

AA-04

HOW TRADING ACTUALLY WORKS

Brokers, accounts, and every order type, explained in plain English.

Alpha Academy · Team Alpha Trading

How Trading Actually Works: Brokers, Accounts & Orders

People say "I bought some stock today" like it is just tapping a button. But behind that tap, a chain of people, computers, and rules moves your money safely to a stranger on the other side of the trade. This chapter pulls back the curtain: what a **broker** is, how the two main account types work, what happens after you press "buy," and how to use the main **order types** — the exact instructions you give when you trade.

> **NOTE**
> This chapter is education only — not financial advice, and not a recommendation for any broker or account. Always read your own broker's current rules, fees, and disclosures before you trade.

What Is a Broker?

A **broker** is a licensed company that gives you access to the stock market. You cannot walk up to an exchange and buy shares yourself — exchanges only deal with member firms. Your broker is your doorway in, like the agent who gives you access to house listings and makes the deal official, for stocks and **options** (contracts based on a stock's price — covered in the options chapters).

Your broker sends your orders where buyers and sellers meet, holds your money and investments safely separated from its own money, and keeps records of everything you own.

US brokers are regulated — watched over — by the **SEC** (Securities and Exchange Commission, the main federal market regulator) and **FINRA** (the Financial Industry Regulatory Authority, an industry watchdog). Customer assets are protected by **SIPC** insurance (Securities Investor Protection Corporation) up to $500,000, including up to $250,000 in cash, if the broker itself fails. Be clear: SIPC protects you if the *firm* collapses — not if your investments go down in value.

How to Pick a Broker

There is no single "best" broker — only the best fit for you:

- **What you can trade.** Some brokers offer only stocks and funds; others also offer options and **futures** (contracts based on the future price of things like oil or indexes).
- **Costs.** Many brokers charge $0 commission on stock trades today, but options and futures usually carry per-contract fees.
- **The platform.** Can you find your balance, positions, and the order screen without hunting?
- **Education and practice tools.** Good beginner brokers offer lessons and **paper trading** — a practice account with fake money, covered at the end of this chapter. Some open accounts at $0; others ask for a deposit.

The Two Main Account Types: Cash and Margin

Cash account

A **cash account** is the simple one. You trade only with money you deposited that has **settled** — finished moving through the banking system and become fully yours to use. Deposit $500 and you can buy up to $500 of stock. You can never owe the broker money or be charged interest. One quirk: money from a *sale* also needs time to settle before you can spend it again, and re-buying with unsettled money can trigger a warning called a **good faith violation**.

Margin account

A **margin account** lets you borrow money from your broker to buy more than your own cash allows. Borrowing to invest is called **buying on margin**, or using **leverage** — a little of your money controlling a bigger position.

Example: you have $1,000. In the US, the starting rule (called **Regulation T**, or Reg T) lets you borrow up to another $1,000, controlling $2,000 of stock. If it rises 10%, your position is worth $2,200 — a $200 gain on your $1,000, or 20%. But if it *falls* 10%, you lost $200 — 20% of your money — and you still owe the borrowed $1,000 plus **interest** (charged on the loan, like a credit card). If the fall gets bad enough, the broker issues a **margin call** — a demand to deposit more money right away — and can even sell your investments without asking, to protect its loan.

Margin accounts also unlock **short selling** (betting a stock will fall) and many options strategies — plus an extra rule day traders must know:

> **NOTE**
> The classic **Pattern Day Trader (PDT)** rule says four or more "day trades" (buying and selling the same stock the same day) within five business days in a margin account requires at least $25,000 in the account. US regulators have been replacing it with new intraday-margin standards, and brokers are transitioning at different speeds — check your broker's current rule.

> **RISK**
> Margin magnifies everything — gains, losses, and interest costs. Learn in a cash account first.

How You Actually Open an Account

The process is similar at almost every US broker. You **apply online**, giving your name, address, date of birth, Social Security number, and employment info — not nosiness: federal law (called **Know Your Customer** rules) requires brokers to verify who you are, partly to prevent fraud. You **choose cash or margin**; margin requires a separate agreement accepting the borrowing risks in writing. You **answer risk questions** about income, net worth, and experience, which decide your approvals — options trading, for example, comes in levels. Then you **fund the account**, usually by bank transfer, which can take a few business days to settle.

How a Trade Travels: From Your Tap to the Exchange

Say you decide to buy 10 shares of a fictional company, **Acme Corp**, ticker **ACME**. Here is its journey:

- **Step 1 — You place the order.** In the app you pick the stock, the share count, and the order type (covered below), and tap "buy."
- **Step 2 — Your broker checks and routes it.** Its computers confirm you have the money, then send the order to a **venue** — a place where trades happen, such as a stock **exchange** (a regulated marketplace like the New York Stock Exchange or Nasdaq).
- **Step 3 — Your order meets a seller.** Another investor wants to sell 10 shares of **ACME**. Every buy needs a sell; the venue's computers match you in a fraction of a second, and the trade prints publicly — that is why prices update all day on financial websites.

- **Step 4 — The trade settles.** Money and shares officially change hands. For US stocks this takes **one business day**, called **T+1** (trade date plus one day) — the standard since May 2024. You *see* the shares right away, but the final transfer completes on T+1.

The Three Prices on Every Stock: Bid, Ask, and Last

Every stock quote shows three prices. Beginners often notice only one — and it costs them.

- **Bid price** — the highest price a buyer is offering right now. Sell immediately, and this is roughly what you get.
- **Ask price** (also called the offer) — the lowest price a seller is asking right now. Buy immediately, and this is roughly what you pay.
- **Last price** — the price of the most recent completed trade. This is the big number on TV and in apps. It is history, not a promise of your price.

The gap between bid and ask is the **spread**. Example: **ACME** shows a bid of $49.98 and an ask of $50.02. The spread is $0.04. Buy at the ask and instantly sell at the bid, and you lose 4 cents a share before the stock even moves. Popular stocks have spreads of a penny or two; quiet, rarely traded stocks can have wide spreads — a hidden cost.

> **RULE**
> Your fill price comes from the bid and ask at the moment your order fills — not the "last price" on a chart. Always glance at the bid and ask before you trade.

Buying Power: How Much You Can Actually Trade

Your **buying power** is the amount your broker lets you commit to trades right now. In a **cash account** it is basically your settled cash: $500 settled means $500 of buying power. In a **margin account** it includes borrowable money — $1,000 of cash might show $2,000 of buying power under Reg T. Buying power drops the moment you place an order, because the broker reserves the money.

Order Types: The Instructions You Give Your Broker

An **order** is not just "buy." It is a set of instructions: what, how much, and *under what conditions*.

Order Type	What It Means in Plain Words	When Traders Use It
Market order	Buy or sell right now at the best available price, whatever it is	When speed matters more than the exact price
Limit order	Buy or sell only at your chosen price or better — never worse	When you refuse to overpay or undersell
Stop order (stop-loss)	Once the price touches your trigger, it becomes a market order	To limit a loss automatically if a trade goes wrong
Stop-limit order	Once the price touches your trigger, it becomes a *limit* order at your chosen price	To control the exit price — but it may not fill at all

Order Type	What It Means in Plain Words	When Traders Use It
Trailing stop	A stop that follows the price by a set amount or percentage	To lock in gains while giving a trade room to run
Day order	Cancels at the end of today's session if it does not fill	The default; for prices that only make sense today
GTC order (Good 'Til Canceled)	Stays active until it fills or you cancel it (brokers cap this, often ~90 days — check yours)	When you will wait days or weeks for your price

Limit order — "my price or nothing"

A **limit order** sets a ceiling for buys and a floor for sells. Example: **ACME** trades at $50.10, but you only want it at $49.50. Place a limit buy at $49.50: you buy only if the price falls there or lower — and maybe never, if it never gets there. Certainty about price; no certainty about filling. For beginners, this is the safest default.

Stop order — "get me out if I'm wrong"

A **stop order** sleeps until the stock trades at your **stop price**, then wakes up as a market order. Its classic use is the **stop-loss**: buy at $50, place a stop-loss at $46, and if the stock falls to $46 your shares sell at the next available price — maybe $46, maybe lower in a fast drop. It limits your loss; it does not promise an exact exit price.

Stop-limit order — control, with a catch

A **stop-limit order** has two prices: the stop triggers it, the limit controls it. Stop at $46, limit at $45.50: once the stock hits $46, sell — but only at $45.50 or better. The catch: if the stock crashes straight through $45.50 — called **gapping**, jumping past a price without trading there, often overnight on news — it may never fill.

One more worth knowing: a **trailing stop** moves with the price. Set one $3 below the price on a $50 stock — the stop sits at $47 — and if the stock climbs to $58, the stop climbs to $55. It never moves backward, and it can be set as a percentage.

Commissions and Fees: The Small Print That Isn't Small

Many US brokers advertise **$0 commissions** on online stock and ETF trades. That is real — but trading is not free. **Options** usually cost a per-contract fee (commonly around $0.50–$1.00 per contract). **Futures** carry per-contract commissions plus exchange fees. **Margin interest** is charged daily on borrowed money at rates that vary widely, and tiny **regulatory fees** are passed through on trades.

> **NOTE**
> Fees change — always check your own broker's current fee schedule.

Fractional Shares: Start Small, for Real

A **fractional share** is a slice of one share. Some famous companies trade at several hundred dollars a share. Many brokers now let you invest by dollar amount instead: put in $25 and own $25 worth of the stock, even if one full share costs $500 — you own 0.05 shares. If it pays a **dividend** (a cash payment a company sends its shareholders), you get your proportional slice. Not every broker offers them, so check yours.

Paper Trading: Practice With the Training Wheels On

Paper trading (also called simulated trading) is a full practice account: real live prices, fake money. You place real order types, watch fills, and track wins and losses — and risk nothing. Use it to practice each order type above until it is boring, and make your first mistakes for free.

> **TIP**
> Paper trading has one flaw — it does not *feel* real. Nobody cries over fake money. Treat practice results as proof you understand the mechanics, not proof you will stay calm with real cash at risk.

Common Beginner Mistakes

- **Using market orders on everything.** On a quiet stock with a wide spread, a market order can fill at a terrible price. Use limit orders as your default.
- **Opening a margin account on day one "for the features."** Borrowing and interest are not features a beginner needs. Learn in cash first.
- **Placing a GTC order and forgetting it.** It can fill weeks later, when you no longer want the trade.
- **Skipping paper trading.** Refusing free lessons and paying for them with real losses is the most expensive habit in trading.

Chapter Summary

- A **broker** is your licensed doorway to the market — regulated by the SEC and FINRA, with SIPC protection if the firm fails.
- A **cash account** trades only settled money: no debt, no interest. A **margin account** lets you borrow (leverage), magnifying gains *and* losses, charging interest, and risking a margin call.
- A trade travels: you → broker → exchange or venue → matched seller, then settles **T+1**.
- Every quote has a **bid**, an **ask**, and a **last** price; the gap between bid and ask is the **spread** — a real cost.
- **Buying power** is what you can commit: settled cash in cash accounts; cash plus borrowable funds in margin.
- Order types: **market** (now, any price), **limit** (my price or nothing), **stop** (trigger, then market), **stop-limit** (trigger, then limit), **trailing stop**, **day** vs **GTC**.
- **Fractional shares** let you invest by dollar amount; **paper trading** lets you practice with fake money first.

Check Yourself

1. What does a broker do for you, and who regulates US brokers?

2. You have $1,000 in a margin account and buy $2,000 of stock that falls 10%. Roughly how much have you lost, and what do you still owe?
3. A stock shows a bid of $30.00 and an ask of $30.06. What is the spread, and which price do you roughly pay if you buy immediately?
4. You bought at $80 and want automatic protection if the price falls to $72, accepting whatever price the market gives then. Which order type fits, and what does it become when triggered?
5. What does T+1 mean, and when did it become the US stock standard?

Answers: 1) It routes your orders to exchanges, holds your money and investments, and keeps your records; US brokers are regulated by the SEC and FINRA, with SIPC protection if the firm fails. 2) About $200 — 20% of your $1,000 — and you still owe the $1,000 loan plus interest. 3) $0.06; you pay roughly the ask, $30.06. 4) A stop order (stop-loss) at $72; at $72 it becomes a market order and fills at the next available price. 5) The trade settles one business day after the trade date; US standard since May 2024.

> **RULE**
> Never place a trade you could not explain in one sentence: what you are buying, which order type you used, and exactly how you will get out. If you can't say it, don't send it.