Title:
Great Profit Potential Comes With Greater Risk

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633

Summary:
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All right then, step right up to the plate and get prepared for some advanced stock market trading.

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For advanced traders, using margin, selling short, getting into IPOs, and other quite sophisticated trading techniques and strategies can open a whole new world of exciting trading experiences and potential profits.

Understanding IPOs

IPOs or initial public offerings are a highly visible sign of the transition of a company from a privately owned organization to a publicly held firm. Every incorporated business issues common stock, although initially this is usually to a few stockholders. In order for a company to raise necessary capital without incurring debt, one commonly used method is to sell stock to the public, thereby becoming a publicly traded company.

There are two ways to potentially make money from these IPOs.

First, the trader needs to get in early and buy stocks through the initial public offering, hope for a large quick increase in share price, and then sell shares for a quick profit.

The other way is to sit back, watching and waiting until after the IPO has begun. See if the new stock is fairly priced. If it’s reasonable, then one would purchase the stock.

Shorting Stocks

Selling short is an advanced technique that many traders do not take advantage of. Short sellers look for the best stock to sell. Short sellers sell stock they don’t actually own with a belief the value will come down by a significant amount in the near future. The shares are borrowed from a stockholder. The borrowing is done by each party’s brokers.

When the price tumbles, the short sellers can buy the stock at the lower price to cover their short positions, pocket the profit and return the shares to the owners.

Short selling is risky though. If the prices jump instead of drop, you will lose money. It is often difficult to easily speculate if a stock will fall. The historical tendency of the average stock is to increase in price over the long term. So the potential for loss is greater than the potential for profit, because the short seller is going against a historical norm.

Margin Trading

Margin accounts can permit the trader to borrow money to buy stock. Margin trading uses borrowed money to increase how much stock the trader can buy. This money can be loaned by a broker.

If you were to buy a stock worth $1,000 on a cash basis, without the use of margin trading, you would have to dish out the full $1,000 dollars, plus commissions. But if you margin trade, your broker can lend you up to half of the amount or $500 on many stocks, and you only need to shoulder the other $500 plus commissions and interest payments.

If the stock gets you $10 per stock, profit will be based on the number of shares of stock you bought with $1,000. Then you can pay the broker back. If you did not margin trade, your profit would only have been for the number of shares of stock you paid for using cash. On the other hand, were the stock price to go down, the loss incurred would be based on the entire $1,000, and you would still owe the margin loan amount to the broker.

Closing

As with everything in life, there is a flip side to every coin. In many cases, the greater the profit, the greater the risk. Advanced trading is not for the faint of heart, and you should only trade with risk capital, not with money that you can’t do without.