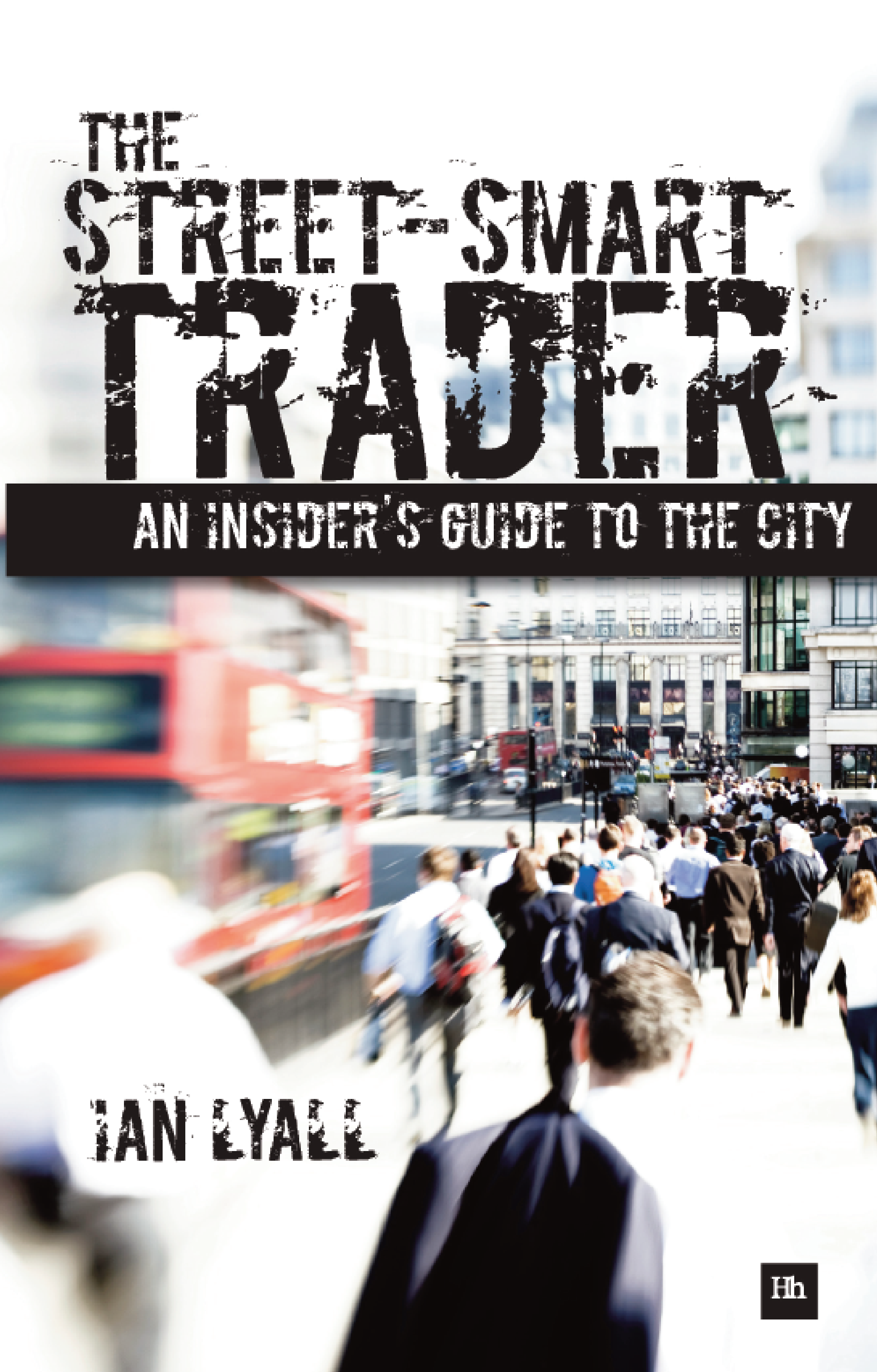
THE STREET-SMART TRADER
AN INSIDER'S GUIDE TO THE CITY
IAN LYALL

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THE STREET-SMART TRADER

IAN LYALL

Dedicated to my wonderful and very patient family.

About the Author

Ian Lyall is the editor of *Proactive Investors*, a champion of the independent stock market trader. Before that he was the investment editor and City news editor at the *Daily Mail,* where he directed the coverage of some of the biggest stories to ever emerge from the Square Mile as it struggled in the grip of the credit crunch and subsequent banking crisis.

In his 15 years as a business reporter and editor, Ian has worked for Dow Jones, writing stories for the international news wire, and the *Wall Street Journal*. He also led the London company coverage for AFX News, now part of Reuters.

Ian's career began on local newspapers in Kent, before moving to a national news agency. His specialist areas are pharmaceuticals, biotechnology and growth stocks. A regular contributor to the *Daily Mail*, he writes the paper's weekly investment column.

Ian lives in Hertfordshire with wife Tanya, children Oliver and Cameron and a Noah's Ark of pets – including a dog, two cats, two gerbils and a pair of goldfish.

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AN INSIDER'S GUIDE TO THE CITY

IAN LYALL

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HARRIMAN HOUSE LTD

3A Penns Road
Petersfield
Hampshire
GU32 2EW
GREAT BRITAIN

Tel: +44 (0)1730 233870
Email: enquiries@harriman-house.com
Website: www.harriman-house.com

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WELCOME TO THE REAL CITY OF LONDON

WHAT THIS BOOK COVERS

This is an insider's guide to the City of London in the 21st century, a hub of unparalleled financial importance since the Middle Ages, and today perhaps the most significant centre of commerce in the world. The aim of *The Street-Smart Trader* is to take the reader behind the grand Georgian facades of the offices that line the narrow alleys of Throgmorton Street and Lothbury, and onto the trading floors of the giant glass and steel edifices of London Wall and Bishopsgate. And of course we will lead you by the hand along the swanky streets of Mayfair, home to London's hedge fund industry, before dropping in on the new Eastenders of Canary Wharf.

If you pick up a standard textbook on the City you'll be presented with the theory – what's *supposed* to happen there. The author might tell you how all the working parts mesh together seamlessly to create one of the world's largest capital markets. What you don't get is what really, practically happens there. Firstly, they tend to miss the context, the setting. You learn *how* the markets work, but not *why* they exist and flourish. Secondly, you rarely get the human element – the fact the City is run by people and not by computers *and what this actually, practically means*.

Therefore, this book attempts to give a flavour of what really happens by showing the broker, the dealer and the market maker at work in their natural habitat. It is not meant to be an authoritative account of how the City of London works. It is, as the title suggests, an insider's look behind the scenes – and a primer on how you can best adapt to take advantage of these overlooked facts. I hope it gives readers pause for thought, as well as fresh insights that prove of use in their own financial activities.

WHO THIS BOOK IS FOR

This is a book primarily for those based outside the City who want to know what really motivates some of the main movers in the City of London and the financial markets. Those working – or who hope to work – within the City itself will also find this book useful (and entertaining) as it reveals what the various participants are actually up to on a day-to-day basis.

HOW THIS BOOK IS STRUCTURED

The book starts by giving a potted history of the stock market from the perspective of the City. Emphasis is placed on what happened after the market liberalisation of the late 1980s, which transformed London into a fast-moving, sophisticated electronic marketplace. But there is also a look at the bygone era when the City was very much like a gentleman's club run for the benefit of its members.

In Chapters 2 and 3 we examine the inner working world of the City, including looking at the advantages professionals have over independent traders. As you will see, this deals with pitfalls and perils that confront even the most experienced traders; the scales are not always balanced. We also look at the murkier side of the stock market with the help of a few shady characters that agreed to be interviewed.

From there the guide moves on to look at the role of the market's analysts, spin doctors and financial commentators.

The focus of Chapter 6 is the role of professional traders. We look at market makers, proprietary traders and fund managers, amongst others, and some of the techniques they use as they go about their jobs.

In Chapter 7 we examine hedge funds, seeking to understand if many of the accusations levelled at them are fair and lifting the lid on techniques they use to get an advantage in the market.

We will also examine – in Chapter 8 – whether it is a useful exercise to scrutinise the people who run Britain's listed companies to see whether their stock-picking actions should be monitored and followed.

Finally, in Chapter 9 we investigate whether mergers and takeovers really do generate the investor returns they promise.

INTRODUCTION

There is a tendency for outsiders to regard the City with suspicion. Its buildings are tall and imposing, often fenced about with elaborate security, and the language of finance used there can seem deliberately obtuse and exclusive. It seems to possess a whole set of practices and customs known only to the daytime inhabitants of a small patch of land on the eastern fringe of central London.

The inhabitants themselves are often caricatured as posh public-school types or brash Essex barrow boys out to make a few quid. That this is not the reality goes to show just how much the day-to-day business of the Square Mile is cloaked in a veil of mystery. This opacity is compounded by financial websites – each day they serve up bland headlines and hours-old newswire copy that omits as much as it reveals about the City and those who work there.

With this in mind, the original aim of this guide was to demystify the City and give outsiders a far more accurate idea of the reality of life in London's financial district. The City has a unique character, attitude and way of conducting business – a real feel for which you just don't get from the *Financial Times* or Bloomberg. In *The Street-Smart Trader* I've tried to capture some of that character and attitude, particularly by drawing upon a series of first-person accounts from those who have been intimately involved in the City. Over 18 months I've spoken to many movers and shakers in the world of London finance. It has been a fascinating series of encounters with the great and the good of the Square Mile, and the fruits of these interviews form the basis of this book.

Now, I said the *original* aim of this book was to move beyond the very easily caricatured (and even more easily obscured) workings of the City. However, as well as doing this, a second purpose occurred to me as I conducted my interviews.

What I found in my series of revealing chats is something I've long suspected: the City, inadvertently, is almost designed to trip up the independent trader. Most of the time the financial scars and injuries are inflicted accidentally – they result from the fact that the financial markets are set up to cater for the professionals, with little thought to the needs of retail customers, or they are just a reality of a situation where professionals have access to better technology and information. Sometimes, however, the abuse is intentional and craftily masked as originating from the City, such as the false rumour put out to con the retail punter, or the pump-and-dump internet scam.

As an independent trader you find yourself up against a formidable and not always fair machine: dealers with more information, professional investors with greater financial clout, and hedge funds with more powerful computers.

The good news is that this need not be a major disadvantage to your trading. So long as you know what you are up against, and realise how the rules for the independent trader are subtly different to those that apply to professionals, the City is not your enemy. The second purpose of this guide, then, is to help independent traders understand the disadvantages that they are faced with and how to work around them.

IAN LYALL
SEPTEMBER 2010

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IN THE BEGINNING THERE WAS COFFEE

In which we open the doors to exclusive gentlemen's clubs with some very odd rituals, and learn about a bloke called Cecil and his Big Bang.

INTRODUCTION

It is important for the independent trader to know how the institutions and infrastructure of the Square Mile have been shaped and moulded over the years into what they are today. It is the fascinating record of how, in the space of a quarter of a century, the City has transformed into the world's biggest capital market, and how the brokers and stockjobbers (share traders based on the old exchange floor) spawned the current crop of traders and bankers.

I'll start by cranking up the time machine to take you back to London 1680 and a place called Jonathan's Coffee-House.

From there we will make a quantum leap through Victoriana to the 1950s and 1960s, when the floor of the market was used to fund some of the great projects of the era. The face-to-face trading of London in an earlier age is what gave us the market maker system, which is still in use today. In Chapter 6 we learn a little more about these traders who create and maintain a liquid market in shares. The centuries old system was so effective, and incidentally very reliable in times of market turmoil, that many City professionals balked when the Stock Exchange decided to introduce an electronic trading system that matched buyers and sellers automatically.

From the Sixties we jump forward to the 1980s – bad hairdos, ill-fitting shiny suits and all – to consider the lasting impact of what has been called the Big Bang. We will give consideration to whether this revolution has actually delivered the shareowning democracy it was supposed to or whether it simply propagated the status quo.

HOT DRINKS AND HOTTER STOCKS

It is amazing how things have turned full circle in the three centuries since the fledgling Stock Exchange first began trading at venues along the narrow alleys of the City of London. In those days on every street corner was a coffeehouse filled with a heady aroma of caffeine, gossip and political and financial intrigue. Today you can't walk more than a hundred yards along Bishopsgate, Moorgate or London Wall, the very heart of the new City, before you trip over a Starbucks, Costa or Caffè Nero. In the modern era, as all those years ago, the cafés at London's financial heart are teeming with business chatter and deal-making.

That London is returning to its coffeehouse roots is not a huge surprise given how the capital has changed since the 1980s. Three-hour lunches are out, time is at a premium and deals need to be done yesterday. So where better to meet colleagues and contacts than a coffee shop? With wifi as well as caffeine on tap, technology is at the ready and business can be done over biscotti.

That said, the earliest incarnations of Starbucks and Costa were far more important to commerce and trade in Britain than their modern-day counterparts. Lloyd's Coffee House spawned the Lloyd's of London insurance market and to this day the historic institution still bears the original Lloyd's name. And it is back to 'Jonathan's Coffee-House' on Change Alley (or Exchange Alley as it is now known), that we can trace the origins of the London Stock Exchange.

Founded in 1680 by Jonathan Miles, Jonathan's Coffee-House was used from 1698 by the Huguenot stockbroker John Castaing to post a bi-weekly list of stock and commodity prices snappily entitled *The Course of The Exchange and Other Things*. This eight-inch by three-inch sheet of paper that appeared on Tuesdays and Fridays was unique as it provided the most accurate and up-to-date list of prices on the markets of London. For the merchant it became an invaluable and highly prized tool of trade, while historians say it provides the first evidence of stock trading in London.

Castaing's list made Jonathan's a magnet for the old City's brokers (who bought and sold stock for clients) and stockjobbers (who set share prices). When several hundred members of the Royal Exchange, *the* centre of commerce at the time, were expelled for rowdiness in the same year as Castaing started posting his prices, it was along the cobbles to Jonathan's that they staggered to ply their trade, and where they would remain for the foreseeable future.

The 50 years that followed the founding of Jonathan's were eventful – they included the very first stock market crash in 1720 when the South Sea Bubble burst. But by 1761 that migrated rabble from the Royal Exchange (who had also set up in Garraway's Coffee-House) had become quite picky about who they did business with. So 150 of them set up an association, or club as they called it, with its own rules and a strict membership.

This newfound respectability also set the members on a quest to find their own premises, which were eventually built a dozen years later in 1773 on Sweeting's Alley near Cornhill, in the heart of the City. What they created was a purpose-built meeting place with its own trading floor. For its time it was at the cutting edge of finance. Whilst first named New Jonathan's, to reflect the increased importance of the institution it was shortly renamed the Stock Exchange.

By the start of the 19th century, as Britannia prepared to rule the waves, the club had developed an even more rigid membership and formal rules. It had also acquired a new headquarters. Given the habitual sparring between broker and jobber it is fitting that the second London Stock Exchange – completed in 1802 – occupied the site of an old boxing salon at Capel Court, near the Bank of England.

Here the Stock Exchange thrived to fund the Industrial Revolution, the great municipal projects of the Victorian era and of course the odd war (the City was always a key source of finance in times of conflict). It did all of this while retaining many of its odd traditions for nearly two centuries (though there was another change of address in 1972, when the exchange moved its headquarters to a grey, forbidding 26-storey tower that dominated the corner of Broad Street and Threadneedle Street).

THE ULTIMATE GENTLEMAN'S CLUB

For centuries this market, spawned in a tiny coffeehouse in the back streets of London, operated essentially as it had at the outset. All trading was done face to face by brokers, who bought and sold stock for their clients, and jobbers who controlled the market for shares.

The one guiding principle of this ultimate gentleman's club was *dictum meum pactum* – my word is my bond (which, in 1923, became its Royally granted motto). It meant that a deal could be done based on little more than a shake of the hand. For those who may be inclined to forget, the phrase is now writ large in bold italics on the wall of the exchange.

LIVING MEMORY: POST-WAR BOWLER HATS AND GORILLAS

By the time we get to the period after the Second World War that leads up to the Thatcherite reforms of Big Bang, we're in living memory, and perhaps the best way of appreciating how the City operated in this somewhat sleepy era is by talking to those who were closely involved in its activities – and have lived to see the marked changes since then.

FOLLOWERS OF FASHION

Mick is one of a dying breed – an old-style broker (buying and selling for clients) who learned his trade on the floor of the London Stock Exchange (LSE). He began his career as a blue button, or trainee broker, for one of the City's more illustrious firms after national service back in the late 1950s. Forget electronic trading – the closest thing to high tech was the Exchange Telegraph ticker tape that churned off news about the market. All dealing was done face-to-face.

The dress code was very conservative: a black or charcoal grey three-piece suit and white shirt with starched collar and very sober tie. The shoes (black of course, or brown on Friday if you were heading off shooting) had to positively gleam. Partners looked very dapper in their top hats – still part of the stock exchange tradition well into the 1960s – while the younger members wore bowler hats. "These days you can rock up to the City in whatever you want." Mick physically shivers, recoiling at the thought.

There was also a rigid caste structure in Mick's day – a meritocracy the LSE was not. You had the public-school-educated principals of City broking firms at the top of the pyramid and "oiks from Essex like me at the bottom," says Mick. The market also kept gentleman's hours of 9.30am to 3.30pm – though the doors would open ten minutes early to allow the stockjobbers to amble casually across the polished marble floor to their stalls.

The geography of the exchange was simple in the 1950s. In the middle traded the industrial and commercial stocks, with pitch-holders of gilts (government bonds) and mining occupying respectively the left and right flanks of the old building. In full throng there would be upwards of 3,000 people on the floor, making quite a din.

"I remember my first time on the floor," says Mick.

> "The walls of the place were marble and the floors were polished wood. It reminded me of a museum. By the end of the day it resembled a giant bookmaker's office – slips of paper littering the floor and discarded copies of the *Financial Times* strewn about the place.
>
> "I was just a junior back then. I was supposed to be seen but not heard. My job was to run in and out of the Exchange, giving the dealers transactions and keeping the brokers informed of the prices. It was like finding your way through a moving maze of bodies. As a young runner, I knew none of these people. The men in top hats I later realised were senior partners."

Brokers had their rituals, like stepping out at 11.30am for a quick snifter before resuming the business at hand. Lunches, meanwhile, were of the three-hour, boozy variety – though only if you were a senior broker. Mick says lunchtime excess was behind some of his biggest trades when eventually he was allowed to wine and dine contacts and clients. He says he would sometimes wake up in a cold sweat in the middle of the night with a raging hangover thinking, "What on earth did I do earlier?"

> "I'd return the next morning to inspect the paperwork, which was flawless, and realise I'd been working on auto-pilot. Luckily I never really mucked up. But I reckon a lot of [the market's] business was done after a bottle or three of red wine."

THE BUSINESS OF TRADING SHARES

The main purpose of the stock exchange was still, of course, to trade shares, but even this was carried out in a peculiar way. As mentioned, dealing was done face-to-face in London in those days (as it still is on the floor of the New York Stock Exchange), but even considering this there was a very rigid, idiosyncratic way of accomplishing it. You couldn't just rock up to the exchange and buy stock. Membership was limited to just a few hundred brokers and jobbers.

If a broker needed to buy 1,000 shares in Imperial Chemical Industries he would go to the 'industrials pitch', a stall on the exchange floor, where he would speak to a jobber who would then sell him the shares. (I say *him* and *he* because the LSE of old was a male-dominated environment. It wasn't until 1973 that the first woman was admitted to the exchange floor.)

But I digress. Working as a jobber was a particularly tricky occupation. Under stock market rules you were required always to quote a price in the particular stock you traded. More importantly, the jobber guaranteed to buy and sell at the prices quoted. Now this often presented some difficulties. A jobber would sometimes be forced to buy stock when he needed to sell and vice versa.

So the jobber needed to be mentally agile in order to constantly recalculate the prices (sophisticated computers are employed to do this today). He also had to be quick-witted to stay one step ahead of the wily broker, who had the luxury of being able to see every price in the market.

The language and ritual made life even more complicated. These days you log on to the computer and can be buying and selling shares within minutes. You might even pick up the phone and use a stockbroker – which is still a comparatively painless exercise. Dealing toe-to-toe on the floor of the market was not that easy. "In fact it was a little like the wary dance boxers perform at the very start of a bout – just before a punch is thrown," says Mick.

It was up to the broker to start proceedings – a process known as opening the jobber up. This sounds nasty, but it was simply a request for a price – two prices actually. The price at which the jobber was prepared to sell and price at which he was willing to buy the shares.

Then the horse trading would begin with the words, from the jobber, of: "What's your size?" This sounds like a rather personal question – and in fact it was. It meant the jobber was trying to find out how many shares he was being asked to buy or sell. (However, he never actually knew whether he was being asked to buy or sell the stock until the bargain was sealed.)

The broker might reply with the word *rouf* (a 4,000 share trade, which was a very small order); a *score* (20,000); a *monkey* (half a million); or a *gorilla* (one million shares – a very big order).

And that was the easy part. You could be stuffed, plugged, or slugged, you had dawn raids, backwardation, shunters and punters, and there was even Jack Idle and Bobby Charlton. All of this is slang and all of it impenetrable to the average man or woman on the street. It was there in many cases as a shorthand, or just to liven up the banter. "You had to be really careful what you said," Mick explains, "otherwise you could get yourself into a real pickle." Squabbles were rare, but there were disagreements, which were settled after hours, often in fist fights.

"The motto of the London Stock Exchange – *my word is my bond* – was taken very, very seriously in those days," Mick explains. "To query a man's trade was effectively questioning his integrity. Many people took it very personally."

CHANGE IS USHERED IN

It is barely conceivable in the internet era that an international market the size of the London Stock Exchange could be operated in such an eccentric and haphazard fashion.

Yet it wasn't until October 1986 – the year of the Yuppie, the mullet haircut and Maradonna's 'hand of god' – that this gentlemen's club was finally dragged kicking and screaming into the modern era. Open outcry trading ended (more on this later) and it was replaced by the electronic market that effortlessly processes thousands of trades an hour.

Today, in its gleaming new offices in Paternoster Square near St Paul's Cathedral, the Exchange is a thriving international business with alliances around the world. The Exchange completed 253.5 billion bargains, worth £1.7 trillion, in 2009, putting it just behind New York in order of world importance.

Many like Mick, who plied their trade on the old stock exchange floor, look back with nostalgia on those halcyon days, but most agree it was a case of reform or ruin. "Do I miss it all? Yes. The long lunches especially," Mick chuckles.

> "But really we were all gentleman players, amateurs in a professional era. London needed to lick itself into shape and this it has done by welcoming in the world and becoming very good, very efficient, at what it does. But in the process it has become a very clinical environment and the City has lost a lot of its character. But then what do I know, I'm just an old fart."

BIG BANG

> "The jousting brokers tilted at each other through the billowing clouds of dealing slip confetti, champagne bottles for lances, sturdy colleagues as their willing steeds. The trading floor was minutes from its final closure and never had it been so crowded. Everyone who was anyone in the Stock Exchange on 27 October 1986 had to witness the Big Bang with which this increasingly arcane world would meet its end."[1]

Ed Warner, a former City broker and now the head of UK Athletics, paints an evocative and romantic picture of how the curtain came down for the last time on the old London Stock Exchange.

Cold, hard pragmatism was behind the far-reaching reforms that came with Big Bang. Whoever dreamt up the name got it spot on. The changes were seismic. Had Big Bang been just a small pop, then it is likely that London would today be a financial backwater.

Instead, London is one of the most important financial centres in the world. It still trails New York in terms of the number of shares traded, but London has become an international Mecca for the world's banks, private equity and hedge funds. It also boasts the single largest market for insurance and is the global centre for foreign exchange. What was once an inefficient cartel, in 2008 generated a £43 billion trade surplus, contributed 4% of GDP and employed around 340,000 people.

It has to be acknowledged that, with the 2007-2009 financial crisis, there was evidence of a downside to the growing reliance on the financial service sector which the Big Bang helped inaugurate. It doubtless made the worst recession in 60 years even harder to bear for the UK.

But, in the main, the changes have been positive for the City.

Despite the positive overall consequences of Big Bang, though, we will see later in this chapter that the reforms probably failed on at least one very important level – in creating the shareowning democracy envisaged by the Thatcher government. Only with the advent of low-cost internet stockbrokers have the costs and barriers of entry to the stock market come down in the way that the architects of Big Bang anticipated they would.

THE REFORMS BEGAN AS A TWINKLE IN CECIL'S EYE

As said, it was hard-headed pragmatism that brought about the changes of Big Bang. In 1986 Prime Minister Margaret Thatcher, fed up with the 'closed shop' that operated in the City, decided to end the fixed commissions charged by the banking elite. She entrusted the job of shaking up the old boys' club to trade secretary Cecil Parkinson. He found a willing ally in Stock Exchange chairman Sir Nicholas Goodison – a moderniser who could see that it was time for London to reform or die.

"You cannot compete if there are rules that tie your hands when your competitors in the US or Europe or Asia are not shackled in the same way," Goodison said in a speech to mark the 20th anniversary of Big Bang in 2006. He continued:

> "It is no good, now that wealth creation depends on being internationally competitive, trying to stop foreigners from buying into national enterprises. It is better to welcome their capital investment in the UK economy. London has done well from Big Bang because barriers to competition were dismantled and London attracted a large concentration of competitive talent and capital from all over the world."

THE ESSENCE OF BIG BANG

A SHAREOWNING DEMOCRACY

At first it appeared that Big Bang would have been more accurately described as Big Flop. Within minutes of opening for business on 27 October 1986 there was chaos as the LSE's SEAQ (Stock Exchange Automated Quotation) computerised trading system went into meltdown. It turned out the designers underestimated the sheer volume of trade that took place on the floor of the exchange, which meant the system was swamped on day one.

It was an embarrassing start. Even a German bomb that crashed through the roof of the Exchange in 1939 hadn't caused this sort of pandemonium, detractors said. But once the glitches were ironed out, there was no going back to the old days.

The introduction of a new electronic platform and the death of floor trading was just the start – there was more to Big Bang.

One of the key objectives was to eliminate the expensive fixed commissions charged by brokers trading customers' shares. In doing so it was hoped that competition would be fostered and investing in equities would be made both cheaper and easier.

In 1980, Thatcher had made it possible for thousands of people to become homeowners by selling off council housing stock on the cheap, so her advisors at the time thought it equally possible to create some sort of shareowning democracy. After all, you only had to look to America, where there was, and still is, a stockbroker in every major town and city and investing in stocks and shares was an essential part of saving, to see it was possible. For the reformers in the UK, fixed commissions were the first and most obvious place to start.

TWO FURTHER FUNDAMENTAL CHANGES

Aside from the changes to commissions, two other fundamental changes probably had the City's big wheels choking on their port and cigars.

First, the reformers could see no obvious reason for the convoluted system of buying shares which involved a broker *and* a stockjobber. These age-old barriers were brought down, sparking a spree of mergers as City firms began to merge their business.

But perhaps the most fundamental change was to open the London stock market up to the outside world. This sparked another outbreak of merger mania, initially between the Brits hoping to ward off the threat from overseas. One of the first deals saw the ambitious S. G. Warburg & Co. snap up jobber Ackroyd and Smithers, broker Rowe & Pitman and the gilt broker Mullins & Co to become the first integrated British investment bank. Others followed suit, with the high street banks at the vanguard. NatWest bought Fielding Newson-Smith and Bisgood Bishop; Barclays bought Wedd Durlacher and De Zoete & Bevan; while even the sleepy Midland Bank got in on the action with its acquisition of W. Greenwell.

However, mergers were not just carried out among British firms – it was not long after Big Bang that overseas buyers swooped. At first it was mainly the Americans that came looking for a toehold in the City. Merrill Lynch was among the first, closely followed by the likes of Salomon Brothers and Morgan Stanley.

Martin Smith, the cofounder of corporate finance firm Phoenix Securities, was at the centre of the wheeler-dealing and reckons he sold no fewer than 20 City brokers to cash-rich foreign clients in the rush of the late 1980s. He tells of one deal involving a particularly aggressive American investment bank that wanted to buy one of London's most famous and successful stockjobbers. The board of the British company was invited to New York to be wined and dined – and of course to discuss the deal. The only problem? The chairman did not have a passport. "That really summed up the City then,"[2] says Smith.

These days London is a global centre for banks from around the world. The old brokers and jobbers are gone forever. None of the great British merchant banks remain: Warburg was taken over by the Swiss Banking Corporation, which then merged with Union Bank of Switzerland; Smith New Court was picked off by Merrill Lynch; while the Schroders banking dynasty finally came to an end when the business was acquired by the South African insurer Old Mutual.

Author David Freud, a former vice chairman of UBS, described this process as the Wimbledonisation of the modern stock market. London, like the lawn tennis tournament, is a premier venue that plays host to the cream of foreign talent – without having a homegrown winner in the fray.

MEASURING THE SUCCESS OF BIG BANG

If you look at the Corporation of London statistics then on the face of it little has changed in the past 24 years. Back in 1986 there were around 320,000 people working in the Square Mile. In 2010, around 300,000 spilled off the commuter trains into the City (though midway through the year that figure was still fast diminishing, according to some studies).

It's only when you dig beneath the headline numbers that the seismic shift is confirmed. For a start, some 30,000 printing and stationary jobs have disappeared, and been replaced by 50,000 new financial jobs. Also, the old City of London, which runs from Aldgate in the East to Ludgate Hill on its most westerly border, is no longer the sole employer of brokers and bankers in the capital. Canary Wharf has sprouted out of the former East End docks to employ 93,000 people, while the capital's West End, specifically the area around Mayfair, has become an international hotbed for powerful hedge funds.

The Stock Exchange itself is also a world-class performer. A glance at the daily trading slips tells you all you need to know about the metamorphosis. From an average 20,000 trades back in late 1986, that figure had ballooned to 313,000 in 2010.[3] The value of the companies listed on the market – more than 2,800 in total – has increased from £324 billion two decades ago to £1.30 trillion.[4]

The make-up of the FTSE 100 also has a rather odd feel to it; the big board is now full of multinationals that earn the vast majority of their cash from overseas. The introduction of strict listing rules in other markets, most notably the US, has turned the FTSE into a magnet for foreign business. Forget the Birmingham Tyre & Rubber Company (a fixture in the top flight in 1986): these days the names are far more exotic. There's Antofagasta of Chile, South Africa's SABMiller, and TUI Travel, the listed wing of a German conglomerate.

THE MARKET BECOMES MORE COMPLICATED AND LESS ACCESSIBLE FOR THE INDEPENDENT TRADER

So, the architects of change, Nicholas Goodison and Cecil Parkinson, succeeded in turning the London Stock Exchange into an international powerhouse and this in turn was a huge catalyst for growth of the wider City.

However, it is debatable whether the pair succeeded in their Thatcherite aim of creating a shareowning democracy. The end of fixed commission did not spark the expected bonanza amongst small private traders. They have largely shunned the stock market, despite big privatisations such as BT, British Gas and BP. In fact it is arguable whether commissions altered a great deal until the advent of internet share dealing and flat fees for independent traders. Data published by the share registration firm Capita is revealing here – it shows that share ownership by private investors had slipped to just 9.5% of the total value of the stock market in 2008. Back in 1986 the figure was 23.5%.

Of course private investors have become a smaller part of a far larger market. So Capita looked at the overall value of shares held by private investors, which has declined from an inflation-adjusted £187 billion to £163 billion in the same period. This is not the sort of result the architects of reform had envisaged all those years ago.

Capita's records go all the way back to 1963, when retail investors owned 54% of all the shares traded in London (worth £407 billion in today's money). So perhaps Mrs T and her free marketeers were always fighting a losing battle.

In the time since Big Bang the market has also become much more sophisticated – some might even say more complicated. For instance the number of stocks quoted has grown by around a quarter in the period – or nearly a third if you include PLUS listed companies – to almost 2,880. The market is divided and sub-divided into a dizzying array of sectors (more than 40) and indices (10). And there's not just one market in London today, but three. You have the main market for shares, the AIM market for small and growing companies and PLUS where the shares of micro-caps are traded. At the same time, internationalisation has turned the once insular London market into a latter-day league of nations. A look at the FTSE 100 throws up names such as Kazakhmys (from Kazakhstan) and Fresnillo (from Mexico) where the main index might in previous years have included staples such as the Peninsular & Oriental Steam Navigation Company (P&O). A ringing endorsement for the proponents of change, but a rather dizzying transformation for those who invest.

And then of course the new electronic era has heralded in yet more choices for the already disorientated investor. Should I use the internet, and if so which system should I use? Who has the best deal? Whose charges are lowest? Forget shares, should I go down the CFD route, or better still try financial spread betting? And Lord help us when the worlds of finance and social media collide, which they will soon.

It almost makes you yearn for the halcyon days where you picked up the phone to your stockbroker and asked his advice. You still can of course, but it is so last century.

Likewise programmed, or black-box, share dealing makes it easier for the professional to trade at the flick of a key stroke, but far more difficult for the independent trader to make sense of the market's movements. Such algorithmic or robo-trading involves the automatic execution of trades determined in advance by a carefully written computer trading program, and inevitably produces somewhat peculiar and irrational quirks now and then, as well as being far more subtle. The same is true of the buying and selling of the hedge funds, which in recent years has rendered the stock market a dangerously volatile place to trade. The private trader is increasingly not up against other humans but algorithms.

I'm not saying that we ought to go back to the era before Big Bang. What I am saying is that progress comes with its own downside. The market for stocks and shares is more complex and difficult to navigate than it has ever been. And perhaps this is the disincentive that has seen share ownership tumble among private investors.

The UK is hardly the shareowning democracy the proponents of Big Bang had envisaged.

VIEWING BIG BANG IN THE CONTEXT OF THE 2007-2009 FINANCIAL CRISIS

As an endnote to this chapter, we should view the events of Big Bang alongside the behaviour we saw (or saw exposed) during the financial crisis of 2007-2009.

One of the main aims of the Thatcherite reforms was to pair jobbers – the equivalent of share traders today – with brokers, and also bring in some much-needed capital from the banks. This would create strength in depth, but it was also supposed to promote investment for the long term rather than chasing the quick buck. What the events of 2008 and 2009 have shown is that, if anything, the City's short-sightedness became even worse: instead of placing risky bets on predictable company stocks, professional traders staked huge bets on exotic derivatives backed by risky American mortgage debt. So it seems the long history of boom and bust that we can date back, in the City, to the first market crash – the South Sea Bubble of the 18th century – continues to dog the market.

Brian Winterflood, chairman of Winterflood Securities, had some interesting words to say on this subject. Winterflood's formative years were as a stockjobber with the firm Bisgood

Bishop, before creating London's largest firm of market makers in the aftermath of Big Bang. He tells an amusing and poignant anecdote about a colleague on the dealing room floor of the London Stock Exchange who, in the great market turmoil of 1974, was reduced to selling carpet squares to supplement his income.

"It was so bad that most of us didn't know whether it was worth buying a weekly season ticket to get to work," Winterflood says of the period. "It was dire. We were booking maybe a couple of bargains a day." Warming to his theme, he regales me with tales of hoarding food in the attic and burying Krugerrands – solid gold coins – in his garden, so fearful was he that Britain's financial centre was about to implode.

So it is chilling when Winterflood declares the latest financial crisis the worst he has witnessed. "We have never seen the like of it before," says the 72 year old, who has spent more than half a century working in the Square Mile. "I was here in '74 and the lead up to that. But it wasn't like this."

"Okay, we're not burying Krugerrands in the back garden and we aren't stashing food in the attic – so in one way things have moved on a long way since then. But at the same time things have magnified themselves in terms of what is going wrong."

WHAT WE HAVE LEARNED

In this chapter we have seen that despite the reforms of 1986 and the easy access provided by cheap internet share trading, the market is still centred around the institutions that dominate in the City of London. Data shows that around 10% of the shares traded on the stock market are bought and sold by independent traders, which inevitably means that the market must operate largely for the professional traders who do most of the business.

With the proliferation of specialist computer technology, the emergence of black-box trading and the volatility created by the trading of hedge funds, it can be argued that the markets have only become *more* complicated and uncertain for the independent trader since 1986.

The street-smart trader must not be downhearted about this, but needs to always bear it in mind. When you enter the 21st century coffeehouse chaos that is the City of London, when you log on to your corner of the *New* New Jonathan's, you need to be as canny, sharp and downright determined to fight your corner as those rowdy gentlemen of three centuries ago. The Big Bang has ended the eccentricity, and advanced the efficiency, of the City; but it hasn't stopped it from being an often dangerous place to make a living.

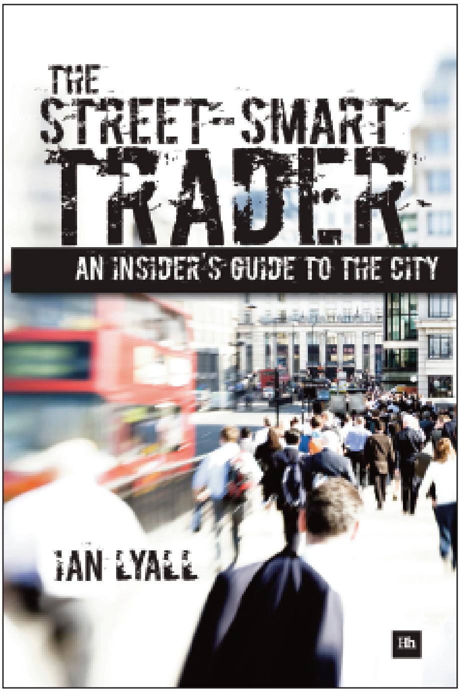
Author and journalist James Buchan wrote: "A City bred on Etonian values, understatement and self-importance, and robbing amateur investors, has been replaced by US values, self-importance and robbing amateur investors." Very droll, and rather too cynical, of course – just don't let it be inadvertently true with you.

The next chapter will start to help you avoid the dangers that are out there.

The Street-Smart Trader

An insider's guide to the City

Ian Lyall



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