Note on the Nairobi Securities Exchange (NSE) Day trading

The Nairobi Securities Exchange (NSE) announced that it has received approval from the Capital Markets Authority to roll out day trading at the bourse, starting from November 22nd 2021. The roll-out follows the implementation of a new trading system at the bourse in October 2019 that enabled separation of trading and post trading activities and incorporated day trading and short selling functions. Earlier this year, the NSE also launched the Unquoted Securities Platform (USP), which allows issuance, holding, trading and settlement of securities of unquoted companies. These measures form part of the NSE's strategies to increase market activity, turnover and enhance liquidity. In a bid to demystify day trading, how it works and its possible impact on the bourse, this note shall cover the following;

i) Introduction to Day trading
ii) Day trading in Kenya
iii) Case studies on Day trading : New York Stock Exchange and Johannesburg Stock Exchange, and,
iv) Conclusion

Section 1: Introduction to Day trading

Stock trading refers to the purchase and sale of shares in listed companies, in an authorized stock exchange. Normally the exchange sets the rules of trading including how long it takes to purchase/sale a security and settle the same. The current trading has a three day trading cycle and this is set to change with the introduction of day trading. Day trading refers to the practice of purchasing and selling a security within a single day or trading session, or multiple times over the course of the trading day. Day trading is mainly done by traders seeking to profit from price fluctuations by taking different positions before the market closes. These price fluctuations are often brought about by various triggers such as corporate announcements eg the release of earnings reports and any material changes affecting the future outlook of the company. Day trading has been actively practiced in developed markets such the United States and has grown following the increased adoption of technology in the stock markets.

The table below illustrates the main differences between traditional trading and day trading;

Traditional trading	Day trading
No limit on the duration a position can be held	Position has to be closed in the same day
Requires fundamental research	Relies on technical analysis and speculation
Mainly for long term investors	Mainly favoured by short term investors

For speculative investors, day trading is attractive as it offers quick and frequent profits if well carried out and eliminates risks of overnight stock holding. However, day trading does not allow investors to carry out fundamental analysis as investors will be trading based on speculation.

Section 2: Day trading in Kenya

The NSE has joined the list of bourses seeking to introduce day trading to their markets with an aim of increasing market activity, turnover and liquidity. In the current trading system rules, it takes T+3 days to settle a trade. The NSE aims to introduce settlement of trades on the same trading day for day traders which will run concurrently with the current T+3 settlement system. Currently in Kenya, day trading is only available for forex trading, through the various licensed forex trading platforms such as FXPesa, Scope Markets and Pepperstone Kenya.

Examples of day trading;

i) Buying stocks at a lower price, with the expectation of selling them for a higher price during the day. For example, if a day trader bought stock at Kshs 30.0 per share and sold the same stock for Kshs 33.0 per share in the same day, the gain would be Kshs 3.0 per share, or a 10.0% gain, and,

ii) Covered short selling which involves `borrowing' stocks from a broker, selling them in the market, with the expectation of buying them back at a lower cost during the course of the day. Covered short selling is part of the new products that the NSE plans to introduce after day trading rollout. For example, an investor may borrow stocks from a broker, sell them at Kshs 45.0 per share, and with the expectation of buying them at a lower price e.g. Kshs 42.0 per share. The gain would be Kshs 3.0 per share, or 6.7%.

Under the day trading operational guidelines, trades that will be regarded as day trades will be trades executed on the same day, for the same security, on the same CDS account and with a single broker. Day trading will consist of two models, non-leveraged and leveraged day trading, with the main difference being the use of leverage. In equities markets, leverage is a trading mechanism which allows a trader to borrow from a broker hence increasing purchasing power and subsequently their exposure to the market. For example, if a trader using a non-leveraged account wanted to buy stock at a price of Kshs 40.0 per share and the stock rises to Kshs 42.0 per share the trader would earn a return of 5.0% on the investment. However, when using leveraged buying, one can front part of the stock price and leverage the rest from the broker depending on their account's margin limits. A trader can pay Kshs 20.0, and leverage Kshs 20.0 from the broker. When the price rises to Kshs 42.0, the trader would earn a return on investment of 10.0%, after paying back the broker the borrowed amount of Kshs 20.0, before deducting interest. Subsequently, should the stock drop to Kshs 38.0, the non-leveraged trader will suffer a loss of 5.0%, while the leveraged trader will suffer an amplified loss of 10.0% on their investment after paying back the leveraged Kshs 20.0. Currently, the bourse will only partake in non-leveraged day trading until the legal supporting policies are in place for leveraged trading.

As an incentive to enhance uptake of day trading, the levy for investors who participate in day trades will be 0.114% on the second leg of transactions, as compared to the normal 0.12% levied on normal trades. The second leg of transactions refers to the closing transaction on the same position, during the same day. The benefit will be enjoyed directly by the investor through their trading accounts. The table below shows the various charges levied to traders;

Type of levy/fees	Transaction Levy	Rebate for day trading	Levy after rebate
NSE	0.12%	5.0%	0.114%
CMA	0.12%	0.0%	0.12%
CDSC*	0.08%	0.0%	0.08%
Broker Commission fees	1.78% for trades below Kshs 100,000.0 1.51% for trades above Kshs 100,000.0	0.0%	1.78% for trades below Kshs 100,000.0 1.51% for trades above Kshs 100,000.0
*Central Depository and Settlement Corporation (CDSC)			

Section 3: Case Studies on day trading: New York Stock Exchange (NYSE) and Johannesburg Stock Exchange

i. United States

In the NYSE charges a cost of USD 0.0012 per share for stocks worth more than USD 1.0 per share, and no charge for transactions on shares worth less than USD 1.0 per share. Key to note, the charges in the Day trading option are the same in the Traditional Trading in the US. The settlement duration is T+2 days for traditional trading while the settlement of Day Trading is the same day. Trading in the US is regulated by both the Financial Services Regulatory Authority (FINRA) and the Securities Exchange Commission (SEC).

Day trading is only allowed for margin accounts (where investors leverage from the brokerage and buy more securities) and prohibited for cash accounts (where investor buy securities with the cash they have in their accounts). Further regulations state that a day trader is allowed to trade up to four times their maintenance margin excess as of the close of business of the previous day. If this limit is exceeded, the brokerage issues a day-trading margin call, and the investor has five business days to deposit funds to meet the day-trading margin call. Until the margin call is met, the day-trading account will be restricted to day-trading buying power of only two times maintenance margin excess.

ii) Africa

In Africa, day trading for stocks is only available on the Johannesburg Stock Exchange (JSE), but other financial instruments like currencies are generally allowed in most jurisdictions such as Kenya, Zambia and Zimbabwe. In South Africa, The Financial Services Control Authority (FSCA), generally allows for unrestricted day trading without special requirements, with the exception of naked short selling which is illegal. Naked short selling refers to an investor shorting a stock without first borrowing the stock from a brokerage. The JSE Equity trading levies depend on the value of the trade with trades below South African Rand (ZAR) 1.0 bn (USD 64.4 mn), attracting a levy of 0.00048% while trades above between ZAR 1.0 bn attract subsidized levies of between 0.00047% and 0.00036%.

Comparison between the NYSE, JSE and NSE Day Trading

Day trading in all three markets is designed to run concurrently and in the same market conditions traditional trading. However, there exists some differences as highlighted in the table below;

Parameter	NSE	NYSE	JSE
Settlement time (traditional trading)	T+3 days	T+2 days	T+3 days
Cap on Daily price movements	10% of average price determined in previous session	Nil	Nil
Leveraged trading	Not yet introduced	Yes	Yes
Rebate for day traders	0.006% of second leg of transactions	Nil	Nil

Section 4: Conclusion

The introduction of day trading in Kenya has long been forthcoming and is a commendable move by the NSE as this will increase the bourse's attractiveness to foreign and local investors and also help the NSE achieve key targets such as increasing market activity, turnover and liquidity. We expect day traders to take advantage of activities like release of earning reports, corporate announcements such as acquisitions which generally affect the share price direction. However, a deterrent to this program is the price movement cap limits set out by the NSE, which dictate that the daily price movement for an equity security in a single trading session shall not be more than 10.0% of the average price as determined in the previous session. Factoring in the various levies against the maximum price movements, means that the actual returns achieved will only range between 8.2% for trades above Kshs 100,000, and 7.9% for trades below Kshs 100,000.

Additionally, we believe that caution needs to be exercised by investors as day trading does not allow for adequate fundamental analysis i.e. investors will be buying and selling shares based on speculation. We therefore do not expect high uptake of day trading by institutional investors who depend on technical and fundamental analysis to take a position. It also remains to be seen whether the NSE will introduce minimum requirements for traders and investors as well which safe guards will be put in place to ensure its operationalization.