

Summer Time Effects on Trading

Seasonal changes affect the stock market. During the different seasons, you may notice notable changes in stock prices, that is, the rise or fall of share prices. This is often a result of the changes in traders' activity in the market.

It is summer, and the stock market is expected to experience some peculiarities. Experienced traders understand that summer is one of the most challenging trading periods, with some similarities to Christmas. Here is what you need to know about trading in summer.

1. Low Trading Volume

The market is slow in the summer months. One contributing factor is that most traders are on vacation during these months, leaving the market with minimal activity.

This leads to low liquidity and, consequently, high volatility. The trading volume drops due to the low number of people investing and trading.

The number of shares sold and bought also reduces. They don't move as much as they do in April and December.

Due to the low trading volume, it is hard for traders to know the reasonable price for a stock they are interested in. Understanding this goes a long way in helping you develop the right strategies.

2. Increased Volatility

When there is low trading volume, there is increased volatility. When stocks have a high trading volume, a considerable number of stocks exchange hands over a given period; many investors are interested in buying and trading the stocks.

When the trading volume is low, the stocks are much harder to sell due to the low interest. The ask and bid price spread is much broader, increasing the volatility of the stocks. The high volatility increases the potential to make profits and the risk of enormous losses.

3. Increased Market Misconduct

When trading volume is low and volatility is high, the market is susceptible to misconduct. For instance, salespersons can make cold calls to traders claiming they have insider information on shares that will appreciate multiple times their current value.

Other types of misconduct during high volatility and low trading volume seasons are stock market manipulation, price rigging, false trading, and misleading information to induce transactions. Many traders are likely to fall prey to dishonest traders in the summer.

4. Market Manipulation

Market makers often inflate or deflate security prices during this period. They understand that buyers are keen on getting in and out of the market when there is low liquidity. They also know they can take advantage of traders.

For instance, they can buy shares at 10% below their market value. This means traders can make huge losses when selling their shares at this time.

How to Trade in Summer

It is usually best for traders to take a summer break and return when the volatility reduces and the slowdown improves. However, if you prefer to remain active, a few strategies exist.

1. Shift to a Daily Timeframe

When there is low trading volume, daily charts are more reliable than hourly ones. Short time-frame charts give false breakouts when the market is slow, while daily charts give traders enough time to cross-check false signals.

Daily charts are also more effective as the indicators are more sensitive to price movements in this market condition.

2. Reduce Trading

Take a step back from trading in the summer to avoid making mistakes. If you trade four times a week, reduce it to about once every two weeks. The high volatility increases the chances of losses, and careful trading is required.

Wait until the conditions are favorable to resume. Use this time to improve your strategy and knowledge of the markets.

3. Adjust Your Risk-Reward Ratio

When the trading volume is low and volatility is high, experienced traders reduce their risk-reward ratio. Adopt the same approach when trading in summer. For instance, if your risk-reward ratio was 1:4, reduce it to 1:2.

A lower risk-reward ratio will help you manage your losses. The strategy's profit potential is higher than the risk, making it an ideal choice considering the high-volatility market conditions.

4. Trade One Stock and Strategy at a Time

Trade using one strategy during the summer months to avoid distractions. It is better to work with a strategy you have tried and proven effective than mix them up. Trade one stock at a time to prevent distraction and minimize imminent risk during this time.

In addition to the trading strategies above, traders should look for market catalysts like company earnings, management changes, and mergers and acquisitions.

Conclusion

Low trading volume and high volatility hurt traders' psychology. They are compelled to trade aggressively to counter the market movement. It also limits trading opportunities for forex investors.

Traders are often advised to take a break during summer and resume activity when the market picks up.

They can take a break to refine their trading strategies, renew their energy, and enhance their trading knowledge.