

Pros and Cons of investing in Penny Stocks

A lot of people when starting to invest tend to go in for cheaper stocks as their first investment. They do this because these stocks are deemed to have higher returns when things go according to plan. This article will show you what to consider when engaging in this.

Investing in the stock market is a long term investment. You may not be able to make money in the short term as the stock prices become volatile. Over the long term, stocks have historically outperformed all other investments. Stocks have historically provided the highest returns of any asset class -- close to 37% over the last ten years, i.e. the Colombo Stock Market has given an annual average return of 37% during the last 10 years.

Investors demand a higher rate of return for taking greater risks. That is one reason that stocks, which are perceived as riskier than bonds, tend to give a higher return. It also explains why long-term bonds pay more than short-term bonds.

Investing in the stock market for the long term is simply the process of buying fundamentally strong stocks and then holding onto them for the long term. Holding onto strong stocks for the long term can be a strategy that can come with a lot of advantages over the long term. Investors invest in fundamentally strong stocks because they perform the best in the long term. But some investors want the best stocks to invest in short term simply because they think that trading stocks quickly is the easiest way to earn money quickly. Short term stock investing is not for the faint of heart. This is because the very real chance exists of losing money on a bad investment when the market is unstable. In a very short time your investments could go down to half of their original value.

What are Penny Shares?

Penny stocks (shares) get their name from the fact that they are cheap. They cost as much as pennies with some even below this. Earnings on them are however limited because if you want significant earnings you must buy a lot of them. In other words a 'Penny Share' is a loose term used to describe shares which have a speculative appeal because of their low value. There is no official rule to define when a stock becomes a Penny Share and different observers may use different criteria.

Penny stocks are usually high-risk investments with low trading volumes and the companies are usually startups and small companies with smaller balance sheets and limited resources. The essence of these companies are that they will more than likely only have a small amount of net tangible assets and a short operating history. This is in contrast to shares in large blue-chip companies which will have the stability of a large amount of assets and a long trading history to fall back on.

According to experts Penny stocks can be a good investment, but can be extraordinarily risky and are generally best for seasoned investors who understand the market and do their homework on the companies they're investing in.

Advantages of Penny Stocks

As with any type of investment there can be a number of advantages as well as disadvantages to investing your money with a company or buying shares. It is important to make sure you fully understand what it is exactly that you're getting involved in, be it a small local business or a multinational conglomerate.

- The major benefit of Penny Stocks is that their Per Share Price is very low. There is no need of large capital to start investment.
- The second benefit is that it's much easier for you to buy penny stocks because these are common shares and easily available for general public to buy. As penny stocks are offered at very low prices, this feature enables investors to buy many stocks. This enhances the investor's options; he can invest in many penny stocks at a time without worrying about the cost. One of the larger benefits is that there is potential of generating higher profit in Penny Stocks investment for all those who manage their investment wisely by research and monitoring stocks fluctuations.
- Most people prefer penny stocks because they move up at quicker intervals .It is a chance to make money in quite a short space of time, for example if you buy 5,000 shares of stock which is trading at Rs 3.00 and the stock doubles in value overnight then you've very easily doubled your cash.
- Sometimes a penny stock will increase and trade as mid-cap stock which can multiply in value several times over. Several skills are essential if you intend to make a profit from penny shares, important qualities such as patience and investing a reduced amount of

money in the beginning and by being smart, getting as much information as possible about the stocks by choosing the correct broker who will be able to invest with a lesser risk, hopefully making more profit from it in the end. Anyone with knowledge of stock investment and the buying of shares will know it can be a very risky business.

Disadvantages of Penny Stocks

- Penny stocks are popular because of their unique advantages, but there are unavoidable disadvantages of penny stocks too. Where, there is possibility of generating smart profit, the chances of losing all your investment is also equal. It's much easier to buy penny stocks but selling them back is quite difficult. So their low liquidity is one of the major disadvantages of penny stocks. Penny Stock investment is also called high risk investment.
- In case penny stocks are issued by a company which is close to bankruptcy, the chances of losing all your investment increases. Moreover when penny stocks are issued by newly established companies, there are chances to lose money when prices do not go up. There is lack of information regarding Penny Stocks
- 'Pump and Dump' scams can ensnare people by popularizing a stock so that the demand for that stock will rise, this in turn brings the price up and any efforts to maintain their value are halted. The end result is that stocks will crash and the only ones that are left to benefit from the situation are those who purchased the stock before the scam was implemented as they were the ones that sold to people when the stocks were high, leaving these unlucky people with stocks that holds a lot less value than what they originally bought.
- Even for people with a good idea of if they're being scammed or not trouble can arise especially with penny stocks as it is usually the case that you'll be dealing with a company that has little or no track record and can be on the brink of bankruptcy without the investor's knowledge.
- Most people lose on penny stocks because it is normally traded by amateurs who are new to the business of trading on the market. Penny stocks don't naturally keep rising. There are times that they dip in prices and also remain the same.

- Penny stocks are risky and shaky. They are very predictable. People can easily tell where the prices of penny stocks will be moving. They can then move accordingly. They are also stagnant and only increase when there is knowledge that the company is about to make significant breakthroughs.
- Penny stocks are also not readily liquidated. Whenever you want to get out of a tight corner by selling you might not find people to take the stocks off your hands. Under ordinary business it is also difficult to sell large quantities of penny stocks as they are thinly traded on a daily basis on the stock market.

As mentioned above the price of a penny stock can drop in value just as quickly. New and inexperienced investors would do well to avoid making penny stocks a major part of their investment portfolio.

In the volatile investing world of penny stocks, if you don't pay attention you could end up penniless.