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EXCHANGE --- Heard on the Street: Not the Best Time For No Commissions --- Free trading is making small investors trade more often. In a scary market, that could be bad news.

By Telis Demos
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The age of free stock trading has arrived at an inauspicious time -- exactly when many individual investors might have been best served to not trade at all.

It was just in October that Charles Schwab , E*Trade Financial , Fidelity Investments and TD Ameritrade Holding announced that they would charge zero commissions for most trades. The moves put them in line with some newer online upstarts, notably Robinhood Financial, and were followed by more expansions of free trading at big banks such as JPMorgan Chase and Bank of America .

In case there was any mystery about whether making trading free would increase some people's consumption of it, the results were immediate: Volumes surged to record levels late last year at some online brokers. At Ameritrade , February daily-average trading volumes were more than double what they were a year prior. Schwab on Friday said that clients hit a high of 2.7 million trades on March 9, twice the average daily level in February, which was itself up 53% year-over-year.

But those who started trading more frequently in a bull market were suddenly confronted with the fastest flip to a bear market ever, sparked by fears around the novel coronavirus spread. Some traders also hit a familiar longtime pitfall for customers of discount online brokerages: **technology** problems. Free trading pioneer Robinhood suffered three outages over eight days of wild trading, including during the huge rally on March 2.

The unfortunate timing of that disruption highlighted one of the most vexing historical challenges for individual traders and one that will likely become only more pressing in the months ahead: Active traders run the risk of underperforming the market, particularly when it turns bearish.

Research shows that active individual traders often trade too much. A foundational study published in 2000 titled "Trading Is Hazardous to Your Wealth" looked at nearly 67,000 households with discount brokerage accounts from 1991 to 1996 and found that those who traded the most underperformed the market annually by more than 6 percentage points.

Other recent work has highlighted that a particular mistake small investors often make is being out of the market after bad days. A J.P. Morgan Asset Management review last year noted that, from January 2000 through December 2019, within two weeks of the S&P 500's 10 worst days came six of its 10 best days. And those days add up. An investor who missed just the market's 10 best days over that time earned an annual return of 2.4%, versus 6.1% for an investor who was still invested on those days. Missing the 20 best days, or less than half of one percent of all days, meant earning almost nothing at all.

Robinhood's recent outage coming on a huge up-day for the Dow Jones Industrial Average wouldn't be the first time relying on an online broker could have cost an active investor in exactly that way. For example in October 1997, following a market plunge amid fears of an Asian financial crisis, several online brokers had limited access on a rebound day that was at the time the best-ever U.S. stock-market point rally.

Even as **technology** has surely become more sophisticated, humans haven't necessarily. Active traders can't be saved from errors of their own making. More data, more news, more sophisticated trading tools and social media may not help some investors. A study by finance professors at the University of Notre Dame and University of California, San Diego found that upticks in Google searches for terms such as "financial crisis," "recession" or "bankruptcy" were associated with flows out of equity investment funds for individual investors, even though price declines were typically soon reversed.

Free trading may benefit investors overall, especially those who place regular trades as part of a strategy of saving money or investing over time, says Terrance Odean, finance professor at the UC Berkeley's Haas School of Business , who co-authored the 1990s discount brokerage study.

But Mr. Odean says that a more recent study, of retail brokerage accounts in Taiwan, found that only part of small investors' underperformance was explained by costs like commissions.

"Some people are inclined to trade too much anyhow, and free trading may incline them to do it that much more," he says.

For any newly active traders it may have been a rough entry, but a perhaps effective lesson in how not to gorge themselves at the buffet.

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EXCHANGE --- Weekend Investor -- The Intelligent Investor: The E*Trade Deal Reveals the New Rules of the Investing Game --- Brokerages don't want to be your 'financial supermarket.' They want to grab your cash.

By Jason Zweig
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Morgan Stanley 's takeover of E*Trade Financial Corp . for $13 billion shows how drastically the brokerage industry's business model has changed.

Firms no longer want to offer investment products from all sources. Instead, they want to milk their customers' cash and manage all of the assets themselves. Investors need to understand the rules of the new game.

For decades, big banks and brokers aspired to become "financial supermarkets" where consumers could open bank accounts and buy stocks and bonds, mutual funds, insurance and the like.

In the 1980s, Prudential Financial Inc . sold securities alongside insurance. American Express Co . pushed brokerage services and financial advice to credit-card customers. In the 1990s, Citigroup Inc . flogged stocks and mutual funds in its bank branches. Even the retailer then known as Sears, Roebuck & Co . sold securities in its department stores, earning the nickname "Socks 'n' Stocks."

Some outfits -- especially Charles Schwab Corp . and Fidelity Investments -- made one-stop-shopping work, managing money themselves while offering funds from other firms as well.

But most flailed. Prudential paid more than $1.5 billion in regulatory fines over sales of risky partnerships. American Express , Citigroup and Sears sold their brokerage and fund units.

Nowadays, the name of the game isn't to offer all things from all sources to all investors. It's to offer only what keeps the fees in-house.

Much as the Plains Indians used every part of the buffalo, from flesh to skin to horn to sinew and hooves, Wall Street excels at creating strategies with fees that can be harvested from every component. In practice, that means investment firms want to grab as much of your money as they can and farm out as little of it as possible.

Wall Street can't make oodles of money off your trades anymore; **technology** has driven commissions to near zero. And it can't make the windfall it once did off managing portfolios; there, too, market-tracking index funds and exchange-traded funds have become cheap as dirt.

Where are the remaining profits for brokerage firms?

They can take your cash and, instead of investing it for your benefit in the highest-yielding money fund or deposit account, they can put it in their own bank and pay you peanuts. Then they lend it out and keep the profit for themselves.

Morgan Stanley , E*Trade and Schwab all own banks to which they route much of their customers' cash. E*Trade pays its customers 0.01% to 0.25% on their uninvested cash; Morgan Stanley , 0.03% to 0.2%; Schwab, 0.06% to 0.3%.

Brokerages have been pocketing 2% and up on that money (and you can do almost as well, if you pull the cash from your brokerage account and park it in a certificate of deposit or savings account at the right online bank).

Schwab, which has hoovered up $220 billion in bank deposits, earned 61% of its total net revenues in 2019 from the interest it captured on those balances.

Financial firms can also invest your money in funds they run themselves. That way, they capture fees you would otherwise pay to somebody else.

By my estimate, 57% of the $16.5 billion in total assets of the FlexShares ETFs, managed by an affiliate of Northern Trust Corp ., are held by Northern Trust clients. The firm "adheres to an open-architecture investment platform, applying the same objective and rigorous selection process to third-party and proprietary investment products," says a spokesman.

Even Vanguard Group , the investment giant owned by its fund shareholders, is freezing out other firms. In its $161 billion Personal Advisor Services program, which manages money for individual clients, Vanguard won't recommend mutual funds or ETFs from any other companies. Clients aren't compelled to sell their non-Vanguard investments, says a company spokesman.

The house brand isn't always bad, of course. A firm's own funds can be cheaper or better than the alternatives. But investors need to be on their guard: Under federal rules, a firm can recommend its store-brand investments whether they are ideal or not, so long as they are a "reasonable" choice.

Finally, complexity pays -- for investment firms, if not their clients. Take "structured notes." The return on these short-term debt instruments is pegged -- often in complex ways -- to the performance of other assets, often stocks or market indexes.

You can lose money, but issuance is booming; in less than one hour on Thursday, banks and brokers filed nine prospectuses with the Securities and Exchange Commission . Here again, firms often hawk them to their own clients.

Structured notes are a fee bonanza. Firms rake in upfront charges of 1% to 4.5%. They earn more fees for calculating the value of the notes. They also can make money by trading against the assets the structured products are linked to. There's generally no market, so if you need to sell before maturity, the firm will buy your note at a price it sets -- including a "spread," or trading cost to you.

The best questions to ask on the new Wall Street, then, are these: What are my financial advisers doing in-house that someone elsewhere could do cheaper or more safely? Where do my brokers put their own cash? Do my advisers buy structured products for themselves? Above all, should I diversify not just my portfolio -- but my financial advice?

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