Why a little discretion may benefit your next stock trade

By John Christofilos

The bid/ask spread is supposed to provide an accurate measure of a stock's current value, but what shows up on the trader's screen has become a bit less reliable in recent years and may not always reflect what it takes to complete a transaction.

This is particularly true when investors are trying to buy a significant position in a less liquid stock. In these instances, investors will often find themselves chasing the trade because the price of the security moves against them at the last moment before execution. This can be highly frustrating and may feel a bit like a friend offering you a ride, only to drive off just as you reach for the door.

To some extent, this is just how markets work, but there's no denying the growing influence that high frequency traders (HFTs) are having on certain trades. Incentivized by numerous market exchanges to simply sit on the bid and offer of a stock, HFTs will quickly react to any whiff of a buyer and work systematically to maneuver prices higher.

So what can be done to circumnavigate this potentially vicious circle? One good option for retail investors with a longer term horizon is to recognize an acceptable level of discretion to transact outside the bid/ask spread in order to get the trade done. This could mean paying up a couple of pennies to buy a stock or losing out on a few pennies to sell, but it keeps from getting caught up in the chase of an ever changing share price, which can often cost even more in the end.

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