What is trading?

Trading involves purchasing and selling financial instruments like stocks, currencies, or commodities with the goal of making a profit.

Trading is the buying and selling of securities, such as stocks, bonds, currencies, commodities, and derivatives, with the goal of making a profit. Traders can include individuals, institutional investors, and financial institutions.

Trading differs from traditional investing mainly in its short-term focus, contrasting with the long-term perspective of traditional investing.

In the stock market, trading is common as people buy and sell shares of listed companies. Share prices fluctuate constantly, giving traders the opportunity to choose the right moment to make a profit.

What is trading?

Trading, in simple language, refers to buying and selling stocks, currencies, bonds, commodities, and other financial securities over a short period to earn profits. While traditional investing focuses on making long-term gains by holding assets, trading capitalizes on market fluctuations in the short term.

Trading is mostly prevalent in the stock market as numerous people buy and sell shares of listed entities. The price of these shares changes every second and a trader can pick a favorable direction to make a gain.

Types of trading

Listed below are the major types of trading strategies prevalent in the market.

1. Day trading

It is a type of trading where traders buy & sell stocks within a single day, from 9:15 am to 3:30 pm. In day trading, the trader purchases the stock, holds it for a few minutes or hours and concludes the transaction before the market closes.

2. Swing trading

In swing trading, a trader usually purchases a stock and holds it for several days or a week to capitalise on the short-term stock patterns & trends. These traders must have adequate knowledge of stock trends and patterns to execute their trades successfully.

3. Scalping or micro trading

Scalp trading is a type of trading in which traders buy and sell stocks in large quantities repeatedly several times within a day. This may result in profits even with minute changes in the stock price. However, there is also a high probability of losses.

4. Momentum trading

Momentum trading is a strategy where a certain stock price moves either upwards or downwards for a certain period, i.e., it gains momentum. When the peak is reached, a downtrend follows; therefore, traders take a selling position at the peak of a stock's momentum.

5. Position trading

Position trading is a long-term trading strategy that involves buying an investment with the expectation that it will appreciate over time. Position traders are less concerned with short-term fluctuations in price and news of the day unless they alter the trader's long-term view of the position. They hold their positions for an extended period, typically weeks, or months, to achieve profit from the price movements of an asset.

How does trading work?

Stock trading in India is the buying and selling of shares of a listed entity in one of the leading stock exchanges like the National Stock Exchange (NSE) and Bombay Stock Exchange (BSE).

The capital market in India consists of two major segments: primary market and secondary market. On the primary market, private companies (who became public) can issue securities directly to the public to raise funds through a public offering. These are of two types: Initial Public Offering (IPO) and Follow-on Public Offering (FPO).

Once the IPO is completed, all shares of a company are listed in the secondary market, where investors can freely buy and sell stocks and other securities. In India, people are required to open a Demat and trading account with a stockbroker to hold and trade shares.

Whenever there is a purchase request with the broker, it gets passed on to the respective stock exchange. Here, the exchange matches a buy order with an equivalent quantity of a sell order of the same stock. Following this, a transaction takes place where cash and securities are exchanged.

What assets and markets can you trade?

You can trade a wide variety of financial assets and markets which include:

Shares: Trading in individual company stocks, allowing you to buy and sell ownership stakes in specific businesses.

Indices: These are indicators that represent a basket of stocks or assets, allowing you to predict the overall performance of a group of companies or markets.

Forex: The foreign exchange market, where you can trade currency pairs, taking a chance on the relative strength or weakness of one currency against another.

ETFs (Exchange-traded funds): These are investment funds that hold a collection of assets like stocks, bonds, or commodities. Trading ETFs allows you to gain exposure to a diversified portfolio.

Bonds: You can trade bonds, which are debt securities issued by governments, municipalities, or corporations, providing fixed income in the form of periodic interest payments.

Commodities: Trading in raw materials and primary agricultural products, including precious metals, energy resources, and agricultural goods.

IPOs (Initial public offerings): Participating in the initial issuance of shares by a company when it goes public, potentially gaining from the stock's early price movements.

While there are various instruments to trade, it's essential to recognize that trading carries inherent risks. The primary goal is to make a profit on the basis of market's movements. However, it's crucial to exercise risk management to avoid unexpected losses, as trading can be volatile and unpredictable.

Trading vs. investing

Trading and investing represent two distinct approaches with different objectives, time frames, strategies, and risk attitudes.

Aspect	Investing	Trading
Purpose	Builds wealth over the long term	Generates profits from short-term market movements
Time frame	Long-term (years to decades)	Short-term (minutes to weeks)
Focus	Capital growth and income	Capital gains from price fluctuations
Risk	Lower, due to longer time horizons	Higher, often increased by leverage
Analysis type	Fundamental analysis	Technical analysis
Emotional stress	Less frequent monitoring needed	Requires constant vigilance and quick decisions

Who trades and who invests?

Traders and investors play distinct roles in financial markets, each with unique objectives and strategies.

Traders engage in short-term buying and selling of financial instruments, aiming to profit from short-term price fluctuations. They typically rely on technical analysis, market trends, and volatility to make rapid decisions. Traders often have a high-frequency trading approach, seeking to capitalise on market inefficiencies and momentum. Their primary goal is to generate profits quickly, often within minutes, hours, or days.

On the other hand, investors take a long-term perspective, seeking to build wealth over time through the appreciation of assets. They focus on fundamental analysis, examining the financial health and growth prospects of companies or assets. Investors aim to create wealth through capital appreciation, dividends, or interest income. They are generally less concerned with short-term market fluctuations and instead focus on the long-term growth potential of their investments.

In summary, traders seek short-term gains by actively buying and selling securities, while investors take a long-term approach, aiming to build wealth over time through strategic investment decisions.