short-term CFD and forex trading."

Mathers says daily financial news events are important to his trading strategies, such as rates, employment and manufacturing.

“Our sentiment is based on price patterns and action with the volume confirming the price," he says.

The Australian Financial Review