Newsletter

What affects share prices?

"Why isn't the opening price the same as the closing price of the previous day?"

"I placed my order after 4pm and it went through – Why?"

These are questions we often get asked so here is some information to help explain market hours and how share prices work.

The main hours of the market are between 10am and 4pm; however there is an opening auction prior to market open (no trades are processed during this time) which may affect a share price at the open. There is also a closing price auction at the end of the day between 4pm and 4.12pm where orders may still be processed.

Game tip 1: *If you are placing an order at the end of the day…it would be best to do so after 4.12 pm.*

To help you understand the auction process more, read the following article Understanding the ASX opening and closing auctions.

Another thing that may affect the share price is if a share goes ex-dividend. More often than not the price of a share will fall by approximately the dividend amount when the share goes ex-dividend.

There may also be some unexpected overnight news from Global markets that impacts share prices.

Game tip 2: *If you place an order before the market opens, it is safer to use a 'limit' order.*

Because, if you enter an order based on the previous day's prices, as mentioned above, the share won't necessarily open at this price the next day. If there is a sudden move up or down and you have a 'market to limit' order in place, you could end up buying or selling the shares for more or less than you intended.

What else can impact a share price?

Company announcements: One of the most important factors affecting the price of a share is a company's future earnings. Any changes to the forecast in earnings, either by company management or by market analysts, may impact the share price. Therefore, keeping up to date with company announcements is important.

Game tip 3: *If there is an asterisk beside a company code, this means there is a company announcement* - click on the asterisk and this will take you to the announcement.

The Economy: Alongside the impact of global markets, a range of economic factors within Australia can also affect share prices, for example, the overall health of the economy, the level of unemployment and interest rates etc.

Supply and demand: The sharemarket is a market place like any other. The more people want to get hold of a particular product or in this case a particular share, the higher its price will go. If people no longer want a share, those looking to sell may have to offer it at a lower price in order to sell it.

Natural disasters such as floods or earthquakes etc. or other disasters can have a significant impact on the sharemarket. Often however, these are simply reactions to the unexpected news and the market or shares affected can recover in a very short period of time. It's helpful not to react to news like this and to take a long term look at your shares rather than a short term panic reaction.

As an investor it is wise to keep an eye on global and local news as well as keeping up with the announcements of the companies you are invested in.

Important reminder: To be eligible for prizes - one buy transaction must have been completed by 11 October, plus you must have purchased shares in at least 4 different companies over the Game period.

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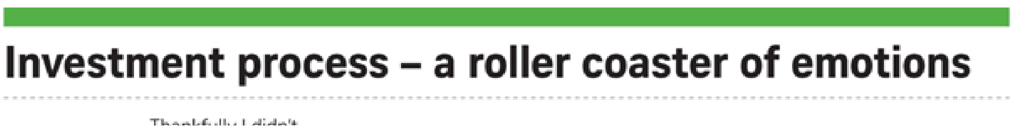
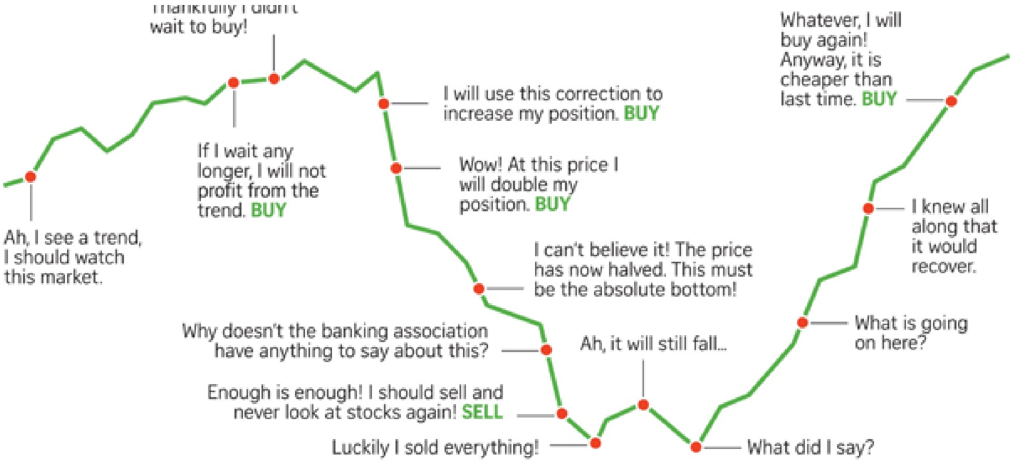
Keeping your cool when share prices change

Most people think that to be a great investor, you need to possess exceptional knowledge and skills. The truth is, the psychological and emotional side of investing is just as important, if not more so.
Share price volatility can typically lead to a rollercoaster of emotions when investing. Unfortunately, for those that do not have a strong investing framework, this can lead to excessive trading, often at the wrong times.





Sources: CREDIT SUISSE; BEHAVIOURAL FINANCE: THE PSYCHOLOGY OF INVESTING SUNDAY TIMES GRAPHICS

Now that we know that share prices generally respond to supply and demand, company announcements and broader economic factors, it is apparent that when share prices move dramatically, we need to evaluate what exactly caused the shift.

If we look back at Newsletter 3, we spoke about the importance of having strong investment theses and catalysts when making investment decisions. If you are confident in your ideas about a stock, irrelevant price moves will do little to affect your emotions. Unfortunately, biases inherent in all investors are often the culprit of weak investment theses. Today, we will identify some common biases to help you avoid them going forward.

Confirmation bias
Confirmation bias is the tendency for investors to search for information that confirms their existing beliefs while ignoring anything that disproves it.

In an investing context, an investor with confirmation bias may unintentionally search for information that supports a potential investment thesis they have in mind while ignoring any information that is a serious risk to their idea. This ultimately leads to a poorly evaluated invesment thesis that has a significant probability of being incorrect.

To avoid this bias, make a conscious effort to weigh up positive and negative evidence when formulating an investment thesis. This way, when share prices become volatile due to the risks that you may have already foreseen, you know exactly if and how you should respond.

Overconfidence
There is a psychologically studied cognitive bias where people overestimate their own qualities and abilities. This is especially true if our first couple of stock picks turn out to be winners. As a result, overconfident investors typically fall into the trap of doing less research and due diligence on their future investments, which is dangerous.

To avoid this bias, you should always ask yourself if your investment turned out to be a winner because your investment thesis was proven correct or because of other factors, which you didn't consider. If the latter conclusion arises too often, you should re-evaluate the way you brainstorm investment ideas to ensure you cover all bases in the future.

Riding losses
Humans tend to be loss averse. We feel the pain of losing money far greater than the joy of gaining it. Studies have shown that people suffer almost twice as much pain losing $100 than they would generate pleasure gaining $100. This means that in a situation where the share price drops dramatically, investors tend to ignore the reality of that accompanying negative information in hopes that the share price will recover regardless.

In situations like these, you should always ask yourself if your investment thesis has been violated. If the share price has fallen due to a company announcement that disproves your investment thesis, it would be unwise not to sell the stock if you don't have any new ideas for the company.

Final words
Now that you are more aware of the biases that are inherent in every investor, hopefully reading this article will help you take action to avoid them. Doing so will allow you to construct more robust investment theses and ensure that when share prices become volatile, you know exactly how and when to act. Whenever you're in doubt, just ask yourself if your investment thesis still stands. If so, keep calm and carry on.

If you want to read up a bit more on this stuff, and some important investment principles needed to succeed in the market, you can check out Simply Wall St's learning center.

Game update