knowledge snapshot

A review of how investing is “gamblified” and may lead to harm

Why is this article important?

Investing in the stock market generally leads to profits for investors in the long run. However, there is a rapid growth of “gamblified” investment products in recent years. Gamblified investment products attract investors due to their potential for large gains, but they result in losses for most investors in the long run. This article is a review of two types of gamblified investing: high-frequency stock trading and high-risk derivatives. The authors reviewed research evidence regarding these risky investment products and the key design features that they share with gambling. The review suggests that these risky investment products attract people who gamble frequently and who are at risk of experiencing gambling-related harm.

What this article is about

Investing in the stock market and gambling share certain key features. In particular, both involve risk and are motivated by the hope of financial gains. The biggest difference is that investing generally allows for people to earn profits in the long run. Therefore, investing in the stock market is a “positive-sum game” where all players have the possibility to earn profits. In contrast, gambling is a “zero-sum game” since the gambling industry makes profits from players’ losses.

In recent years, there has been rapid growth of investment products that could be considered to be “gamblified”. A gamblified investment product has three key features. First, it is designed so that few people who invest in it earn profits in the long run. Second, it must lead to behavioural patterns that are similar to those found in people who experience harm from gambling. Third, it uses key design features that the gambling industry uses to create products that attract but are unprofitable to players. This article is a review of two types of investing that have strong evidence of being gamblified: high-frequency stock trading and high-risk derivatives.

What was done?

The authors reviewed research evidence regarding high-frequency stock trading and high-risk derivatives, and how these risky investment products may be linked to gambling.

What you need to know

High-frequency stock trading

Trading refers to the buying and selling of stocks. The field of financial economics recommends that people should not trade frequently since there are costs to trading, including commission fees and potential taxes. Also, the stocks brought may do worse than the stocks that have been sold. The certain costs of trading are likely to be higher than the uncertain gains. Research has consistently shown that higher frequencies of stock trading have worse returns.

Day trading involves buying and selling the same stocks within the same day. It is the highest frequency form of trading. A study looking at 12 years of investor returns concluded that only 5% of investors in day trading make profits. Therefore, the majority of investors in day trading lose money over time.

Investors who trade frequently show similar behavioural patterns as people with problematic gambling. A number of studies have found that investors who trade frequently are more likely to gamble. Some studies have reported that a small number of investors refer themselves to gambling treatment clinics due to their problematic investing behaviours. Frequent trading and gambling have been associated with the same personality traits, such as overconfidence, impulsiveness, and sensation seeking.

The ability to trade stocks via mobile apps can increase investors' trading behaviours. These mobile apps are often marketed using the same strategy of the gambling industry. Marketing of these apps often emphasises that they have low or zero fees. The apps have constant notifications and other elements that nudge investors to trade frequently. Similar to the marketing of gambling products, these apps do not clearly communicate the true costs of their use.

High-risk derivatives

Derivatives are investment products that provide a payoff based on the price of another underlying financial asset. They can be used as high-risk bets for a small chance of gaining a large amount of money. The most common derivatives include options, futures, contracts-for-difference, and foreign exchange speculation. For example, option is when an investor has the option to buy or not to buy an underlying asset (i.e., a stock) for a fixed price within a fixed period of time. The investor pays an upfront fee for that option, and the option will expire after the fixed time period. Investors may use options in the hope of a gain from a stock's price increase or even from a fall in price.

High-risk derivatives are difficult to understand and to value due to their complicated payment structures. Although some investors may gain significant amount from high-risk derivatives, international studies have found that most investors lose money over time.

There is evidence to suggest that investing in high-risk derivatives is similar to gambling. People who invest in high-risk derivatives are more likely to experience harm from gambling. High-risk derivatives also share certain design features of gambling products. Offering the potential of rare but big wins is the main design feature of high-risk derivatives that is adapted from gambling. Moreover, people who win big through gambling or investing advertise their success on social platforms and attract attention. This can promote a biased view of gambling and investing.

Who is it intended for?

This review could be used to guide future research into the potential gamblification of other investment products, such as cryptocurrencies. It might also be relevant to regulators of financial products.

About the researchers

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