

New Danger for Small-Time Investors

Zweig: When trades turn into a costly, convoluted nightmare for investors who aren't vigilant to the point of obsessive.

By **JASON ZWEIG**

DECEMBER 13, 2011

For small investors, buying or selling a stock has never been cheaper or easier; the vast majority of the time, small trades cost next to nothing to complete and occur within the blink of an eye.

But every so often, a trade turns into a costly, convoluted nightmare for investors who aren't vigilant to the point of obsessive.

On Thursday, at 2:00:07 p.m., the stock of **United Continental Holdings (UAL)**, the airline, was quoted at \$19.85 bid, \$19.86 ask meaning that potential buyers were willing to pay \$19.85 and potential sellers would part with shares for \$19.86.

Within 25 thousandths of a second, however, [142 trades went off in UAL stock](#), nearly all outside that one-penny "spread," according to Eric Hunsader of Nanex, which analyzes trading data. Someone ended up selling 800 shares of UAL for just \$19.54, or 32 cents below the ask price that traditionally marked the maximum point at which a sale would go off.

Such blips, Mr. Hunsader says, happen "dozens of times a day."

With billions of shares trading hands a day, that makes such events fairly rare. But they are devastating to the confidence of investors. After all, most of us wouldn't want to play Russian roulette even with a pistol that has 999 empty chambers and one chamber with a bullet in it. That is how buying and selling a stock has come to feel for many retail investors.

Just ask Deane Penn, a 70-year-old gastroenterologist in Scottsdale, Ariz. He isn't just a physician; he also worked for several years at a hedge fund researching health-care stocks and is a registered investment adviser who manages roughly \$6 million.

On May 21, 2010, just after the "flash crash" of May 6, Dr. Penn put a stop-loss on 400 shares of **Alexion Pharmaceuticals (ALXN)** at \$47 an order to sell the shares if, but only if, they fell to that price. On June 1, he was sold out of his shares at \$49.49, or nearly \$2.50 above his stipulation.

That took Dr. Penn out of a stock he wanted and handed him a capital-gains tax bill he didn't want. After a 2-for-1 split earlier this year, Alexion recently traded at \$64; the shares Dr. Penn was forced to sell for just under \$20,000 would be worth some \$51,000 today.

More troubling still: It isn't easy to get clear explanations for such errors, both of which might alarm a small investor trying to make a simple stock trade.

Dr. Penn's case appears to have been a fluke or clerical error, Mr. Hunsader of Nanex says, since there is no record of Alexion ever hitting \$47 that day. In other words, it is anyone's guess.

The UAL trades seem to have been caused by a split-second choice of where to send the orders, triggering some sales well below the latest price buyers had paid.

A new proposal by the New York Stock Exchange to trade retail orders in increments of a 10th of a penny down from today's one-cent ticks is meant partly to restore the confidence of retail investors by keeping the exchange competitive with alternative trading platforms.

"We're trying to further improve the quality of order flow for retail orders in the public markets," says Joseph Mecane, executive vice president at the exchange.

But those tiny trading increments could present new opportunities for mischief by high-speed traders and lead to more "collateral damage," says Kevin Cronin, global head of equity trading at **Invesco** (IVZ).

So what can you do to trade more safely?

First, avoid open-ended buy and sell orders. The UAL trade was a market order, or an instruction to sell at the best available price. "Rule No. 1 for the small investor is never, ever put in a market order," says **Joe Saluzzi**, a partner at **Themis Trading** in Chatham, N.J. Instead, use a limit order that stipulates either the price below which you won't sell or above which you won't buy.

A traditional stop-loss order, as Dr. Penn found, has become dangerous. A "stop-limit" order, combining a stop-loss with a limit below which you won't sell, is a safer approach.

Because some exchanges, including the NYSE, require "clearly erroneous trades" to be reported within as few as 15 minutes, complain instantly to your broker if a trade goes off at a price that looks wrong.

"Many times trades are adjusted [by brokers] to bring them more into line with the market if the price was illogical," says Leonard Amoruso, general counsel at **Knight Capital Group** (KCG), a large trade-execution firm.

Above all, be aware that the only way to prevent errors like these is to follow up immediately on every trade a commitment that most people can't reasonably make. "This is ridiculous," Dr. Penn says. "How can a hard-working person who can't watch the market every single moment of the day be able to invest at all when things like this happen?"