Wiley Trading

The TRUTH About Day Trading Stocks

A CAUTIONARY TALE ABOUT HARD CHALLENGES AND WHAT IT TAKES TO SUCCEED

Josh DiPietro

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I would like to dedicate this book to all day-traders, amateur and professional, who have learned the hard way. To the traders who understand that becoming a successful day-trader is a process that cannot be fast-tracked.

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Preface

The most successful turtle was apparently Curtis Faith. Trading records show that Mr. Faith, who was only 19 when he started the program, made about $31.5 million in profits for Mr. Dennis.

—Stanley W. Angrist, The *Wall Street Journal*

The above is a dangerous citation. No one should use it as assurance. Not every amateur day-trader succeeds like Curtis Faith. Many beginners lose all of their start-up capital—sometimes more than once. The purpose of *The Truth About Day Trading Stocks* is to caution, and to some degree reprogram, the naïve, heedless amateur day-trader. I want to prevent beginners from watching their money disappear.

In this book, I offer the amateur day-trader, a candid account of the challenges I've encountered while developing in the profession. By candid I mean brutally truthful, mostly about myself, mostly with the side-splitting laughter that the distance of hindsight provides!

This is my personal story, and I tell it like it is, just as if we were kicking back and having ourselves some brews, letting it all hang out at times—that is, confessing all my mistakes. My personal day-trading horror stories are a constant, vivid motif. Laced through that saga is my identification of key psychological factors that destroy wise day-trading performance, interspersed with my cache of antidotes, all self-disciplinary, that I've developed in the contemplative aftermath of my most harmful mistakes.

My tone is both comical and compassionate, with a practical and generous infusion of informative techno-speak. My approach to instruction is an emphatic departure from "golden goose" strategies, and my overall intention is twofold: to slow down the hazardous fervor of the average amateur, and to demonstrate the ways he can become a professional and not lose his shirt in the process. Throughout the book, you'll notice the word "**hold**" highlighted when I discuss disastrous situations involving "**holding**" stocks without any real plan of exit. If you're reading this you're probably a beginner in day-trading. Or maybe you're somewhat experienced, but not yet a confident pro. You're highly motivated and eager to learn how to day-trade with success. You're probably a risk-taker by nature, with a high tolerance for stress.

You're willing to stop at nothing to achieve the status of a professional trader who's thriving—a badge of honor. In the beginning, the process may seem thrilling. The opportunity to trade for a living looks wonderful. This is gonna be an adventure! You've found there are scads of outfits to train you (for a hefty fee, of course). And you could line a mansion's mantel with how-to books. You sign yourself up for a training program. You're greeted with head-swelling optimism and hope by the truckload, and you start harboring dreams of grandeur. The prospect of succeeding as a trader is making you almost giddy. Now you have a vision of perfection: you see wealth, freedom and leisure!

Who wouldn't want to make $5000 a week from home, sitting in his or her underwear?

I'll be the first to admit it: I'm guilty of indulging in euphoric expectation without the self-disciplined expertise to make it all come true. I started down my path to day-trading glory late in the 1990's. I moved to San Diego from Buffalo, New York. When I got to the West Coast I immediately learned of this potentially lucrative career.

Well, it's 2009—a whole decade has passed and I'm here to warn you about something that nobody wants to hear: You'll probably never master the profession without losing money first. Many beginner traders are brought to their knees by despair and lose their will to deal with the market. Even the more fortunate protégés, those who got into trading with almost unlimited wealth, learn that the pain of losing can take a big toll on their egos.

I realize that my focus on losing sounds annoying and counterproductive. Well, you can trust me on this one: I have reasons for emphasizing loss. Taming the loss monster is paramount to creating your long-term, *consistent* success. In day-trading, consistency rules.

The Truth About Day Trading Stocks shows how trading decisions are bent and shaped by emotions. Day-trading is a psychological process. Day-trading is emotional. Anyone can learn how to research and scrutinize fundamental business data. Anyone can master chart pattern analysis. But in the end the execution of an *actual real-time order* is all that really matters. That's why feelings take over. I show what can happen when feelings are heightened—especially by the powerful factors of inevitable fear and greed. The outcome can be very dismal.

Again, I'm *not* here to show you the "golden goose" of ultimate strategizing, while neglecting to reveal the grim hazards involved in keyboarding for money all day. I feel that it's crucial to emphasize the downside, in order to shed light on the maddening fact that most new day-traders are pickled and stewed in the positive view of this career—encouraged to inflate with ambition and adrenaline—all at their neophyte peril.

I designed this book not only as an escape from dry tedious texts, a ramble down Easy Read Lane, but also as a reference tool for serious day-trading careerists. If you approach this tome as a tool, you may be inclined to pick only the passages that address your most pressing questions. I feel that I should warn you not to do that. You should read the chapters in order. Later chapters build on ideas presented in earlier chapters, and if you skip around, the ideas may not gel.

When it comes to pure technical know-how, I've made sure that my advisories take off and expound in ways that five-day seminars don't. I reveal some harsh truths about day-trading stocks; my intention is to burst the greenhorn's bubble. Then, with the illusions dispensed with, I proceed to realistically useful advising. I compare pay-per-trade with pay-per-share brokers, determining which works best, and when; I define how day-trading isn't gambling; I repeatedly stress the wisdom of maintaining low exposure; and that's just a sampling of my arsenal of disaster-averting discussions.

Although I conclude with a chapter that exemplifies a great trading day, I did not write this book to spotlight and boast the performance of perfect trades. I wrote it to offer suggestions on how to avoid the prospect of perfect trades turning ugly. Throughout the book, I describe my development of acute self-awareness while figuring out how to succeed. My goal, in that blunt self-portrayal, is to help you create a disciplined mindset, and apply it to your own trading style.

In the back of the book, you'll find a section called "Rules to Remember," a list of over eighty rules, simply stated and easy to grasp, to benefit amateurs' performance.

I close with an offer of mentorship, designed to equip you with the tools to succeed. I believe that the best way to learn is direct experience under the supervision of a well-seasoned guide. Through my mentorship program, I will day-trade with you live, one-on-one, for an entire week or month. For more information, go to: www.DayTraderJosh.com.

In response to my ominous precautions, maybe you're thinking: *"If I want to make money, don't I just buy low and sell high?*

Well, take that simplistic outlook and throw it right out the window. Why? Because it will hurt you. I sure wish someone had told me that when I started out.

Acknowledgments

I want to first give special thanks to Serene Sao. She is the person, very close to me, who initially supported my decision to become a professional day-trader.

I wish to thank Georgianna Groen, a fabulous author and mentor, for her tireless editorship. She has aided and encouraged me throughout my work on this book.

Many thanks to my father and his friend Lee McCormick for accommodating me in their beautiful cabin style home, in its mountainous New England setting. The atmosphere has been perfect for my clarity of mind, for both day-trading and my work on this book.

INTRODUCTION

The Wholehearted Amateur

The year was 1999. I was in my car, on a mission.

I was driving to Irvine from my home in San Diego. Every mile glowed with deep indigo skies and the kiss of a warm, mellow sun; these were the everyday blessings I enjoyed in Southern California . . . even in the middle of winter. This climate made me hopeful and encouraged. It felt like a good luck charm. I had moved here from the cold, gloomy Rust Belt.

I was headed for a three-day program of training that focused on day-trading strategies. One week before this, while talking on the phone, I had become convinced I should go. The sales rep I spoke to from the sponsoring firm had performed his job admirably; he had made me charged up to attend.

Up to this point in my business career, I'd been trading stocks for six months. I hadn't yet done any day trading, however, and I was gung-ho to learn how. As I narrowed the distance between myself and Irvine, my expectations were high. I never took in any scenery; I was so deep in thought that I was driving by reflex.

I kept thinking of the things that I was going to buy soon after I got back from the training program, when the big bucks were going to flow. You see, I was brimming with confidence. In my short time in the profession of dealing with stocks, I had made a few really good trades.

It had never yet occurred to me that they were just dumb good luck.

Well, I got to the designated luxury hotel and let it gouge my credit card, and then I settled in for three mind-blowing days of comprehensive, motivating coaching.

When it was over and I was driving home, I was so pumped up to start day trading that my eagerness ran amok. I had to unload it on someone. I pulled up to my fiancée's workplace with my tires screeching a bit. I couldn't wait to tell her in person about what I'd just learned.

It came out of me allegorically: "Honey, I've been given a golden goose! Things are going to change like lightning!"

I couldn't have been more right about the "change" part. I was pitifully wrong, however, in my belief that it would be change for the better.

The next morning, as soon as I rolled out of bed, I made calls to all the online resource companie—the ones that were required by my newly learned "bullet-proof" system for day trading. Mostly it was access to real-time data feeds and proprietary stock analysis.

In a heartbeat, I had it set up.

So there I sat in my shorts, with my bare back feeling winged. I was magically launching into professional day trading, all in the comfort of my home! Because now I possessed all the big-time tools that the big boys on Wall Street had . . . right?

The California sunshine streamed through my den window and smiled on my new life. My fiancée and I had recently bought the house I sat in. The location was the lovely but costly enclave of Oceanside, North San Diego. She and I were currently splitting all the bills. I was determined to start paying for everything, as soon as the money poured in. My girl was proud and happy for me, supportive and full of encouragement.

And so it all began. Armed with the training and the sunshine and support, and with all my online access and resources, every morning I stretched, scratched, stepped into my shorts, and went to work with bare feet and shoulders.

At first I was not trading live; in other words, I was "paper trading." That means I was doing everything I'd been trained to do when executing a real-time order; but this was only practice. I was simply noting the entry price in a log, on paper. Paper trading is designed to teach methodology without real losses or gains. Well . . . just like the handful of good stocks trades that I'd lucked into in the past, it gave me a false sense of confidence.

Oh, yeah. That first month I developed a lot of self-assurance, because of the paper trading. In that short time, I made over $100,000 in fake money. I was buying 10,000-share blocks at a time, on paper. My confidence levels were off the charts, literally. . . .

And then came the months after that, the months when I lost everything.

But during those first few weeks paper-trading, fresh from that three-day seminar, with over 20 books on the subject read to shreds, I felt just like a pro. I had subscriptions to several money-market magazines, like the

Wall Street Journal and *Stocks & Commodities*. I had all the tools, all the resources.

I had very little *real* experience.

I was using a prominent pay-per-trade online broker. Back then I was paying $15 per trade.

I'll never forget my very first day of *real* day trading. That means with my own real money. I was online in front of my 36″ Gateway computer monitor, and also my separate laptop, and I felt as though both could talk! The successful-but-fake paper trading was all behind me now.

Today I was going *live*.

I clearly remember how nervous I felt when placing my first real monetary trade. My feelings were overwhelming. They were 10 times more powerful than when I made successful small trades in stock, those lucky ones I've mentioned, the ones before my day trading training. None of them had been on this scale!

And all trades thereafter were scary. Every trade I got into now made me extremely anxious. There's something about taking your hard-earned money and putting it on the line, like when you bet at casinos. Your heart rate doubles instantly, and your mind begins to race.

It's hard to think clearly like that. I think every trader has felt that, even those who can fall back on a healthy cushion of cash. Nobody likes to lose money!

A wise man once said, "It's smart to learn from your own mistakes, but it's wiser to learn from others.'" I ended up learning from only myself. For you it will be somewhat easier . . . here you have my blunders to study.

PART I

Psychological Truths and What to Do about Them

I'm amazed at how seldom the day-trading training programs address the vital subject of beginners' emotional response. Anyone offering instruction in this work should know that day traders *will not* have consistent success until they've learned to control their emotions.

Therefore, my first goal is to explore the psychology of day trading, and to offer my hard-learned advice. I've placed this part first so you'll study it first. My hope is to dissuade you from thumbing to the technical-strategy chapters—not until you've thoroughly internalized what's here.

Why is this so important? It's absolutely critical to understand yourself before you get deeper into this high-stress career.

CHAPTER 1

Truths about Yourself to Know First

You'd be totally realistic to ask this: *What is day trading, exactly? How does it differ from other types of stock trading?* And last but most definitely not least: *What's my skill level in day trading? Where do I fit in?*

Before you get into the profession full time, you should know all the answers to those questions.

You may find, however, that the answers don't come easily. Confusion about just what day trading involves is common in the stock brokerage industry, and gauging just how adept you are at it can feel a bit nebulous, too.

Consider the *Investopedia* definition of day trading:

> *Day trading is defined as the buying* and selling *of a security within a single trading day.*

Does that description define much?

As a beginner, you should start with an awareness of the distinct separation of day trading from investing. Be clear about which one you're interested in, and just how well-honed your skills are. You may find that sorting out these questions requires some headwork, because day trading has come to be associated with a variety of workplace scenarios.

Prior to the Internet takeover, a decade or more ago, for the most part day traders worked at bank or investment firms and were known as equity investment specialists, or else fund management pros. But now, in the midst of both changing legislation and proliferating prospects online, day trading has emerged as a popular calling for thousands hooked up at home. *Private equity trader* has become their official job title.

Approach two strangers on the street, ask them what they think a day trader is, and they'll probably mention either Wall Street or a person online in his den. One of them might talk about a brow-sweating guy with his tie loose and shirtsleeves rolled up, barking market orders across the pit to a just-as-harried colleague on the floor. The other one might talk about a barefoot guy in his shorts, glued to his PC all day.

Both of the people surveyed would be right. There's no single definition of a day trader anymore. Day trading has vastly diversified. And as if the expansions I've mentioned aren't enough, there are also, within those assorted scenarios, traders with assorted approaches. This is where things get even murkier. You've probably heard of the handles that express styles and strategies: momentum trader, scalp trader, equity trader . . . whew.

If you find yourself getting a little bit flustered by all that stuff to take in, remember that the main point to focus on is this: Professional day traders close out all positions at the end of the day; day traders don't **hold** overnight.

The best way to further get the gist of day trading is to recognize what it is not: It is not investing. With regard to stocks, investing differs from day trading because of four primary factors:

1. Investing in a stock requires substantial research and knowledge of the company.
2. Usually a large portion of your capital is used in a single position.
3. The general plan, when investing, is to **hold** a position longer to get a bigger return. How long you **hold** the security is a major indicator of your expected return on investment (ROI).
4. Investing requires forecasting the future.

Stock investments are classified as short term or long term. A short-term investment is usually a position **held** for one business quarter or less—that's up to three months, never longer. A long-term investment is usually **held** for longer than one business quarter, with an expectation of receiving dividends and future earnings growth in the company.

When the term *invest* is very loosely applied, you can actually call day trading investing. It's true that you're taking your funds, for the moment, and investing them in a stock. But you don't have to know the stock's company like you know the back of your hand, you're not (well, I hope you're not) putting up most of your money, you almost never **hold** overnight, and you don't need to forecast the future. That's why you're referred to as a *trader* as opposed to an *investor*.

When the term *investor* is aptly applied, we're usually talking about hedge fund managers and portfolio investment pros. Those brokers usually work in large firms, like Goldman Sachs or Merrill Lynch. They handle investment capital that numbers into the millions, and that money belongs to their clients. Because it's not their own capital, their licensure is a must. Their time is spent researching companies, forecasting earnings, seeking out new clients, and retaining existing clients.

Those managers, or licensed brokers, however you want to call them, decide on what companies to add to investment portfolios and how to manage the risks. Once they know how much of their clients' money they want to invest in a stock, they alert their firm's trading desk. A hired day trader then purchases the shares on the order form given to him.

That sort of day trader is not an independent. Like the broker, he has to be licensed. His job is to fill all the execution orders he receives throughout the day. Most likely he's paid a base salary and some sort of a commission.

The independent day trader (or independent equity trader) goes by the same name, but his job is decidedly different. He uses only his own funds. He doesn't have to get himself licensed. He either works alone from home or at a private-equity trading desk, usually at a pay-per-share firm.

The role that all types of day traders share is that they spend their time immersed in the business of placing intraday trades. Their attention is riveted to the volatile price swings that are so characteristic of stocks.

Day traders care mostly about how volume and price movement are being affected by those swings. They don't get caught up in the huge panorama of forecasts and company analysis. That would be like viewing the forest, not the trees. Day traders squint, up close, all day long, at the endless flitting motion in the trees.

Since day traders don't plan to **hold** overnight, news about stocks and any earning announcements aren't likely to affect their day's trading. Though company information and other fundamentals are somewhat important to traders, they aren't critical. Remember, they're not investors. They're not betting their lives on a company. They're trading on the volume created by intraday investor interest in a chosen company's stock price.

Well, at this point you may be thinking I'm making it sound as though day traders don't care about the companies they're trading. You'd be half right to assume that. Chapter 14, "Stock Picking: Simplifying the Process," and also Chapter 15, "Why News Can Be Just Noise," further drive that point home.

In response, you might pose the question: *Just what does a day trader do that's beneficial to the market?*

For starters, day traders are crucial to a stock's price movements, called market liquidity. The more liquidity there is in a stock, the better the stock will trade. Liquidity means that there are many buyers and sellers interested in the stock. Without day traders, investors wouldn't be able to buy large volumes of any given stock without driving up the price as they were buying up their positions. Conversely, and just as importantly, when investors begin to sell off, day trading liquidity helps keep the stock from dropping precipitously.

Now that you're clearer on what a day trader is and does, and also what a day trader isn't and doesn't do, your immediate priority should be to ascertain your *skill level*. If you were discussing that subject with me, I'd have several questions for you. Going from most to least important, they'd be:

- How *often* do you trade, and how profitably?
- How *much* are you trading in capital and leverage?
- How *long* have you been trading?
- *What* are you trading (your financial instruments)?
- Are you trading *other people's money*, or only your personal capital?
- Are you a *licensed* trader, or trading independently?
- *How* were you trained?

And then we'd elaborate on all of them.

HOW OFTEN DO YOU TRADE, AND HOW PROFITABLY?

More than any other factor, your skill level is based on how many trades you place per day and the consistency of the profits. If you do well with one trade per day, that's great, but the same intraday performance with a hundred trades is much more desirable. Your *frequency* of trades is the quintessential signpost that indicates your level of skill. Frequent trades, frequently profitable, are the visible proof of a pro.

HOW MUCH ARE YOU TRADING IN CAPITAL AND LEVERAGE?

An affluent beginner might trade with a million dollars. With a 50-to-1 leverage, he can capitalize on his margin mightily. Does this mean his skill level is higher than that of a guy with just five thousand bucks? The answer is clearly *no*.

In order to buy ten times the shares, of course, you always need ten times the capital. If you have that kind of capital, that's great. But that won't ensure you more profits. It just means you'll make more or lose more.

You don't want to increase the share size just because your funds make it possible. *Your share size should only increase with your skill.* I recommend a very slowly graduating climb from 100-share blocks to 200, onward and upward in increments that small, in careful correlation with your growing expertise. Whenever you find that increasing your share size is causing your profits to crash, you need to back down to something smaller. No matter how much capital you play with, there's no sense in losing big chunks of it just because your skill level is low.

I always use 100-share blocks as a starting point. Why? If you consistently trade at a profit by executing 100 trades per day and sticking with 100-share blocks, then what you've developed is a *high* level of skill when trading with the amount of capital required for purchasing 100 shares at time.

Here's the flip side. Take any average stock, let's say a $50 stock. All you need is $5,000 to purchase 100 shares. If you have $1 million in capital you can purchase 20,000 share blocks, or four similar stocks each in 5,000 share blocks, and so on. Can you see where I'm going with this? The more funds you have, the more likely you'll get in trouble if your skill level isn't sufficient.

Here's an unpleasant scenario I've lived through.

Part of being an amateur, for me, was learning to properly handle my leverage. With my initial, traditional pay-per-trade broker, it was usually 4 to 1. This increased my buying power (my capital), so I felt as if I was four times as rich. I immediately began to purchase larger share blocks, sometimes 10,000 share blocks at a time. What followed was a nightmare of loss.

As I take you through my confessions, which essentially make up this book, I reiterate that nightmare, and others, from different angles in different chapters, to help you see where I went wrong. In this chapter, what I want to make clear is that I lacked the skills that the increase in capital made me think I had.

I eventually discovered that a highly skilled trader profits, no matter how great or how little his funds. Even if he's playing with as much as $1 million, he'll wisely purchase only 100-share blocks, and he'll utilize his skill and decrease his risk by trading multiple stocks.

That guy could buy 20 stocks in 100-share blocks in a heartbeat. Maybe you're thinking, if he were to do that, then he'd be spread way too thin.

Watching 20 stocks is scary, that much is very true. But it's still better than putting all of your capital into one stock and one trade. You certainly don't want to start out as a day trader nervously eyeballing multiple stocks, but later on, after some practice, the wise thing to do is just that: to diversify your daily portfolio. Literally speaking, that's your stock list, and by making it longer and having a lot to watch, you minimize your risk by about 80 percent.

Though having more capital does not in itself increase your skill level at all, it does make you gradually smarter, because you have money for practice. But fear not, comrades with average funds: whether or not you have a truckload of capital, this is the thing to remember: learn how to manage your risk. The higher your skill level, the better you'll do that.

Risk management is knowing when to use your capital—just how much, and when. Chapter 6, "The Importance of Risk Management," illuminates that mastery, applied to intraday trading.

HOW LONG HAVE YOU BEEN TRADING?

This question implies some tough answers. I've heard of amateur traders who have gone to a mentorship program, read a couple of books, practiced for a couple months, and then began trading with a great degree of consistency and profit. In less than a year, all of a sudden they're exemplary professional day traders.

And then there are the traders, myself included, who must struggle for years to find their niche. It's difficult, if not downright impossible, to approximate how much time it takes for individual traders to build and improve their skills.

The longer you're in this industry, of course, the more skill you'll acquire. And here's something I'll assert with conviction to any and all day traders, no matter how quickly or slowly they profit, because time always proves this truth: The key to increasing your skill level is to remain very active in trading.

The question of how long you've been day trading does not just address the time spent; the underlying query—the important thing to know—is what have you been doing with that time? Have you been using it wisely?

Here's a list of suggestions that can help speed up your process of attaining trading skills.

- Be active. Stay with it—full time.
- Budget, borrow, or plan what you have to in order to be able to take some time off to focus *only* on day trading.
- Get involved in a mentorship program with someone you can watch.
- Get your New York Stock Exchange Series 7 (General Securities) license and go to work for a salary-based position at a brokerage firm like Merrill Lynch (optional).
- During your free time, inundate yourself with market information, especially day-trading tactics and strategies.

WHAT FINANCIAL INSTRUMENTS ARE YOU TRADING?

Are you trading stocks, commodities, treasuries, option contracts, future contracts, penny stocks, or some other financial instrument?

A professional day trader can trade virtually any medium of exchange. Most beginners, however, only trade in equities (stocks). That, in my opinion, is the safest place to start. Stock exchanges have the most transparency and market data available; what that means is that for the beginner, they're the simplest instruments to learn from.

That doesn't necessarily mean that if you never trade options or future contracts, you'll never reach professional status. It really boils down to what you're comfortable with and what interests you the most.

The key is to find your niche, and stick with it. For instance, if you choose to trade only stocks, then over time you'll become a master at trading in equities. Most likely you'll find that you only trade one type, such as tech stocks or energy stocks. The more you fine-tune your trading style—as a "scalp trader" or whatever—the more skill you'll acquire for that financial instrument.

ARE YOU TRADING OTHER PEOPLES' MONEY OR YOUR PERSONAL CAPITAL?

In order to invest clients' money, you have to be a licensed broker. And no one, of course, is going to trust you unless you're extremely experienced. But just the same, always remember: Just because you're an unlicensed, independent trader doesn't mean you're not a professional.

ARE YOU A LICENSED TRADER, OR TRADING INDEPENDENTLY?

If you're trading from home, you're most likely an independent. If you opt to trade at a professional trading desk, you have a couple of choices: You can remain independent and trade from the floor of a pay-per-share firm, or you can obtain a license (Series 7) and apply to work for a large investment firm like Goldman Sachs.

I've learned to never judge traders by where they're trading from or whether they're licensed. I've known some licensed day traders who can't be consistently profitable. And I've known some home-based, unlicensed traders who've had sterling track records for years.

In day trading, a license doesn't make you a professional. If you study for your Series 7 license, as I have, the first thing you'll notice is the manuals' remarkable thickness. They're loaded with virtually everything to know about corporations and all the information you could ever cram in about how the stock market functions. You'll learn all the federal Securities and Exchange Commission (SEC) regulations, and the entire process of how corporations disclose their earnings statements. Basically, you'll get an entire overview of the stock market universe.

Most large investment firms require the license as part of their application process. You don't actually learn how to day trade until they show you how. That's why the license means nothing—It's really just your pass for admission. Having one proves you've been checked out for things like a criminal record.

But you still have to learn how to day trade.

HOW WERE YOU TRAINED?

Training is everything. If you've only been to a seminar or read a book or two, you're like a lamb being led to the slaughter. You can't possibly learn how to day trade from reading manuals and getting tested or licensed. The most effective form of training is by far the mentorship programs, sometimes called in-house training. Most of those programs have you and a professional trader working one-on-one.

Stay tuned for a lot more on mentoring.

Well I hope that I've helped you be clearer, at this point, on whether you're meant for day trading or investing. And I also hope that I've helped you get a fix on your current skill level.

That way you're more likely to know just exactly what you're getting yourself into!

RULES TO REMEMBER

- Increasing your skill level is a gradual process; never rush it without the help of professional mentorship or in-house training.
- A Series 7 license doesn't mean you're a professional day trader. You still need to be trained.
- When day trading, always remain active. That's the key to increasing skill.

CHAPTER 2

How Emotions Can Destroy a Trade

In day trading it's immediately obvious: Your emotions can be your worst enemy. They're usually counterproductive to all your day-trading efforts. As an amateur trader you learn right away that emotions are the bane of your strategies.

The control or even the elimination of feelings should be the Holy Grail of day trading. If you're out there high-strung, acting like a loose canon, you're not day trading, you're gambling. You're not in control of your trade.

You know when your feelings are wrecking a trade. You're in one and it goes against you. You **hold**, and then you **hold** it for longer, and then you get mad at the stock.

If you're like me when I was a greenhorn, you might start to viciously mutter: "You better go back up, or I'll throw this monitor out the window!"

At one time or another, all day traders feel that way, and it leads to big trading mistakes. Though few of us ever smash up the equipment, when we feel that frustration we *do* have a tendency to actually break trading rules. We also tend to invent new rules that make no sense at all.

To err is human . . .

We know, we know.

Emotions are like frenzied little voices in your head. They get riled when things don't go as planned. They're the part of you that freaks at uncertainty. Well, uncertainty in day trading is a given, a fixture, so . . . what can you do about that?!

I've been struggling with that irony for my entire day-trading career. I can never make my feelings disappear. I've tried to rid myself of them, but they're part of me, they're permanent residents: They're just as attached as my hands and my feet, and just when things start to get rough in a trade, just when I need to rely on my wits and not my proliferating angst, that's when they make the most noise.

I've learned that this problem must be dealt with proactively. The issue is just as threatening as hurricanes are to buildings. We have to construct strong defenses against our own primal reactions. In trading, as in any other worthwhile endeavor, both anxiety and acquisitiveness are instinctive and neither can be removed, but lessening their damage is crucial. We must learn to corral them and manage them, just like a highly skilled animal trainer who effectively reins in his beasts.

I've identified the worst of the monsters. They are, as you'd probably guess, *fear* and *greed*. When I'm angry, depressed, desperate, or scared, those are the underlying factors.

THE FEAR FACTOR

Let's begin with the fear factor. Our minds are hardwired with fear. This is the vital, indispensable reflex that keeps us alive and strong. Fear serves us well when we're running from lions, or clobbering each other in wars. But when fear overpowers the detached, calm analysis that's always required in day trading, the mechanism meant to secure our survival turns into the cause of our downfall.

Amateur traders, of course, get beat up the most by fear. Their lack of experience creates overconfidence, and that, as we'll later observe, creates recklessness, which causes nosedives to big losses. The result is someone who's completely lost his nerve—now he's completely scared and discouraged. From the quagmire of defeat he must now learn to rise and wield the great tool of true confidence.

True confidence is all about learning the virtue of old-fashioned, joyless-sounding prudence. Prudence is an extremely underrated state of mind. Prudence helps traders discover the path to losing a much less, and successfully taming the fear. I'll return to that virtue in a bit.

When I was a beginner, the fear factor undid me. It messed with my need to make quick and wise decisions. It came down to two main scenarios.

First, and most often, the fear would take over just before I entered a trade. I'd look at my charts and see a perfect setup, and just when it was time to get in it. . . . I'd stop. My emotions were suddenly churning. I was questioning my system of trading. I was suddenly thinking, *The trade is too risky*. My jam-up might take just 10 seconds, but in day trading, 10 seconds can be way too long.

I eventually learned that the way to quell fear is to find a comfort zone. To find it, know it, and stick to it, always, as a mandatory self-imposed recourse.

Here's a simple rule to remember: When you feel the fear, lower your risk. Don't think about it, just do it. Do it right then and there. It's the obvious way out, but in that kind of pinch, you might hesitate. So learn to *automatically* do it. If you're about to make a trade with a 1,000-share block and the fear factor kicks in, immediately lower your exposure to 500 or 100, whichever amount feels okay. I can almost guarantee that your anxiety will vanish if you're *programmed* to *immediately* decrease your exposure.

The second scenario happens when you're already into the trade. Your fear can make you sell miserably short of a decent, attainable profit.

Suppose you've just entered a trade. You got in at $49.75 with a 100-share block. You expect to sell once it hits $50 (Limit) or sell at $49.65 (Stop/Loss). You want to make $25 on the trade (25¢ × 100), or you risk losing $10 (10¢ × 100).

In rare cases the stock will shoot up to your exit point, allowing you to quickly and painlessly sell at (All *right!*) a planned profit. But most likely the stock price will exhibit volatility and bounce on a one-minute chart. It will soar to $49.90, just shy of your $50 exit point, and then all the way back down to your $49.75 entry price. It might actually test below it. Figure 2.1 illustrates this scenario.

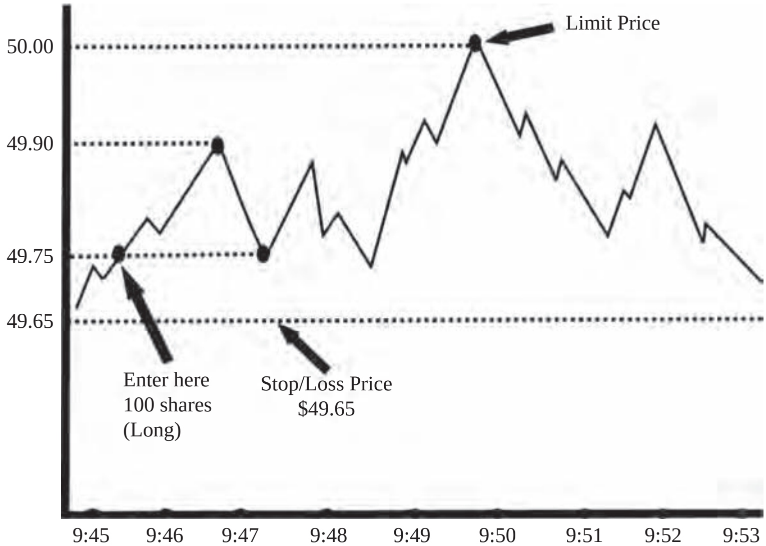


FIGURE 2.1 Intraday 1-Minute Chart

The volatility on the up-trend direction toward $50 can cause you to get emotional during the five minutes of trading. The price very seldom shoots straight down or straight up.

The hard part is dealing with this several times over, all in the space of one minute. Amateur traders get nerve-wracked, and tend to sell short of their predetermined exit points. They'll either sell at a loss before they hit those points, or they'll sell when the price, though ascending, is shy of the upper limits.

The fear factor urges them to sell *right now*, before the predetermined $50 exit point, especially if the price doesn't zoom straight up.

For example, take me when I was a beginner. I sold at $49.80, because the suspense was too grating. Then I only made 5¢ on the trade. Or I sold at a loss when it dipped just short of $49.75, bailing out too soon. Either way I had messed up the trade, because the fear factor froze me. I was overexposed when trading a 1,000-share block. I was afraid to continue.

So there it was again, like the moment before the trade, when I was too scared to jump in. Anxiety was causing me to lose bigger profits. My emotions were getting the best of me.

Those intraminute oscillations can cross your eyes, tense you up, and make you want to run. They can make you reconsider the wage-slave life—broke, living paycheck to paycheck, and bored right out of your mind, but at least you're not tearing your hair out.

Eventually, I discovered some inner solutions. Along with the prudence I've mentioned, I found out how right my mom had always been about the power of patience. Add those two virtues to much less exposure, and now you've got it together.

I'll return to those virtues again.

The less your exposure, the less your fear factor; anyone can see that on his own; but a beginner might not see quite soon enough that he needs to establish a powerful *reflex of instant exposure reduction*. That way, when he's caught in that intraminute bouncing, he doesn't have to freeze up and wonder what to do; instead, he decisively acts.

GREED IS NOT GOOD

Now let's move on to the *greed factor*. Greed, just like fear, is inherent in humans, and it can't be avoided, only tamed.

In day trading, we actually need a little greed. That's the fuel that keeps us going. Acquisitive goals, the motives and the reasons to take higher risks, distinguish us from plodders and wage slaves.

But greed can create overconfidence. Greed can make a day trader reckless. Diametrically opposed to the fear factor, the greed factor causes the amateur to jump into numerous trades without enough hesitation. Uncontrolled greed can push him to break his sensible system, hazard trades he normally wouldn't, and get himself in all kinds of trouble.

Greed is by far the most dangerous emotion. Fear, though detrimental, won't make you lose big. The greed factor, however, can destroy you. Greed can lead to excessiveness, and in the end, inconsistency. Your greed can land you in a devastating number of ruinous trading situations.

The greed factor causes two downfalls.

The first can occur when you're in a good trade, and you exit with a small well-planned profit. "Good" and "well-planned" are important terms here; they suggest that you've been prudent and patient.

But now you've just noticed that the stock price keeps shooting on upward. So you eagerly opt to get back in, and follow the run-up even farther.

And that's when your avarice kicks in. You're avidly re-entering at a much higher level than you did in your *good* trade, and of course you're expecting, with beginners' foolish courage, to see the price trade to the upside.

Unfortunately, it does not. The price turns against you, and now you're losing money, and you regretfully, belatedly recognize that you entered these straits on emotions.

And there's more. The greed factor isn't yet through with you; here comes downfall number two. With the trade gone against you, now you **hold**. You **hold** with the hope (and isn't hope an emotion?) that the price will go back up.

You're now at the mercy of the market, with all your good planning shot, and all I can say is, *Good luck*. Are you getting a sense of the proverbial snowball, getting larger as it rolls down a slope? That's the greed factor at work in you, doing its dubious magic.

One day I was trading Amazon.com (AMZN)—and I stuck with it all day. I was trading smart. I was entering only when I knew my exit points. I was only buying 100-share blocks. It was a good day to trade—there was little volatility. The stock price kept trending up. Virtually every trade I entered went up to my limit price quickly. Easy trading!!

It was 3:00 P.M., the final hour, and after commissions I was up about $650 for the day. I'd been trading consistently all day, in and out, with $15, $25, and $40 profits. I had a few stop/losses of $20 to $40, but that's normal and expected.

In this very last hour of trading, I was watching the charts and lo and behold, I noticed a big spike in volume. Then the price shot up about a dollar—*in just under five minutes*. It hadn't spiked that much, that quickly, all day. There was no particular news about AMZN, and the indexes were relatively steady.

It annoyed me to miss out on that spike. I wanted to make more money. I wanted to make a nice round $1,000 profit for the day; I wanted a few hundred more.

I wanted . . . I wanted . . . I wanted. That's greed. And then it turned to smoldering envy. I felt as though everyone was getting rich but me. All day I'd been making chump change, and now that the stock was running strong to the upside, I coveted a piece of that pie.

I began to psyche myself up. I convinced myself that the stock was going to keep ascending gloriously. I let my greed morph to that dangerous headiness that makes you or breaks you—and breaks you more often. I abandoned my prudent consistency. I purchased 1,000 shares.

And soon after I bought that huge block, the stock dropped 20¢.

No problem; I was used to 20¢ moves. That's how things went, all day. The hundred-share blocks meant a 20¢ move would gain or lose me $20. But this time, remember, I was strapped to a thousand shares. So this time, I was down $200.

I lost control. I could feel the greed completely take over. I didn't care; it was just like a gambling compulsion. I began to average down. I purchased another 1,000 shares, then another, and another. By the time I realized how screwed I was, I was trading 5,000 shares.

The stock price dropped an average of 35¢ on my 5,000 shares, accumulated while averaging down. Within 20 minutes, I was down $1,750 (5,000 × 35¢).

My greed then collapsed into panic. I knew that if the price continued to drop, I was going to lose much more money. So I surrendered and sold all 5,000 shares at a $1,750 loss.

This horrible scenario is illustrated in Figure 2.2.

Up till three o'clock I traded consistently in 100-share blocks. The very first 1,000-share block just happened to be near the top of the late-day spike. If I had purchased only a 100-share block I would not have gotten into so much trouble.

On the bright side, the stock did retrace down, all the way to the closing bell. If I had **held** any longer, I would have lost another $5,000. After I exited, it dropped a full dollar.

But what if it had gone back up? Would I have made a bad decision to sell at a loss? Those are the questions that can scrape on your brain, and make you lose sleep at night. Either way, I was fatally greedy to purchase the first thousand-share block. I vowed to never do that again. But I did. . ..

As I mentioned at the start of this confession, fear and greed are unavoidable. The traits are psychological fixtures; they're a part of us, and can only be tamed, not destroyed. Trading in 1,000-share blocks is greed that hasn't been tamed. The 100-share blocks are small increments, quite manageable even if you lose. Every time you enter a new trade, 100-share

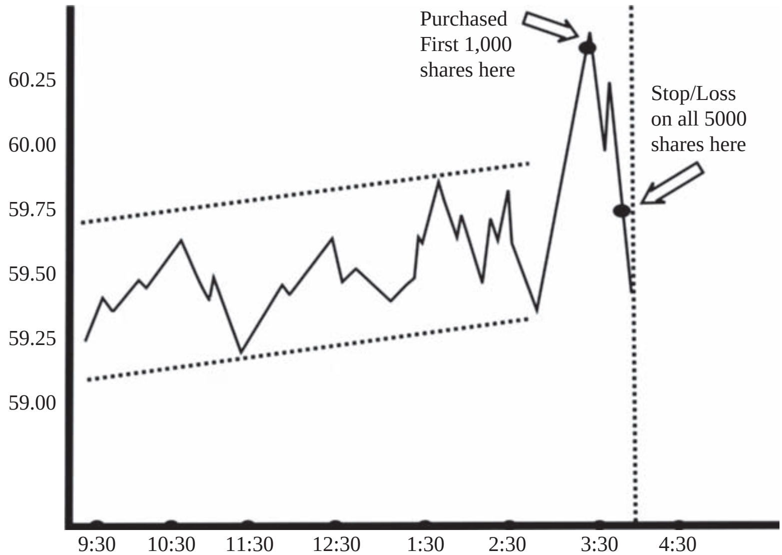


FIGURE 2.2 Intraday 30-Minute Chart

blocks fuel your want, your desire, to make more money all day—and yes, that's greed too—but it's tamed.

Greed is a vital but lethal beast, licking its chops inside you. Greed should be locked behind bars. It should only be freed in the vigilant presence of leashes, restraints, and charged stun guns. In other words, when you're consistent—when you're sticking to a strict risk-management system, like trading in hundred-share blocks—your greed is still there, but not loose.

Understand the powers of fear and greed; understand the dangers and advantages. Know that self-discipline is key. In day trading, your primal emotions must be caught and confined, yet masterfully drawn upon also. Lock them down, scrutinize them, and train them. I'm talking about *you against you*, here: the quintessential human condition. Making great money in day trading is all about beating the human condition.

RULES TO REMEMBER

- If you feel yourself being controlled by your emotions—reduce your market exposure immediately.
- Stay consistent *all day* while trading—stick with 100-share blocks.
- Set realistic profit goals, and create a realistic budget.

CHAPTER 3

Preventing Overconfidence

With remorse I think back to my excessive confidence, back when I was fresh from my first training program. I was using what I'd been taught to believe was a wonderful, "bullet-proof" system. I actually had so much faith in myself that my initial losses didn't bug me.

But I got over that fast. My losses were so consistent that I had to. And then I desperately needed to know just *why* I was losing so much. The first thing I started to realize is that I was too sure of myself.

Confidence in trading styles is similar to the way a busy cook relates to his pot mitt. The wise cook, no matter how harried, always takes the time to put on his mitt before he grabs a pot off his stove.

So it's not the inanimate mitt that protects him; the bottom line is that it's the cook himself. Knowing when it's necessary to put that glove on and having the good sense to do it is what he's really relying on. Accordingly, the day trader must fully understand that it's his judgment, much more than any system he's learned, that affects his trading the most.

Confidence, just like the cook's pot mitt, is a tool. If the trader's confidence wildly balloons and he becomes zealous, stubborn, or careless, then he's just like the heedless, inexperienced cook who thinks he'll get by without his mitt. In both of those scenarios, overconfidence burns.

I'm aware of no chart pattern or stock analysis methodology that shows you a confidence factor. No system will tell you to buy or sell with 100 percent certainty—because there simply is no such certainty!

But we traders need confidence—lots of it—in spite of the uncertainty. Without that mental asset, there would be no trading career. Too much of it, however, can destroy us. Confidence it is a tool that must be utilized, but always judiciously. Otherwise, it gets in the way. It tosses good judgment in the trash. To literally understand this, you need only to think of the hurry-up cook who doesn't use his mitt when he should. You know what will happen to his hand, and then his ability to work.

For the day trader, overconfidence is that detrimental. Mastering confidence as a tool, not an obstacle, is a lifelong, ongoing process. I am still growing in that process, and at this point I've learned some reliable skills in it.

But during my first weeks of day trading, my confidence levels were overzealous: They were hardly a powerful tool. Soon I began to understand that overconfidence led me astray into two classic trading mistakes.

Those mistakes are ignoring your predetermined stop/loss price and **holding** too long.

IGNORING YOUR PREDETERMINED STOP/LOSS PRICE

I enter into a trade, it immediately goes against me, and I **hold**. This is *after* the triggering of my predetermined stop/loss price—and I don't give a damn.

To **hold** is an act of stubbornness. It's a lethally wishful kind of thinking. This is where I'm allowing my confidence to become, not a tool, but something irrational. Now I'm just being a daredevil, like a bungee-jumper. I'm bouncing in midair, and risking a deadly collision.

And then I make things worse for myself. I buy more—I average down.

At this point I've blundered into the minefield of way-too-confident trading. To buy more at a lower level, after the initial trade has gone against me? What was I thinking? Now my emotions control me. I got into a trade and it down-slid, and now I'm irritated and worried, and I'm kicking myself for failing to wait for it to decline before buying in the first place.

So basically, I've now bucked the system. Now all I'm doing is gambling. I'm betting that the price will go back up, with the faith of the fools at casinos.

HOLDING TOO LONG

I'm in a trade and the price goes up, but in my opinion, not enough. So my overconfidence tells me to **hold** for just a while longer. Then (of course!) the stock price retreats to break-even, so I've lost out on a good trade. That same trade might even continue to retrace into the red.

It doesn't get any more ugly than that. I feel like an idiot for failing to sell when I had a profit and I should have had a clear plan of exit.

So now I could see that it was getting imperative to harness my confidence, somehow. To grab it and throw it onto a table, deep inside my head, and strap it down and hone it into a tool that would fit my needs.

After a day of that self-search, I understood what to do. My confidence, if made precise with prudence, would help me pick my own realistic entry and exit price levels. Overconfidence amounted to a careless lack of that precision.

I needed to *trust and never abandon* a system of reliable stop/loss and limits. Then I'd be halfway to Mecca.

I've never regretted those insights.

The key is to stick to your plan. If your chart analysis indicates you should stop/loss when the price hits $50, then *do it!* Sell at a loss, then move on. You'll feel even worse if you **hold** past your exit point. Whenever you put yourself in that situation, you're at the mercy of the market.

When structured right, your confidence serves you, just like a trusty wrench. If I enter a trade and I feel pretty sure that I'd sell it at two price levels—the stop/loss price and the limit price—then I'm using my confidence correctly. I'm making that trait a useful component in my mental system of trading.

Yes, I found that my predetermined price level is where that tool does me good. For instance, if I lose on the trade, at least I can feel sure I was right to get out. The price may continue to fall further against me, but now I'm safe on the sidelines and free to get back in at even lower levels, pending further stock price analysis.

If a price movement shows a clear pattern and my current trading system is indicating an entry price, then my confidence gets high, but not foolishly so. I can never know for sure, but I can fairly approximate how much I'll make or lose, because of my stop/loss and limit exit points.

To conclude, overconfidence is your confidence tool broken apart and malfunctioning. It compels you to try to pick bottoms or tops. It's crucial to be cautious instead, and to know your stock very well. You must know it just like you know the lyrics of your favorite song.

You must know your stock's rhythm like the back of your hand. If you don't, and you're trading it anyway, that's another sign of overconfidence.

Analyze the average daily price ranges and minute ranges, take note of how fast or how slowly they move, and how they retrace during trends, and when. You should mentally trade your stock first. Once you feel sure enough to dance with it, then and only then should you begin your careful planning of entry and exit points.

Trading with confidence is all about being familiar with your stock, and prudently sticking to your plans. Trading with overconfidence is neglecting to know your stock and haphazardly changing the exit points while already in the trade. If you're an amateur trader, that's a very perilous stratagem. Only the experienced trader can handle it, and even he might regret it.

If you think you can trade like a pro, then most likely you're overconfident, and most likely, you'll lose your shirt. Stick to the program, every time! Be reasonably certain, not reckless! If you're a born risk-taker or daredevil, it will take force of will to achieve that.

RULES TO REMEMBER

- Confidence is an emotional tool, and you must harness it and control it.
- Never enter a trade without knowing your exit points.
- Once you've predetermined your exit points, always stick to them.

CHAPTER 4

From Impatient to Cool, Calm, and Collected

Your-day trading performance is the result of your patience, or your sorry lack thereof. No matter how well-schooled you've made yourself in the technical applications, if you're short on that virtue, you're in big trouble.

Impatience is a threat, and it's constant. As an amateur you'll sometimes feel edgy, no matter how determined you are to stay cool. You'll have to chase down your impetuousness, and catch it and totally stun it, and lock it up tight with the greed.

No matter whether you've traded for a dozen years or mere days, your level of self-discipline is crucial. In pondering that fact I've come to understand that patience, when seen as an emotional tool, actually divides into two: the tool of amateur patience and the tool of professional patience.

The beginner's need for patience is simple, yet challenging. For him or her, it's all about staying power. He's a lot like a determined new dieter, trying to stick to a stringent way to eat.

Impatience, in amateur day traders, reminds me of the foolishness of dieters taking the easy way out. They might get tummy tucks, or have their stomachs stapled. Are they doing anything, or learning anything, that will consistently keep the weight off?

And the ones with the tummy tucks? If they haven't learned to successfully diet, then they just keep on overeating—and all that surgically tightened-up flesh begins, once again, to swell and bulge and droop.

In the effort to conquer obesity, what matters the most is to comprehend the underlying personal factors. What causes the overeating in the first place? How can it be overcome? A lot of self-searching is required for that, and self-searching requires patience. The commitment to study and renovate oneself isn't easy for fat people, or anyone. It amounts to the acceptance that there is no easy way, and that only the long haul works.

In day trading, if you want to *consistently* profit, then you need the intensive, nonstop self-vigilance that accompanies victorious dieters' weight loss. You have to grow that much patience.

As I've established in Chapter 3, first you must develop a prudent trading style, and the discipline to always stick to it. Patience is the in-the-thick-of-it glue that keeps it all together. Strengthening that virtue can't be done overnight; you won't walk away from a seminar with it. It's a process that you, the beginner, must gradually, painstakingly master, while executing multiple intraday trades.

It's all about baby steps ... and who wants to move that slowly? I'm sorry, but that's what it takes. Keep your shirt on. Take a deep breath. Slowly count to ten. *Patience.*

Most beginners sit there for hours, waiting for a price to hit. Sometimes they even wait for days. That isn't patience, that's obsession, the confusing of a virtue with the grave mistake of **holding**. That certainly isn't day trading. Neither is the flipside, impatience, the hurry-up quest for quick results.

Patience, especially for the young or inexperienced, is all about learning to control one's annoyance. It's about a high endurance for tough day-trading situations. To achieve that takes dedication to active trading days.

To help yourself develop your patience, it's crucial to find your niche. You might change your strategy at least 20 times before you see what works best. Some find that day trading several stocks, daily, results in a relatively peaceful state of mind. Others feel best when they trade just one stock. The point is that you, the beginner, must find yourself a method that bolsters your tolerance while you're caught in the gyrations of a trade.

Yet after you find your most comfortable trading style, you'll still have to struggle with yourself. I can't think of one trade I've ever been in that didn't demand a great focus. Whenever I've enjoyed a good trade, it's usually because I made myself wait for the hit of the entry and exit points. A lot of my bad trades have been all about the flipside: I failed to wait for the proper setup, or I exited too soon or too late.

I may have a superior chart-reading system, and an arsenal of proven techniques. All of it increases my chances of successfully selecting intraday bottoms and tops. But what matters the most, as I've stated before, is my confidence in my system. Once I decide on which price I need to enter and exit a trade, the key is to stick to the plan, and that's where the virtue of patience comes in. I know I'm getting redundant here, but sticking to the plan can be so hard to do that I don't mind repeating that point.

It could take several minutes for the price targets to hit. Waiting that out is critical to the success of the trade. If boredom makes me sway from my predetermined price levels, then I'm regressing, I'm committing the beginner's mistake. Just as with the fear and greed factors, now I'm trading just on emotion. It's been said that the essence of patience is all about clear thinking, unencumbered by any emotion. Who but a sociopath can do that!

A day trader has to learn how.

THE WAITING IS THE HARDEST PART

Tom Petty and the Heartbreakers have a classic-rock hit: "The Waiting Is the Hardest Part." Oh, yeah. The chords and the beats and Petty's wail of that tune are the sound of your knuckles clenched up. They're the sound of you holding your breath in pure angst, so tense that your stomach feels squeezed. You listen to it knowing that somebody understands and has spun the tedium into a song.

Waiting for your price level to hit can be boring beyond words. It's especially hard on the days when the market is trading sideways. But there are some ways around it. For instance, if you're waiting for more then 10 minutes for your entry or exit point, then most likely, on that day you've picked the wrong stock to trade. Chapter 14, "Stock Picking: Simplifying the Process," advises on that problem.

Here I want to reiterate rule number one: only trade 100-share blocks at a time. And when you get fed up with the monotony of it, always remember this: trading in 100-share blocks does *not* mean you're *not* trading like a professional.

Impatience is what often causes amateurs to place large and risky trades. Impatience makes you go for unrealistic profits, when you should be thinking much smaller. Your *only* objective should be a keen focus on keeping your profits consistent.

When you're trading in 100-share blocks, you're not going to make any more than $50 on each trade, but you *will* build consistency and skill. Most stocks, with $45 to $85 price ranges trade in 25¢ cent ranges within five minutes. During these intraday swings, you can easily grab 25¢ to 50¢. Those moves usually take anywhere from 10 seconds to 10 minutes, depending on the stock.

Let's say you have a $50 stock. It has an average daily volume of five million shares traded. It also has a proven track record of moving 25¢ within five minutes, and it does this all day long. That's a good stock to trade. That's a potential profit of $25 every five minutes throughout the entire day, when trading in 100-share blocks (see Figure 4.1).

At 9:45 the price was $58.75, and at 10:25 it retraces back to $58.75. On the surface it appears the stock is trading sideways, but take a closer look at the intraday swings. You can make 25¢ trading long or short. That's a stock you'll stay relatively patient with, and consistently profit from.

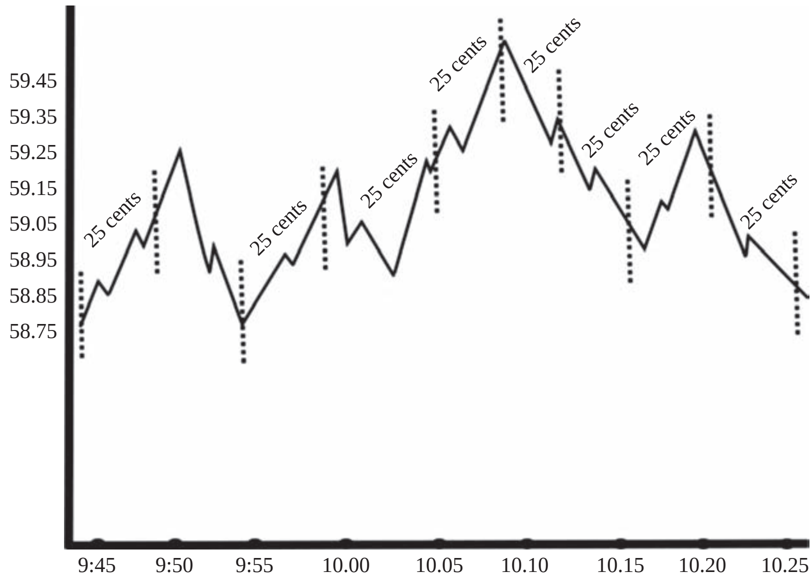


FIGURE 4.1 Intraday 5-Minute Chart

If the stock can fluctuate 25¢ within every five-minute rolling period, all throughout the day, then you can make a lot of trades. There are 78 five-minute periods in a trading day, excluding premarket and after-market trading. Therefore, you have a chance to make 78 trades, producing an average profit of \$1,950 per day (78 × \$25 profit per trade).

Not a bad take for the day!

(If you're trading with a pay-per-trade broker, as opposed to pay-per-share, then it's just as true that you should trade in 100-share blocks. The difference is you should *intraday* ***hold*** the stock for longer periods. That way you can afford the outrageous commissions you're made to pay on each trade. I know that sounds contradictory, because I usually say never **hold**. (Chapter 17, "Picking the Right Online Broker," explains that incongruity.)

Whenever you get tired of the fluctuations or waiting, think of the nerves of steel it takes to be a long-term investor. You're waiting for months, not minutes! The point is whichever you are—hedge fund manager or day trader—impatience is extremely detrimental, and must be controlled and outgrown.

Imagine yourself a college freshman, demanding a diploma in your very first semester. That's pretty much what you're doing if, as a beginner day trader, you're expecting to immediately make a huge profit.

Patience, patience, patience. That trading seminar or infomercial may have strongly implied that you can, but the truth is you're not going to consistently make $5,000 a week. What's closer to the truth is that things won't take off until you've lost so many times that you're humbled. At that point you'll learn to respect the market. You'll learn to understand every trade that's gone against you. You'll learn to take the time to understand exactly where you went wrong.

When I was a beginner, I had great difficulty. I had no consistency, no confidence in my schemes, and my emotions ran wild on each trade. I was constantly changing my stock-picking methods and trying new chart-reading strategies. I had no committed system. I was a mess.

I was wildly impatient and intolerant.

I began to search for penny stocks that were going to "pop" (yeah, right!) I also made some big trades, overexposing myself to more risk and uncertainty—the bigger the trade, the bigger the loss. What little staying power I had was running so thin that I felt I couldn't breathe. I felt suffocated by my wrought nerves and failures. I needed to slow down. I was completely desperate to know how to trade consistently and profitably, but far too impetuous to learn.

According to my talks with seasoned pros, it seems that many day traders go through that phase, at first. If you're losing on trades, losing confidence, and losing your keen interest in the market, then you're being controlled by impatience.

DECIDING TO LEARN MORE

One day I accepted that I was bad at day trading, but I also knew I wanted to learn more. This was the true beginning for me. Wall Street had beaten the tar out of me, but I got up and wiped off the dust and blood, and I realized I wasn't as good as I thought I was. I realized that all of my training and education had not been nearly enough. Something was missing, and I knew it was my fault.

As a beginner I began to understand that I had to learn to strategize against my flaw of impatience. For instance, I noticed that every time I placed a stop/loss, the darn price would go back up, after I was out. *Ouch!* That felt like a slap in the face. I thought that the market was stealing from me. I could swear there was a guy who was watching my trades, and then he would trade against me, just to tool with me. (Note: This can actually happen if you're trading certain stocks; refer to Chapter 14, "Stock Picking: Simplifying the Process.")

I eventually got over the conspiracy theories. Except for the situations parenthesized above, I stopped placing blame on others. I started to try out new things. Instead of attempting a whole new method of stock picking or chart reading, I tried an approach of risk management. I simply began purchasing smaller share blocks. Though I did make less on each trade, my newfound willingness to take baby steps was slowly but surely propelling me forward.

Most beginners who refuse to blame themselves certainly do blame the stock market. They grumble, “Its one big scam.” Have they taken the time to study their bad habits, and to learn from their mistakes? I think not.

They probably just need to slow down, like I did, and stop being so impatient. The money will come: You have to earn it. The stock market isn’t a slot machine. You can’t just keep pulling the handle and hoping for the best.

After you’ve been day trading and profiting consistently for at least three months nonstop, you’re past the amateur phase. If you’re making at least 10 round-trip trades per day and never **holding** overnight, then you’re approaching professional day trader status.

Professional patience evolves when you’re so busy placing trades that you haven’t any time to get annoyed. Indeed. I’ve found that the more trades I make, the less time I wait. This minimizes my risk of becoming impatient.

But when I was an amateur, I sometimes sat there all day, trying to purchase 5,000 shares of one particular stock. I had to make sure the entry price was right, and that was far too much pressure.

So why do most amateurs do that? Maybe because they’re trading on emotion created by botched trades, and now they’re desperately trying to get back what they’ve lost. The point is, they’re no longer trading. Now they’re just gambling.

If you’re trading that way, take a time-out.

Try to find the patience to read this book.

Learn from my mistakes.

The execution of a 100-plus trades per day requires professional patience. To sit with back aching and shoulders tensed, pumping out multiple trades while making multiple decisions, requires the precision and focus of a dedicated, competitive skeet shooter. The shooter makes split-second decisions on which flying clay target to hit, and he does this over and over, sometimes for hours at a time.

If he misses a few, he doesn’t get riled. He keeps himself focused and confident. He takes aim and almost always fires with accuracy, with less than a moment to think, and he ends the day with a respectably high percentage of hits, even if he started off lagging.

Such skill isn’t learned overnight, by either skeet shooters or day traders.

Most of the trades we place don't exceed 100 shares at a time. So we tend to place many trades all day long, usually exceeding 100.

To monitor such small profits, incrementing all day, requires tremendous self-discipline. The average professional day trader makes only about \$15 to \$25 on a trade. But here's the thing to consider: \$15 to \$25 multiplied by a 100. That's totally worth the tedium.

When do you know that you're trading with a professional level of patience? The virtue is admirably evident when you're completely in rhythm with your stock. You're like the skeet shooter smashing flying clay targets with barely a second to aim. Stocks prices, like the movements of rapidly flung discs, move up and down all day. Your charts indicate when to enter and exit. Your patience is the intangible tool that enables you to wait for the perfect moment to execute an order. You're almost preternaturally focused.

In the amateur day trader, patience is all about never giving up. It's the process of changing bad habits into productive habits, and finally earning consistently, as surely as true dieters finally begin to slim down.

In the professional day trader, patience has become a deep skill. It's been growing right along with trust in his system. As with the habitual skeet shooter, his aim has been perfected with practice.

RULES TO REMEMBER

- Never pick entry or exits point when feeling out of control and impatient.
- Find stocks that move at least 25¢ every five-minute period.
- Do not trade more than 100-share blocks per trade until you become more advanced.
- Don't expect to make a lot of money in the beginning.
- Finish reading this book before you begin or go back to day trading.

CHAPTER 5

Taking Breaks

If I had a dollar for every time I've taken a break from day trading, I could buy you and me a lot of drinks. In my early days in the profession, I timed-out when I ran out of money. I needed time off to save up more money for starting all over, reinvesting.

That pattern is typical.

That pattern is pathetic.

Depending on the state of my finances, my breaks were for differing segments of time. The result of those time-outs, however, was always exactly the same: I kept going back into the arena and getting beaten up again.

I wasn't yet aware that taking a break is supposed to be for attitude adjustment. It's also for improvement of strategies. It's *not* supposed to be about sadly attempting to find more funds to throw in.

I felt like a compulsive gambler, and in many ways, I was. But gradually, during the course of each time-out, I learned something new. Those downtimes were causing some soul searching. I was slowly recognizing my shortcomings.

That was when I actually wrote my first book. It was one year after my first day of trading. It was after I sold my first house. Some major losses I'd suffered, which occurred in the 2000 recession, had forced me to relinquish my beautiful California home. That house, you'll recall, was the property my fiancée and I purchased just prior to my first day trading seminar in Irvine.

That sacrifice, as you can imagine, was one of the roughest points in the saga of my day trading journey.

That first writing project was self-therapy, a way to reaffirm some good strategies. In the end, however, I could see that it was basic to a fault. It was typical, just a step-by-step manual of all the essential rudiments: how to set up accounts with online brokers, how to read basic chart patterns, and how to scrutinize fundamentals. It was nothing I wanted to publish.

What I left out was the hard truth. At the time I hadn't yet faced it. I only knew how to buy and sell stocks. I wasn't yet aware that buying and selling is only 1 percent of day trading.

Eventually I came to see that almost anyone can go online and learn how to buy and sell, within a few measly hours. And that making *consistent* profits is something else entirely.

I was zealous to learn to successfully day trade, and as I've described before, I saw that my zeal was my problem. My eagerness and overexuberance were blinding me from the truth. The truth is that the stock market is like a merciless shark, digesting its dinner and not caring about *me*.

Day trading is a little like car racing. Both are intense and hair-raising, and both require much rest. You the day trader are like the NASCAR driver who learns how to speed to a 500-victory and not wreck his car or himself. Both of you must be deeply prepared, before every race or each trade, because what you've done during your downtime will directly impact your performance, whenever you dare to return.

After my first time off, which followed the loss of my first house, I began to understand that day trading is more than watching chart patterns and forecasting fundamentals. After all, if it were that easy, college campuses around the world would have day-trading courses and majors.

Please don't get me wrong about this: By taking a break I never mean that you're moving in the direction of quitting. I'm actually suggesting the opposite: During your time-outs, you should remain very acutely involved.

I didn't trade during my downtimes, but I continued to monitor the market. I studied the stocks' movement in conjunction with news and economic announcements. I got even more involved than before, in spite of my backseat position.

My time-outs grew into sabbaticals. My breaks became my chance for regrouping. They were also my times to heal. They were sojourns when I went deeply inward, to examine my day-trading faults, and to discover the ways I could strengthen my skills.

So many times in the past, I'd blamed the market for my misjudgments. Take, for example, the Enron debacle, my largest loss to date. Back in early 2001 I purchased 80,000 shares of Enron. I remember buying when it hit low at $1.00; a lot of Wall Street brokers did the same. The big bad news (you remember that nightmare!) came out the very next day. The stock eventually crashed down to less then 30¢ per share.

So I lost over $55,000 in no time, because I was an amateur.

In that case, that landmark, infamous case, it was easy to fault the market. But in truth, it was I who had screwed up. Here's why.

During my time off I did a little research. I found out that most of the people who lost on Enron were independent investors, along with the unfortunate Enron employees who had company stock in their 401(k) retirement packages.

The reason that the stock dove so sharply is that the Wall Street day traders, who purchased the stock at $1.00 when I did, knew enough to sell it when it dropped to 90¢ with incredible volume to the downside.

What happened over the next few days was disastrous for me, of course. But for the savvy Wall Street day traders, it was business as usual. I had thought I was smarter than Wall Street. When Wall Street began selling, I **held** my shares, overconfident. I believed that the price would go back up.

Well, I know better now. Basically, there is no conspiracy. If you lose on a trade it's simply because you didn't see the signs.

Those Wall Street day traders saw the signs. They bought Enron at $1.00, sold at 90¢ cents, and only lost 10 percent. I, on the other hand, **held**, all the way down to almost nothing.

My fault, my fault.

During the break I took afterward, I agonized over how Wall Street knew to sell at 90¢, at a loss. I discovered the basic strategies that Wall Street day traders live by. I'll state it here very simply: they're masters of risk management. I elaborate on that mastery in Chapter 6, "The Importance of Risk Management." Also, they have billions of dollars to invest, intraday. This is why you see huge swings on an intraday chart.

The challenge for the independent day trader is to learn how to ride on Wall Street's coattails. I can't stress that point enough. Whenever you take time off from day trading, you must stay in touch with your stocks. You can learn so much from simply watching how the stock prices fluctuate, intraday.

This doesn't mean that when you return to active trading, you'll be ready to roll with the big boys; but staying involved is a start.

If you think you can totally disconnect, totally ignore the market, and return when your pain of losing has passed, and if you haven't learned a thing while you've been gone, then you're setting yourself up for another big fall, caused by repetition of mistakes.

Let's get some basics together with regard to this "taking a break" thing. Like, just *when* and *why* should you walk? And most importantly, *what*, exactly, should you do on that time off?

I'll begin with the *when*.

BREAK WHEN YOUR CONFIDENCE IS LOW

The time to take a break is when you've lost all your confidence. Because of your sagging self-assurance, your system of trading has been demolished, and you find yourself way too emotional.

If you're slapping the side of your computer monitor, then by all means get out of there. If you're so stressed out that you're taking it out on people, even the people you love, then you obviously need some downtime.

But even if you're a whole lot calmer than that, there may be other indicators of how badly you need to walk. If you find yourself constantly changing your strategies, especially intraday, then you need to immediately recognize that you're getting confused and scared, and it's time to cease and desist.

Accordingly, if you're only trading in order to regain yesterday's losses, then you're fueled by sheer desperation, and again, you should get away.

Here's some good news, however: Most of the problems you're having are psychological, and they can be repaired.

Now I'll go into *why* you should walk.

BREAK BECAUSE IT'S JUST NOT WORKING

The main reason to take a break is that your current system's not working. You need to back off, and regroup. In day trading, taking a break is never the act of a loser or a slouch. It's not any sign of incompetence. On the contrary, it's part of the day-trading process. Everyone takes a time-out at least once—it's absolutely crucial to do so. How can you handle the pressures and pitfalls of learning to day trade consistently, without taking breaks to gauge your performance?

Everyone makes mistakes day trading, even the Wall Street experts. Their errors can cost millions, and so, just like the amateurs, they walk sometimes, too.

Time-outs are much like when you were a kid, and your parents told you not to hit. "You should walk away and calm down," they wisely admonished.

Taking a break takes off pressure. Your emotions begin to subside. You can bask, for a while, in a sense of relief. Once all those panicky emotions are no longer controlling your thoughts, only then can you recuperate, and intelligently work out your kinks.

Okay, so let's move on to the *what*.

BREAK AND THEN WHAT?

What do you do on your time off? For one thing, you rebuild your self-confidence. *Overconfidence* most likely got you into this trouble, and now you've completely one-eightied: Now you've lost so much money that you're shut down and afraid.

What you need to do, first, is brush off your mistakes. View them as surmountable obstacles, and never as signs to quit.

But wait a minute, you might want to say to me. While reading this chapter on taking a break—on stopping, desisting, and resting—maybe you're thinking: *This is crazy. I can't just seize up, fall down all defunct, and shuffle off to some mental rehab.*

Who does this guy think I am, you want to know. *One of those trust fund babies? I've got bills to pay!*

Believe me, I understand. I would be blowing steam in your face if I didn't consider the need to pay bills, not to mention eat. We day trade with money in order to make more money, because we really need more money! So I know how tough a decision it can be to just *stop* trying to earn.

But here's the thing. After each episode of taking a break (usually a week or two), I returned with a much better mindset, and my trading performance improved. That's when I realized that having no income, for just a short, purposeful time, is better than continuing to trade at a loss. I realized that I should internalize time-outs as part of the process of becoming successful.

Here's what to do to get through it:

First you should remind yourself that you're a beginner, and admit that you have much to learn. How fast you progress past amateur status depends on your trading frequency. If you're only executing one trade per day, then you're not day trading like pros. You should execute at least ten round-trip trades per day. Then you'll have enough samples for statistical significance when you gauge your performance, during breaks.

Frequency of trading is the key to success. If you've been making just one trade per day and winning every trade, that's great, but how much are you making long-term? That you made a lot on that one trade means either of two things: you purchased a lot of shares in one trade, or you got extremely lucky because the stock shot up in one day, and you **held** all day, then sold before the close.

Good luck keeping that up.

Another risky system is habitual overexposure. That, as addressed in Chapter 7, "How Overexposure to the Market Can Hurt," is day trading stocks with huge share blocks of 1,000 or more at a time. A word to the wise: Most day traders on Wall Street usually purchase only 100-share blocks at a time. Just watch any Level 2 table and you'll witness the actual trades in real time. In case you were not sure, a Level-2 table displays streaming and real-time bid and ask quotations on any given stock. This allows for transparency in market prices: You can watch the trades being executed right in front of you.

In Figure 5.1 I show an actual Level 2 quote chart.

The quantity column in Figure 5.1 shows real-time orders. Most of them are in 100-share blocks (as indicated by the arrow). You don't usually see any orders over 500 shares. Most execution orders are based on the most current bid and ask price.

When you're trading consistently and frequently, you're likely to do very well. But once you become routinely inconsistent, that's when it's time for a break. Take that break, and tell yourself it's normal. Don't allow your ego to dictate that it's not. Nobody gets rich overnight in this career that requires so much skill.

Second, have a good budget or even another job. The advice offered in Chapter 8, "Budgeting: Knowing Your Financial Limitations," will get you through the time-offs.

Bank of America CP

Enter Symbol **BAC**

HI	**32.80**	CHG	**–2,28**
LOW	**30.50**	CHG%	**6.91%**
LAST	**30.68**	VOL	**69,911,280**

Qty	MM	Price	Qty	MM	Price
100	ISLD	**30.67**	100	ISLD	**30.68**
200	ISLD	**30.66**	100	ISLD	**30.69**
100	ARCA	**30.65**	100	ARCA	**30.70**
100	ARCA	**30.64**	200	ARCA	**30.71**
400	ISLD	**30.63**	400	ISLD	**30.72**
100	EDGX	**30.62**	100	EDGX	**30.73**
200	BATS	**30.61**	300	BATS	**30.74**
100	ISLD	**30.60**	200	ISLD	**30.75**
100	BTRD	**30.59**	400	BTRD	**30.76**
200	ARCA	**30.58**	100	ARCA	**30.77**

FIGURE 5.1 Level 2 Quote Chart

Such planning and budgeting require the trait that encapsulates this book's major theme, that personal tool called self-discipline. Build it, own it, and use it. It's you making yourself work. It's you getting the most of your on-the-job training, and also your time-outs. It's you holding down that day or night job if you have to, while you learn and grow as a day trader, taking the necessary breaks.

Even if you're wealthy, and you don't have to work, and you simply add cash to your trading account whenever you lose big, you need to take a break when your gains go south. Affluent friends of mine have lost insane amounts of money simply because they let their egos get the best of them, and they never took off to seriously ponder where they went wrong and how they could improve.

Rich or poor, seasoned or amateur, make sure that you take those breaks!

Use them for stock research. Go back to every trade you've done and scrutinize each one. Find your strength and weakness points. Ascertain your primary issues.

For instance, are you only losing on trades that you average down on? Or are your biggest losses the ones that you **held** overnight? Whatever you discover, focus on it. Then you'll see, as clear as the daylight, that you should *just stop doing it.*

Yeah, right.

I'm chuckling right now. I know it's not quite that simple. In my early trading years, I knew that I had to stop **holding** overnight, but I kept on doing it anyway. I did it because the stock price had not gone up by the end of the day, so I figured I had another day—another chance—if I just **held** that long.

That's a very common amateur blunder, not to mention poor strategy. At one time or another, most of us have been guilty of it. And if you, the reader, are a very new trader, then I suspect that no matter how much I warn you not to do certain things, sometimes you just might anyway, and learn the hard way like us all.

And that's why we all must withdraw, and reflect. Any time we recognize a pattern of trading mistakes, that's when we should take off.

I define the time frame for "pattern of mistakes" as one full trading week. If you're trading all day long for five days straight and you're in the red every day, then you definitely need to regroup. Don't go thinking your luck will simply turn around next week. That kind of mindset might influence you to start gauging your performance on only a monthly basis, and that's not often enough.

Technically, your "break time" is every single evening, after the market closes. That's your time to recap your daily trades, and plan for the next day. Accordingly, you should determine your performance levels *daily*.

Yes! We do need to do homework.

I'm not suggesting, however, that you should take a time-out after just one bad day. But if by the end of the week you're persistently unsuccessful, then you should take the *whole* next week off. Sit on the sidelines, think it all over, and transform your trading style and behavior.

Day trading is a never-ending learning process. Don't be discouraged when, after you return to your trading, something *else* stops you from profiting!

Not everyone is cut out for this high-stress profession. You may like the stock market and enjoy buying and selling equities, but that doesn't make you a day trader. You'll know that you're a true day trader if you keep coming back and keep on improving because day trading is a process, and that process requires you to continually evolve.

RULES TO REMEMBER

- Don't take time off just to get more cash.
- Gauge your performance at the end of each trading day.
- Log in the reasons why a trade went wrong.
- When things get consistently inconsistent, stop and take time off.
- During your time off, actively research your mistakes. Mentally prepare yourself for the return.
- Plan a budget for the inevitable—the time offs.

PART II

The Truth about Your Risk

In terms of the potential for heavy financial losses, day trading is a high-risk profession. No one should contemplate day trading without giving thought to the ways he can lose, and all the ways to lessen or avoid them.

I've elaborated on the primary areas of risk. This part offers some vital techniques that can greatly minimize losses. Risk management and budgeting are deterrents to gambling, which day trading must never become. My goal in this part is to have you come away understanding how to budget for training, and also how to decrease your risk.

CHAPTER 6

The Importance of Risk Management

The higher your skill level, the better you are at protecting your capital from taking huge hits. Along with that key capability, you typically trade in the green. So the big question is, the only question is, how in the world do you get there?

In day trading, it usually boils down to how well you manage your risk. This amounts to some educated guesswork. You figure—you try to very nimbly figure—just exactly when you should use your funds, and how much to risk at a time.

The subject of minimizing risk is so hot that it could fill several books on its own. It could dominate the five-day live training programs—and I've been shocked to find out that it doesn't. Though all of the programs and seminars I've attended have somewhat conveyed the hazards, I feel that they've failed to teach amateurs precisely how to avoid them.

To be frank, I'm disgusted by the inadequacies I've witnessed. At those vital hubs of instruction, risk often isn't even mentioned until the very last hour of the very last day.

I've been bored by advisements on the obvious, like: "You should never trade money you need."

Duh!

Here's one so brief and deficient that it really gets under my skin: "Know your limitations and stick to them."

That's like telling a toddler to stay in, and not bothering to explain to him why, and then leaving the front door wide open while you nap and he's wide awake.

Likewise, instructors warn of day-trading dangers, but they neglect to present any practical guidelines for building trainees' skill in risk reduction. They toss their enrollees some vague platitudes, and then they send them into the real trading world sorely lacking in any real knowledge of how to use vital precautions.

I actually think that's criminal. I intend to right that wrong. For starters, this is the main point, and I urge you to keep it in mind: the potential to lose big in day trading is an ever-present threat, and strategies for decreasing that potential must be part of your trading style. They must bolster your trading psychology.

The following are predominant factors of risk:

- The amount of trading capital allocated to each trade
- The timing for allocating capital to trade
- Overexposure to risk
- The stock or company you're trading
- The time of day you're trading
- Gambling

Now I'll elaborate on each factor and on ways to reduce or totally avoid the losses that can result.

THE AMOUNT OF TRADING CAPITAL ALLOCATED TO EACH TRADE

The question of just how much money to use, combined with the myriad options regarding just why and when, is the core of all investment strategizing. We're expected to have this stuff down like the pros.

Well, do we? *Can* we? Let's address those qualms first.

When it comes to stock market professionals, you have investment managers with doctorates in finance, and hedge fund managers who handle multibillion-dollar portfolios. All of them struggle with the perils of risk, and all of them astutely maneuver.

How can we, the independent traders, possibly know what they know?

Good news! Our challenge isn't nearly as formidable as the one that the Ph.D.s face. We have a few major advantages.

We only have to focus on money that's *our own*, and we can choose to deal with only one, diminutive trade at a time. Our money is usually in just one account, and it's comparatively easy to calculate the balance on an intraday (not long-term) basis. We almost never **hold** a position overnight, and we usually trade small positions (under 1,000 shares).

Those conditions, which amount to only having to watch out for ourselves, mercifully set us apart from pro investors.

So now you might ask, how much of my trading capital should I allocate to a trade?

It depends. In response, I'd ask you this: *What's your skill level? How long have you been trading that particular stock? What's your threshold for stop/loss amount, per trade?*

If your answer indicated to me that you're a beginner at day trading, I'd dictate a rule of thumb I've enshrined, torn straight from my tale of hard knocks:

The amount of shares you trade in one particular stock should equal your sustainable risk.

Your reaction to that rule might go something like this:

If my stock price fluctuates 50¢ every five minutes or so, and I can afford to take a $500 loss on each trade, then it's okay to trade in 1,000-share blocks, right?

My reply to that would be instantaneous! The volume of my voice would get louder! I'd tell you *that may be true in theory, but don't put it into practice!!* I'd say that you, as an amateur, do *not* possess the skill level needed to deftly handle such losses, especially when they can happen every five minutes, all day!!

I would urge you to take this advice: *only trade in 100-share blocks.*

I've stated that before, in the previous chapters, and I feel I can't stress it enough. Once you establish that maxim, your risk will be minimized, and besides that you'll find that it's always a breeze to come up with a capital value. For instance: if your stock is priced at $50 per share, then in order to invest in the trade, you'll only need $5,000. You won't have to worry about ratios and percentages, as in what amount of your investment money to allocate to which stock, because lowering your exposure to the risk by trading in 100-share blocks has made such calculations unnecessary. If you don't have $5,000, all you have to do is find a lower-priced stock.

Your next question might be: *When* do I allocate capital to a trade?

THE TIMING FOR ALLOCATING CAPITAL TO A TRADE

The issue of when is a bit more complex. Suppose you have enough capital to purchase 20 trades at a time, when trading in 100-share blocks. With $100,000 in buying power (trading capital), this would be easy to do. But what does that mean? Should you purchase 20 stocks all the time? Certainly not! You need to know your personal limitations. Every trader has different thresholds and tolerances to risk. For instance, some traders only trade one stock all day, placing over a 100 trades. Other traders like to deal with several stocks all day, and place only a handful of trades on each one. It's all about what you feel comfortable doing.

Once you get a feel for the stock you've been trading—a real sense of knowing how it moves—you can eventually start trading it in 200-share blocks, and gradually increase to 500. Everything depends on your skill level, and how quickly or slowly you grow there—and that's where I urge cautious treading. Chapter 1, "Truths About Yourself to Know First," is placed at the beginning for that very reason. Knowing your skill level *before* you increase your risk is the biggest point I'll ever make; I make it emphatically there, and I don't mind repeating it here.

The average independent day trader, trading for primary income, is aware of the amount he needs to make daily, and of what he can afford to lose. Though no exact science exists out there for negotiating the hazards, especially for independents, I'd bet that limiting exposure to each and every trade eliminates nine-tenths of risk.

Hence my clear directive to trade in 100-share blocks: When you doggedly (if with boredom) stick to that rule, you may not make as much as you want to in a day, but you certainly won't lose a lot, either. As an amateur, that's all you should venture. You're also not likely to lose very much if the amount of your risk taking parallels the rate of your gradual skill.

OVEREXPOSURE TO RISK

For *all* the lowdown on disasters that can happen when you're overexposed, make sure you tune in to Chapter 7, "How Overexposure to the Market Can Hurt." For now I'll just offer a word or two about it—but notice my urgent tone!

As I've shown in the section on emotion, it's easy to know when you're overexposed because you become stressed. Maybe you're safely trading in prudent 100-share blocks, but just the same, your nerves feel shot.

Well, I'd bet the farm that the reason for your angst is that you've let the price drop past your exit point (stop/loss), and now you're sitting there **holding**. You're sitting there praying it will go back up. That's a typical beginners' fiasco.

My advice here is simple: don't do it again! Whenever your stop/loss price hits, you should exit. Just take the loss and move on. It should only be a small loss of $25 to $50, and you can get that right back. Remember, you have all day.

That's only one cause of overexposure. The other causes are: choosing to trade in more than 100-share blocks without first trading in 100-share blocks; trading several new stocks at once (and by "new" I mean unfamiliar); and attempting to trade in premarket and after-market hours.

Anytime you feel as though you're losing control, most likely you're overexposed. To minimize your risk, you should minimize your exposure, always, in every trade.

THE STOCK OR COMPANY YOU'RE TRADING

Most would assume that the greatest risk of all is the chosen company itself. Well, we day traders don't have to go there. We don't have to get ourselves bogged down in company analysis and earnings forecasts. We only need to know what's transpiring on *that* day.

With that said, however, there's another point to make, and this is essential in day trading. Each stock *does* come with different risk levels, depending on the company you're trading intraday. For instance, if a stock is affected by government regulations, then it might just drastically drop in price, right when you're sitting there trading it. For example, an announcement might go out, right then, intraday, that Congress has just passed a strict new law that devalues the company's product.

So when you consider that kind of risk, it becomes obvious that your chosen companies should be able to boast the following:

- Little chance of regulatory processes that might affect the product, as in antitrust laws (for example, Microsoft), and FDA rulings on biotech products.
- No chance of filing bankruptcy soon (as with Enron and WorldCom).
- No chance of an employee strike taking place, as in the airline industry.

See Chapter 14, "Stock Picking: Simplifying the Process," for details on the process of choosing the stocks best tailored for intraday trading.

THE TIME OF DAY YOU'RE TRADING

This risk factor is pretty straightforward, and so is its management.

Premarket and after-market trading are too chancy. A lot of volatility occurs at those times, and besides, when it's too early, you haven't yet viewed the development of the current intraday trend.

Have you noticed how, in the first 15 minutes, from 9:30 to 9:45 A.M., the market trades fast and crazy? The rule here is *don't trade until after 9:45*. Not until you're very highly skilled.

Also, right around 3:00 P.M., when the Futures and Treasury markets stop trading in Chicago, the stock/equities market picks up volume. This part of the day can be very unpredictable. You may have been in rhythm with your stock all day, and then, at the hour of 3:00—, whoa! Suddenly your stock movements become completely erratic!

This is a great time to simply stop trading, or at the very least, to limit your exposure.

During certain times of the day, most stocks react the same way, especially the frequently traded. The key to decreasing the time-of-day risk is to know your stock very well, particularly how it trades daily. The longer you trade your stock, the more you will know its price movements and rhythm, and the better you will be at perceiving exactly when to bail.

GAMBLING

In Chapter 11, "Gambling versus Day Trading," I elaborate on the big differences between casino-hopping and day trading. Here, I'll be brief but emphatic.

If you have a strict risk management system and then you abandon it, I can assume that essentially, you're gambling. When you go that route you're *failing to use* some vital strategic options. They are:

- Subtracting money (lowering your exposure) if the price goes against you
- Predetermining your stop/loss and limit prices
- Adding more money as the stock price goes up
- Changing stocks
- Intraday **holding** until it retraces (note: this is only for experts)
- Averaging-down your position (also only for experts)

Whenever you gamble as a day trader, you've put yourself at the mercy of the market. You're praying that the price action will favor what amounts to your roll of the dice. Your plan, if you can call it that, is to **hold** until the price retraces, and if it doesn't, you're in trouble.

If you're willing to take that kind of risk, then you're not *managing* risk. You're trading like a crazy person! You're trading just like a degenerate gambler who's placing wild bets at casinos.

In a nutshell, risk management boils down to your skill level. The more you experience risk, the more you master your tolerance for it. This is why the low-risk (low exposure) trades are crucial: you learn without getting killed.

It takes time and patience to acquire expertise. As an amateur, the key to minimizing risk is to think small and trade small at first. Eventually you'll understand the nature of your risk, and you'll deal with it expediently.

The ultimate goal of a professional day trader is to wheel and deal in a high-risk environment without *ever* losing his shirt. This is when the real money flows to you. But for now . . . patience! Take tentative baby steps. . . .

RULES TO REMEMBER

- Trade only the amount of shares, in one particular stock, that won't exceed the risk you can handle.
- If you're an amateur, always trade in 100-share blocks.
- If you're feeling stressed, get out of the trade.
- Until you're highly skilled, don't trade until after 9:45 A.M.
- Practice learning your tolerance levels in low-risk (low-exposure) trades.
- Never overexpose yourself in any of the ways we've discussed.

CHAPTER 7

Why Overexposure to the Market Can Hurt

Exposure to the market usually refers to how much you can afford to lose. Overexposure occurs when you're not prepared for the losses, and in some cases, even the gains. Overexposure can indicate that you've purchased too many shares at one time, and you're not yet used to the swings and the rhythm of the stock. Overexposure can also mean that you've purchased a stock at the wrong time, as in premarket or after-market, and uncertainty is dangerously high.

In the rare circumstance of the trader who enjoys unlimited wealth, it doesn't matter much to him if his stock price plummets. Because he has no pressing financial concerns, he's never overexposed.

If you're reading this, however, I can bet my life you're not him; neither you nor I will ever indulge in his carefree, cash-burning capers. We and the other struggling hopefuls on this planet are consumed by the quest for more money, and the fostering of a personal tolerance level to the losses that hit us like bricks. Some of us would rather deal with our losses at the end of the trading day, and some of us prefer to recognize them after every trade. Either way, overexposure is an intraday threat that we have to learn to manage.

Suppose you've been trading a particular stock all day, and you've gotten into its rhythm. You've been trading 100-share blocks the whole time, in and out. Overexposure happens as soon as you choose to purchase more than 100 shares at a time, or if you begin averaging down.

There may be something more than simple financial exposure going on. You may be creating a sort of mental overexposure when you give in to your temptation to hazardously stray from a tried-and-true, "bulletproof" strategy. To swerve like that from your system, especially mid-day, is a risk you shouldn't be taking. Your system is based on the exposure you're used to, and that's where you should stay.

If you've been trading 100-share blocks all day, then you're comfortable with the price swings, and how those swings affect the margins for profit and loss. As soon as you add exposure, however—by way of more shares or more highly priced stock—then you've just become overexposed.

I mentioned in the first paragraph of this chapter that overexposure can happen when you buy stock at the wrong time. I believe that bad timing is the worst of the pitfalls that torture amateur day traders. Eventually, however, time teaches.

TIME VERSUS TIMING

Time is a term with several different applications.

Time, when understood as amount of experience, can conquer overexposure, because after you've gained familiarity with the share blocks you're trying to handle, what was once a scary minefield is now your norm, your safe haven.

But in the market there's another meaning of time. It's simply the time of day. During different points in the day, you can expose yourself to more risk.

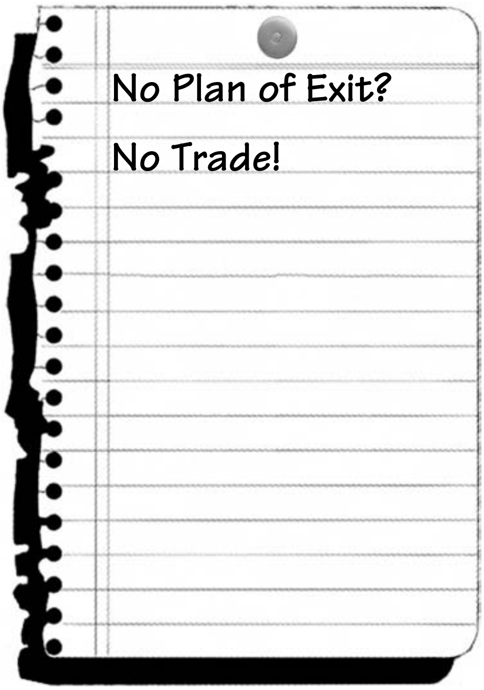
I'll never forget the times I lost big while trading in premarket and after-market. And also when big news was developing, and I was in a trade just before. Trading premarket and after-market has benefits, of course; like when you get in before the big move. That's a very tempting situation, and hence, very hard to resist. But that's also when you can lose so much that you still cringe from the memory, years and years down the road.

I'm not necessarily saying that you should *never* trade premarket or after-market, or that you should *never* trade in tandem with relevant news and announcements. Right then you can trawl for a lot of easy money. But watch out: You're overexposed. You're diving into treacherous seas. You might as well be gambling.

If you're going to jump in over your head, then at the very least you should lessen the danger by limiting how many shares you buy, as in 100-share, not 1,000-share, blocks. That avoids overexposure, because when you trade prudently, then you're only exposed to the market risk that you've proved is tolerable for you.

For instance, if you know that you're going to sell at a loss when the price hits a certain level, then all the risk you're exposed to is an amount that you've prepared yourself for, in the event that the price goes against you.

You should *always* have a plan of exit in place, *before* you enter any trade. This point is obvious yet hard to apply, and so I've thought up a rule. Commit this rule to your memory. But no, do better than that. Write it in rainbow magic-marker colors on a big chunk of white posterboard, and tack it right over your desk.



Yeah, write it up just like that. Then patent it and sell it, because every trader needs it, and you could get rich just selling that proverb.

It doesn't matter whether the price spirals up or down: You should always know when to sell. All you need to know are two specific price points: the one to sell at a profit and the one to sell at a loss (see Figure 7.1).

The price levels of $49.50 and $50 are example levels that you should buy or sell when the price reaches that level (it varies depending on if your position is short or long). The gray areas of Figure 7.1 represent the overexposure zones. If you **hold** past your predetermined exit price, then you're trading without a plan of exit. This exercise separates gamblers from day traders.

Never forget that those price points *are* your exposure levels. As soon as you slide past them, you're overexposed and gambling with your money.

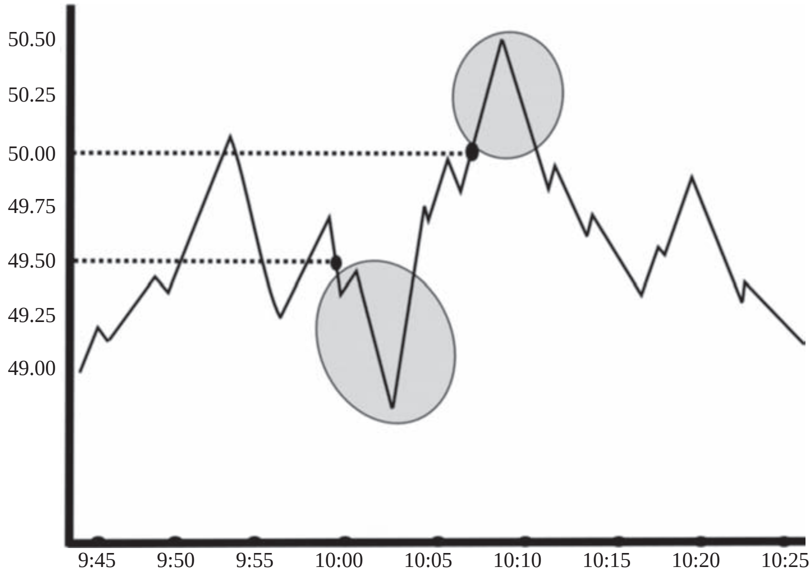


FIGURE 7.1 Intraday 5-Minute Chart

Even when you **hold** past your exit price for profit, you're overexposing yourself. This means that if you become used to **holding** past your price point when it goes into the green, you're slathering yourself in that deep mental quagmire we've identified as the greed factor.

As soon as greed loosens your exit points, you're no longer trading with a plan.

You need to get accustomed to making or losing a certain amount of money on each trade. I can't stress that point enough. I know that selling your profits short sounds rather counterproductive, but all it takes is a few episodes of breaking your protocol and losing, and then you'll understand what I'm saying.

Self-discipline means avoiding the consequence of overexposure to market uncertainty. Here's an example of the need for that avoidance from my own regretful experience:

I was successfully trading all day with Pepsi Inc. (PEP). I'd been trading 100-share blocks (with a pay-per-share firm) and making an average of \$12 per trade (loss and profit). I had about 30 trades so far; 25 were in the green and 5 were in the red. I was up about \$240 for the day ($25 \times 12 =$ \$300 and $5 \times 12 =$ \$60).

It was around 1:30 P.M., just after lunch, when I decided to change my system. I began to purchase 200-share blocks. My first trade went smoothly.

The price quickly went up 10¢, so I made $20 (200 shares at 10¢). I continued trading with 200-share blocks.

Then everything went south. My first adverse position happened so fast that I didn't have time to sell at a 10¢ stop/loss ($20 loss). I got scared, froze up, and waited for it to retrace, but it never did. The price continued against me. The price dropped another 50¢ before I came to my senses and placed a stop/loss. I lost 70¢ on the trade (200 shares or $140). Most of my profits for the day were gone, and I dejectedly slumped in my chair, feeling stupid for switching up after lunch.

I had much to learn from my mistake. Though I was no longer a beginner, I still struggled with consistency issues, and I lacked a complete understanding of the effect of overexposure.

With chagrin I recall my dumb rationale for increasing my shares to 200. I figured I was up over $200 and I could afford $20 losses. What I didn't anticipate was the increase in *volatility*. I should have been more mindful of the fact that there's always volatility, and the more exposure and more shares you have, then the more volatility you're dealing with.

Earlier that day I had been in a trade for about 30 seconds at a time. That particular stock, PEP, took about 30 seconds to move 10¢, which meant that my 100 shares would become a $10 loss or profit in about 30 seconds. I was accustomed to that intraday timing, I was comfortable with its price swings and rhythm, and I didn't think that doubling the shares would make much difference at all.

But two things went terribly wrong. First, I was unprepared for the volatility boost when changing from 100- to 200-share blocks. Second, I was still at a point in my know-how where I allowed my emotions to control me. I **held** the fallen stock, which was falling with twice the impact I was used to all day long. I broke down completely, and was totally at the mercy of the market.

Please understand that I'm *not* advising you to *never* go ahead and buy 200-share blocks; not at all. I'm establishing the importance of being consistent when dealing with the issue of exposure. I'm showing how consistency, or the lack of it, directly affects your ability to master your performance, when exposed to market uncertainty. As soon as you change your familiar routine, if you don't give yourself time to adjust, you're overexposing yourself.

Whether you choose to trade in 100- or 200-share blocks, it only makes a difference when you *increase* the share volume, or trade a more expensive stock. This means that you can choose to start off trading 200-share blocks, and you'll get used to trading in that volume. But when you decide to increase the share size to 300 or more, you should start it fresh in the morning, and you should have paper-traded it for at least a few trades to get a feel for the swings and the rhythm.

If you want to trade larger share blocks, then I suggest that you begin with stocks of half the value. For instance, if your goal is to trade a $50 stock in 100-share blocks, then first trade a $25 stock in 200-share blocks.

The point is that the day trader should never try anything new—not share sizes, stock prices, or a different time of day—until he has practiced his strategy in low-exposure trades first.

In conclusion, the key to avoiding overexposure is to first take the *time* to create consistency in low-exposure environments, and then gradually work your way up. For more on this strategy, see Chapter 19, "Trading for Skill versus Trading for Income."

RULES TO REMEMBER

- Always trade stocks that are new to you in amounts no larger than 100-share blocks.
- Until you're consistently profiting during regular hours, avoid premarket and after-market hours.
- When you're feeling completely lost and are most likely overexposed, apply stop/loss immediately.

CHAPTER 8

Budgeting: Knowing Your Financial Limitations

In day trading, there's the ever-present potential to make a fantastic income. But you could also lose everything, fast. Avoiding big losses takes frugality and patience. I know my tone might crash and burn your dreams of professional grandeur, but there's really no way around it. I feel that my job is to tactically slow you, to help you stay financially safe.

For the beginner in day trading, the management of finances is two-phased. The first phase is all about floating your boat during your full-time training. The second is all about later on, when you're actively trading for income and you need a reliable cash flow.

I'll assume that before you started reading this book, you already had some knowledge of day trading. Most likely you looked at the subject online, and you purchased several good reads. So far, maybe that's all you've spent on it. Most likely you've still got your day job. You haven't yet taken the plunge.

I'll also assume that at this point, you're ready for some serious training. Well, before you do that, you need a budget. I'm talking about a budget that keeps you afloat during *live* trading, while training. Because even when you get to where you can safely trade with real money, you're basically still a cadet. Even if you've done more than buy a few books—even if you've dished out thousands of bucks for a week-long day trading program—you're still a rookie, deep in training, and you need a trainee's budget. (Refer to Chapter 16, "About Training Programs," for more thorough revelations about that.)

Remember this distinction about training: when you go live for the first time, you should view yourself as someone who's still a trainee, *not yet* an amateur day trader. Because if you think you're going to earn much during your first few months, you're in for a rude awakening.

And now make another distinction. Ask yourself this question: which kind of trainee am I? A rich one or a poor one? If you're not in the wealthy category, then you're definitely feeling the crunch. Accounts with traditional online brokers require at least $1,000 dollars to start. And later, it will get a lot worse. When you're ready to bravely go to bat with any of the pay-per-share firms, these days they usually require a minimum of $25,000.

Maybe you're feeling the bite even more, because you've paid for a training program. Did that endeavor clean you out? Did it gouge away your life savings? If so, then you've got to prepare yourself for all the new hurdles to come. You need a carefully tailored budget.

To the well-off guy or lady with a huge hefty cushion who doesn't have to be a wage slave or a tip-chaser and can easily shrug off a job, I'd still offer frugal advice. I'd say try not to lose gory chunks of your wealth. I'd advise you to train in small share blocks. You might scoff at that; devastating losses don't scare you. But can you afford the mental anguish and embarrassment when you're trading too often in the red? Your main source of pain is your ego. To offset that pain you should train just as if you're on a very tight budget, like the rest of us.

To the rookie, rich or poor, my advice is the usual: Don't trade in more than 100-share blocks.

DON'T QUIT YOUR DAY JOB: CATCH-22

Now I'll get back to the financially deficient, a category that includes many more people than the other categories. I'll begin with the obvious. Make sure you don't quit your day job!

I know I sound just like your skeptical friends, or else your nagging mother. Wasn't it somebody just like that who immortalized that insult?

Most of you are holding down day or night jobs, and you do have to watch your wallets. And you don't need me to tell you. What you might need me to tell you is this: being monetarily average doesn't necessarily mean that you can't get your feet wet in day trading. You just have to be creative and careful.

But creative and careful may not be enough. There's a major Catch-22. You need to pay bills, but you also need time for active day-trading training. So right about now you'd ask the obvious question: If I have to traipse off to a job every day, and working nights isn't an option, then how can I train as a day trader? Argh!

My answer returns us to the main point: budgeting. You have to plan for time off from work. That means you have to have enough money saved to pay your bills during that period. A three-month leave is about what you need, if you're going to train all alone. But if you take advantage of my mentoring, then the time it takes for you to gain expertise will be cut by about two-thirds. Over the course of about a month's time, you'll learn to trade safely and profitably. (Refer to my website, www.DayTraderJosh.com, for more information on my mentorship program.)

The amount you'd have to budget would be gauged by your training time frame. In order to train by yourself, you'd need to free up about three months. If $5,000 dollars a month is what you require to feed the relentless bill monster, then you'd have to have $15,000 saved up. If you trained under my mentorship, then you'd only have to budget for one month off from work, and you'd need only $5,000 saved.

If you couldn't get an authorized leave from your job, and you didn't know whether the job would still be there if you decided to return, then you'd have to have another job firmly lined up. Otherwise you'd have to be certain that day trading is it, that there would be no turning back, and you'd have to be determined to learn how to keep yourself firmly financially safe there.

Don't expect to make much money during your training time, whether you're alone or training with me. If you have nothing saved then you'll likely find out that some of your bills won't get paid—certainly not from your trading! If you need $5,000 per month, then you need to *consistently* make about $225 per day trading, and that's *after* you deduct taxes. As a trainee you'll be trading in very small amounts, only 100-share blocks, so realistically you won't make any more than $150 per day, and you can bet your life it won't be consistent. Your time spent as a rookie is for learning, not earning. You should view it as a full-time college semester.

During my first three years of day trading, I went through a miserable cycle. I would trade for a few months and either break even, or I'd lose a lot. As soon as things got too crazy, I would go back to my job.

Upon reflection I realized that I repeatedly failed because I didn't see my comebacks as training and progress. I saw them as last-ditch chances to get back the money I'd lost. I was focused on making money, not on learning from my mistakes. I was desperate!

That's why your prior training period is crucial. I can't stress that enough. It will prevent you from edging too close to the holes that sucked me down into hell.

You'll recall from Chapter 1, "Truths about Yourself to Know First," my point that it's essential to be totally committed, in other words, to trade full time. In order to be a full-timer, you need to trade five days a week. Otherwise, your skill level will fail to grow as it should. You *won't* become successful at day trading by placing a few weekly trades from your current work place computer. You *won't* get the in-depth experience required to make you professional.

I'm not saying you shouldn't be placing trades ever, in your free time, at work. That can be a great way to start out, and if you get lucky and make a little money, you can allocate the proceeds to a carefully planned budget for training full time.

Okay, let's say now you've finished with my one-month mentorship program, or you've finished that three-month stint by yourself, and things have gone really well. You're ready to evolve from active live training to active live amateur day trading. You're just like a newly certified teacher, fresh from the halls of academia. You're ready to become a professional, but you're green as leaves on a tree. You're ready to use day trading as your primary source of income, but your lack of experience in the real world is sure to make your path rocky.

Along with this, your debut in professional day trading, your budgeting now must change. Chapter 1, "Truths about Yourself to Know First," and Chapter 13, "Trading Consistently All Day," nail home the importance of learning to be consistent before you try trading for income. During your training period, you should have mastered strategic consistency. You can now put together the second budget phase, which amounts to another type of consistency, the very strict management of income.

CRUNCHING THE NUMBERS

If you've been profiting an average of $250 each day and limiting yourself to $100 losses for each day, then you can start depending on that. This is performance-based income, after all. You're in charge.

I like to gauge my performance on a monthly basis. If I have a bad day, I don't get too stressed about it, though I do have a daily limit for both profit and loss. What matters the most is that I meet my monthly quota. If I fall below my monthly budget, then I step up my efforts. Determining my monthly profit/loss is simple. I always have a minimum amount in my account. Whatever exceeds that amount is my profit.

On every first of the month, I complete my monthly budget. I simply take the base amount (the minimum requirement or more) and subtract the total account value. So if I have $25,000 in my account at the beginning of the month, and at the end of the month I have $30,000, then my gross profit is $5,000 that month.

Here's how I do my taxes. I allocate 30 percent of my gross profit for the month toward taxes. I keep that 30 percent in a separate, interest-bearing account. Example: with a $3,500 (.7 × $5,000) net profit for the month, I set aside $1,500 (.3 × $5,000) for taxes.

So at the end of the year, the money I need to pay taxes is there. Once I prepare my taxes, I can immediately recognize my tax returns. Let's say that in that fiscal year, I've made $60,000. I've already taken out the 30 percent; therefore I have $18,000 (plus the annual interest accrued) to allocate to my owed taxes.

Note: *If you have a good tax attorney, one who specializes in trading equities, then you'll most likely get to keep a healthy portion of the saved $18,000. The amount you don't have to send to the IRS is considered your tax return.*

Well, all of the above is an idyllic scenario, a world made controllable by budgeting. I'd be grievously remiss to give that impression and ignore my obligation to modify it somewhat.

CUSHION CASH

Never forget this truth: In day trading, nothing is guaranteed.

You always have to have a Plan B. You need to have funds set aside for the bills, just like when you were training. You could have a very bad month; you could end up in the red. You might not have enough in your trading account to withdraw for all your expenses.

You'll never have to worry about any of that if you've socked away enough. And if you decide to take a break from trading in order to reflect and learn, then you've got that reserve to fall back on.

Can you imagine trying to trade every day, with absolutely no safety net, knowing that if you lose you'll be living on the streets? Don't do that to yourself, *ever!*

Before you decide to start trading for income, you should set aside enough money for at least three months (cushion cash), and you should keep backup money on the sidelines in excess of your account minimum. For instance, if you're required to have $25,000 in your account (most pay-per-share firms enforce this), then you should have at least an additional $10,000 sitting in a separate account, serving only as a cushion. In other words, *to begin trading, you should have at least $35,000*.

I hate to be the bearer of bad news, but there's a strong chance that a couple of times, you'll fall well below your minimum balance. The $10,000 backup fund is your savior. It's your safeguard against going crazy when you get an equity call to add more cash to your account, in order to maintain the minimum. If you don't have backup cash, then you won't be able to day trade on your account until you find more money. That stinks! Trust me, I've been there, and the aim of my mentorship program is to minimize your chances of having to go through that nightmare.

Don't make the mistake of being overconfident, thinking that you're one of the lucky ones. Here I'm coughing up very hard-wrought advice. Trust me, it's better to be safe then sorry. Do not start trading for income until you have cushion cash. Furthermore, don't keep that cushion in your trading account. Trust me again on this one—not using it will be very difficult, especially if you're trading on emotion.

Knowing your financial limitations, and wisely planning and budgeting, can greatly increase your chances of survival in this high-risk, low-certainty environment. Prepare an Excel spreadsheet for your budget. Use it every day that you trade. Keep all your accounting up to date. If you don't know how to use Excel, then use a software program like QuickBooks to keep your finances in order.

In day trading, you need to be organized and diligent, not to mention good at saving cash.

RULES TO REMEMBER

- If you're planning to train on your own, save up to prepare for three months of unemployment. If you're planning to be professionally mentored, save up for one month of unemployment.
- Don't try to trade for income until you're consistently profitable, after three months of training on your own or one month of mentoring.
- If you quit your day job, make sure you can get it back. Or, as an alternative safety net, bolster your day trading training with mentoring.
- Always have cushion money set aside for both your training and your active trading.
- Never keep your cushion money in your trading account.
- Use budgeting software to keep your accounting up-to-date and available.

CHAPTER 9

Minimizing Your Risk with Stop/Loss

As it goes with every investment system, the fundamental risk for a day trader is trades that run into the red. From the viewpoint of accounting, that red might as well be spilled blood. The good news is that as a day trader, you can control the amount of spillage. With a proper stop/loss system in place, you're in charge of how much you can lose.

Just what is stop/loss, exactly? The answer to that question is a little complicated, because day traders have different definitions and strategies. In general, stop/loss is the choosing of a predetermined price at which you immediately sell your positions, if they nosedive or skyrocket *to* that price. The point is that you sell at a loss, a small loss you've determined you can handle—so it's never a devastating loss.

MAKING STOP/LOSS AUTOMATIC

By *consistently* applying strict stop/loss procedures, you minimize your *unplanned* risk. As soon as you meander from that method, you invite unpleasant surprises. Therefore, the application of stop/loss should be engrained in you, automatic.

That sounds like a no-brainer, doesn't it? Well, it's not quite as easy as it seems. You have to be on the lookout for your own capricious temptation. It's so easy to stray from your system, especially when you're an amateur.

Take me, for example. I remember first learning how to stop/loss. It was back in 1999, at my very first training program. They made it all sound so simple. If your trade goes against you, they told us, all you have to do is sell your position at a small, very tolerable loss. Then you just move on.

Well, I certainly can't say they were wrong about that; the procedure really is that straightforward. The trouble with the whole thing, I found, lies within me. It's just not that easy, psychologically speaking, to dump something I'm fixated on.

And then there was the other psychological pitfall that affected me when I stop/lossed. After I consecutively did it, my losses were more than my profits. That's when I began to get peeved. The stop/loss system was working, all right! I kept selling at a loss!

I had learned how to minimize my risk, but now I had to also learn how to minimize my stop/losses. After all, I complained to myself, if you want to make money in day trading, you have to log more green trades than red!

The training program had neglected to prepare me well for that problem. I hadn't been drilled on how to avoid excessive stop/loss maneuvers. My instructors had only showed me the general importance of integrating that routine. I'd been taught, for example, to try to make 10 points on a trade, and then sell at a loss when it moved 2 points against me.

Again, that all sounds so simple.

A few things were missing from that training program. There are issues that should have been dealt with, such as the fact that not every trading situation is the same. Some stocks are highly volatile, and you need to allow yourself more distance for the price to run against you, before it retraces back up to your profitable exit price. And in other situations, you may actually want to average-down before you impose a stop/loss (this strategy, however, is only for advanced traders).

Because of these reasons, learning how to use stop/loss involves some trial and error. And that's another reason for my continual exhortation that until you increase your skill level, you should only trade in 100-share blocks.

Here are some basic guidelines and strategies to help you along your way to mastering stop/loss.

First of all, before you even try to gauge the price level you want to sell at, you need to know your financial limitations. For instance, if you figure you can handle a $200 loss for the day, then you can afford to stop/loss when you're down $200 on the trade. If you plan on placing multiple trades, then you may want to limit your loss on each trade in terms of your daily loss limit. For example, if you plan to place 20 trades per day and your daily financial limitation is a $200 loss, then you should limit each trade to a $10 loss ($200 per 20 trades).

That's a plan any training program will show you. Now I'll expand on it.

You're a human being, so you know this: you may have a daily budget, but there's no guarantee that you'll stick to it. Trust me when I say that in day trading, it's especially hard to do that. I can't tell you how many times I've exceeded my daily budget—by a lot. It's happened whenever I've found myself losing on most trades, on that day. I've abandoned my stop/loss system midday, and started trading like a chest-banging ape.

The problem didn't come from the stock I was trading, or even from the market itself. The issue was that during my intraday action, I failed to tailor my system. So I set about learning how. I learned that throughout the day, a day trader's stop/loss exit points should change on each trade.

Though it's true that once you enter a trade you should stick to your predetermined stop/loss exit point, the intraday stop/loss levels need constant reevaluation. For example, during your first trade, you may have decided to stop/loss once the price hits $44.00 (if in a short position) or $42.75 (if in long position). On your next trade, however, in same stock, the stop/loss exit price may need to be changed to $44.50 and $42.50, respectively.

How do you predetermine all those stop/loss exit points? What you do is keep your eye on the charts. You continuously reevaluate the intraday support levels and resistance levels. You stay cognizant of how the prices react when they approach and/or break through. You take note of how far the prices move, once they exceed those levels.

The stop/loss points should be placed just outside the new resistance and new support levels. Notice in Figure 9.1 how after the new resistance and new support levels are formed, the price retraces.

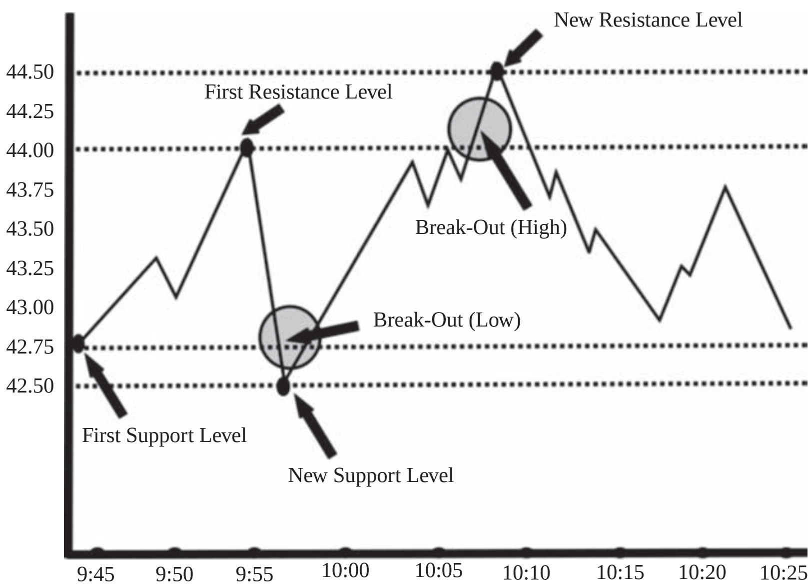


FIGURE 9.1 Intraday 5-Minute Chart: The Price Retraces

The intraday reversals are perfect opportunities to make a quick 15¢ to 30¢, or more. The breakout zones (as indicated in Figure 9.1) are great areas to enter a trade.

And that's where things can get tricky. To master the strategy of stop/loss takes a lot of experimentation.

I came to understand that intra-day stop/loss exit points are flexible and changeable. I realized I needed to grow competent at intraday stock price analysis. Each trade has different stop/loss thresholds. Here, in a nutshell, is what I found out: your exit points should never be static. Both they and you should be *dynamic*. You're learning to mentally juggle a number of variables. When you're gauging the right stop/loss exit price, you should focus on more than just how much you can afford to lose on the trade. From one trade to another, your exit points must never be set to the same dollar amount or price level.

Some stocks take an hour to move 10¢. Others move 10¢ in 10 seconds. Suppose you're just trading one stock. I'll assume you've been trading it long enough to be well aware of its rhythm, meaning you know how the price moves intraday. You also know how fast and how much the price breaks through support and resistance levels. With all that lined up you can dynamically gauge what the proper stop/loss point should be, on any given trade.

Here's an example of how changeable things get. I like to trade stocks that move about $1 every 20 minutes. I like them highly volatile during their $1 moves. That means the stock price fluctuates 10¢ to 20¢, one way and then the other, but ultimately it moves a full dollar in one direction, over 20 minutes. By knowing the rhythm of my stock that well, I can effectively tailor my stop/loss points, throughout the entire day.

Suppose the stock Amazon.com (AMZN) is trading at $70 today. Before I can gauge the stop/loss points, I need to know a few things. I scrutinize the charts. I'm looking for the major intraday support and resistance levels. I take the previous day's *high*, and I make that today's resistance level. Then I take yesterday's *low*, and make that today's support level. I use these levels to start trading AMZN.

Now I can prepare to trade lightly, meaning (you guessed it) in 100-share blocks. When the stock price begins to approach my predetermined intraday support or resistance levels, I usually start planning my entry. If the price breaks through a resistance level (top), I may choose to *sell short*. If it breaks through a support level (bottom), then I may chose to *go long*.

Wait, you might respond. You'd say, *Shouldn't you have done just the opposite? Why would you* sell short *if the stock price is shooting up and breaking though a major resistance level?*

My answer to you would be this: Wall Street brokers have to take profits on their trades. When they sell their positions, the prices retrace, and that's when you should make your move. It's much harder to predict how much the stock price will continue on any trend up or down, but it's almost guaranteed it will retrace. The price is most likely going to retrace at major levels. Our job as day traders is to capitalize on those quick (and fairly certain) reversals.

I've found that at those levels, they almost always retrace. And if they don't retrace, I quickly stop/loss. Having a predetermined exit price (a stop/loss plan of exit) means there's virtually nothing to worry about.

Suppose a major intraday resistance level for AMZN is at $70.50. I will wait for the price to reach $70.50. It may take only minutes. Once it hits that level, that means it's way overbought, and ready to retrace, just a bit. Or so you think.

If you're in good rhythm with your stock, you know at this point what direction it will most likely continue, and how fast. The key is to patiently wait for the intraday support or resistance levels to hit. Once the price hits those levels, you should be looking to enter. Before you enter you should already know your predetermined exit points: the profit price (limit) and stop/loss price.

If I enter the trade at $70.75 (short sell), I will most likely have a $71.05 stop/loss price in mind. If the price hits $71.05 I'm going to lose $30 on the trade ($70.75 − $71.05 = $.30 × 100 shares). If the price continues down I will cover my short position at a profit when it hits $70.25. In Figure 9.2, I was forced to stop/loss at $71.05.

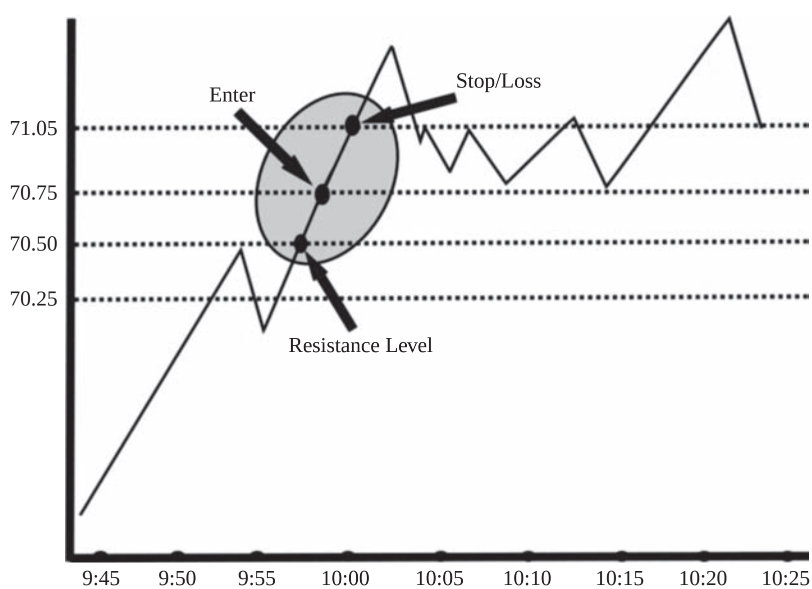


FIGURE 9.2 Intraday Five-Minute Chart: The Price Goes Against You

The gray area in Figure 9.2 represents the trading range. The price never retraces, so I quickly stop/loss at $71.05.

The time it takes from entry to exit is only about four minutes.

When the price breaks through a major support or resistance level, in most cases it retraces by about 25¢ or more. This happens before it continues to new and higher levels, so I tend to allow my stop/loss points to be about 25¢ past where I enter trade. I usually enter trade once the price shoots past the original intraday support and resistance levels by about 25¢. Therefore, I am allowing the price to travel a full 50¢ past the original intraday resistance level before I stop/loss. There is a much higher chance that the price will retrace once it shoots past the resistance level than continuing to shoot straight up to higher levels.

In the AMZN case in Figure 9.3, I would like to show what happens when things go right, using the previous situation from Figure 9.2.

Suppose the price breaks the $70.50 original intraday resistance level and then shoots up 25¢ past it (extremely overbought). I entered the trade (short sold) at $70.75, and then it quickly retraced to $70.50 before it hit $71.05, so I made a quick $25 on the trade. (Translation: *shorted* stock at $70.75 with 100 shares, *covered* at $70.50.)

I entered trade around 9:58 A.M. and exited about three minutes later. Notice how the price retraced after I got out. It shots back up. Once it

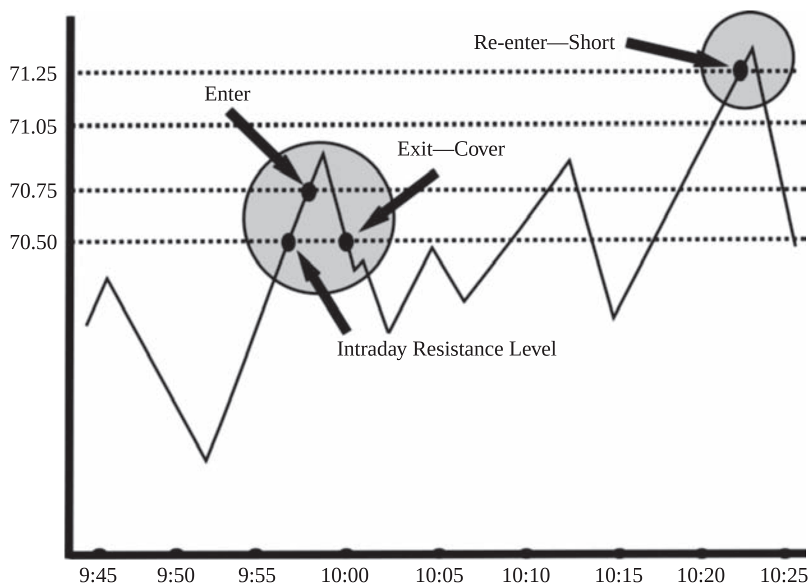


FIGURE 9.3 Intraday 5-Minute Chart: Things Go Right

hit $71.25 I would most likely have reentered a short-sell position. The stop/loss and profit exit points will be different on the next trade. I would probably cover at $71.00 this time, or stop/loss at $71.50 (this is what I mean by *dynamic* exit points).

That seems like a lot of planning and waiting for a measly $25 profit and a possible $50 loss. Well, keep these things in mind:

- Your initial setups, done properly, have 10 times the chance of retracing when they hit the major intraday support and resistance levels, before they continue to new levels.
- As your skill level increases, you'll be watching more and more setups. I usually watch 10 stocks at a time. Most of the time, every one to five minutes, at least one of them hits a major level. It might only take one minute to get in or out of the trade.

The point is that it's okay to stop/loss, because I've lined up other trades, so I can get back my money. For instance, I may stop/loss on 5 or 10 trades, but I'm going to profit on 50 or more, all throughout the day.

Accordingly, I've learned to resist **holding** a losing position past my stop/loss exit point. Not only am I placing myself in treacherous waters, but my capital is getting tied up. In the time that I'm **holding** my losing positions, I could be placing other quick trades, and profiting from them.

Here, as in every other chapter, I stress patience and the taking of baby steps while you trade as an amateur. While you're learning how to properly stop/loss, there's unavoidable guesswork. You'll certainly make some mistake. This, however, I can promise: The more you trade a particular stock, the more you'll get to know it, especially with regard to how it approaches the entry and exit levels. Eventually you'll get much better at gauging which prices are best to enter, and which prices are best to exit, all on an intraday basis.

RULES TO REMEMBER

- Learning how to properly stop/loss is a process of trial and error. So again: trade in small (100-share) blocks.
- Never try gauging a stop/loss price until you've determined the support and resistance levels for that day.
- Before you even try to gauge what price level you want to sell at a stop/loss, know your financial limitations for that day.
- On every trade you enter, always stick to your predetermined stop/loss exit price.

CHAPTER 10

Averaging-Down: A Skilled Strategy

Averaging-down is a strategy to lower your average cost in a stock that has dropped in price.

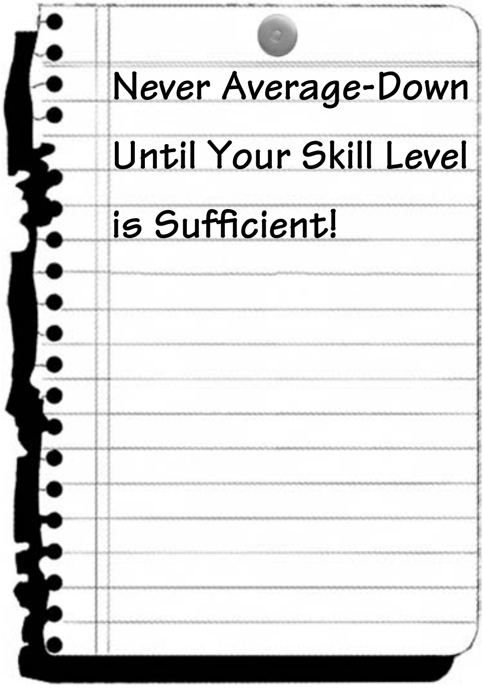
Question: Is this a truly good maneuver, or are you just chasing a botched trade?

The answer depends on your skill level.

Here's how it works. In a typical averaging-down situation, you buy 100 shares at $50 per share, then the stock drops to $49 per share. So you buy another 100 shares at $49 per share, which lowers your average price to $49.50 per share.

On the surface that sounds like a good plan, but now you're trading a 200-share block. Overexposure just became a real issue, and that's especially true for amateurs. Beginners aren't ready to *keep on* averaging down, which means 300 shares, and then 400 shares, and so on and so on.

The key to successfully averaging-down is to have a shrewd, careful plan. Amateurs might start with smart strategies, but things can get ugly fast, because when they add more shares to a trade, they may forget their overexposure. I'll address that issue right here and now with a loud and clear proclamation:



Go ahead and make another sign for your wall out of that.

An amateur must struggle to consistently profit when only trading lightly. That means 100-share blocks. He doesn't possess the expertise to execute complex maneuvers. Averaging-down is a *professional* device. A beginner might try it and get lucky a few times, but all it takes is one trade gone south and he's likely to **hold** until the cows come home.

And he'll probably lose really big.

TO AVERAGE-DOWN SUCCESSFULLY TAKES MASTERY

So how do you know when your skill level's sufficient? If you're trading a stock often and profiting consistently, then maybe you're ready to try something advanced. In order to gauge your readiness, refresh yourself with Chapter 1 on evaluating your skill, "Truths about Yourself to Know First."

I've averaged-down as an amateur, and then again as an experienced trader. As an amateur I've suffered bad consequences. As a seasoned trader, I've done much better. As usual I'll now share the dark gory details of how badly I bombed as a beginner, and then how, when I'd garnered a lot more skill, I made the maneuver work.

My heaviest *unplanned* losses to date have been caused by *incorrectly averaging-down*. As a beginner I had basic know-how—you know, buy low and sell high (yeah right). I would enter knowing what price to sell at, if the price happened to shoot up to my limit price (profit), and I also had a planned stop/loss price. But if the price dropped very quickly or I was having a bad trading day, I would get too emotional. I would get angry at the stock. I wouldn't apply my stop/loss; instead, I would watch it continue to drop. I would then buy more stock at lower price levels.

I would completely abandon my original plan. If the stock continued to drop, I would buy even more without hesitation. I did try to find new support levels, but once I started *incorrectly* averaging-down, I was dangling, and I had no smart stratagem. This would go on until I used up all my capital.

Sometimes, if I were lucky, the stock would rebound just enough for me to break even. You might ask why I didn't allow it to run up into the green. Usually I never let it ride any higher because I was so drained from being in over my head that I just wanted out, and quickly.

In some cases I was down over $1,000 on one single intraday trade, and then it would finally retrace, at the end of the day. Once it got back to break-even, I was so stressed that I sold all my positions and bailed out. I was relieved, but also I felt lucky, because, after all, I was gambling.

Most trades where I averaged-down unfortunately never rebounded, so I had to sell at a very large loss, or else I **held** overnight. When I **held** it was because I was hoping, of course, that tomorrow it would go back up.

And most often, of course, it did not.

Averaging-down as an amateur, I broke every trading rule. I wasn't emotionally disciplined, and I lacked the experience to execute complex technical tricks. I felt like a starving puppy, lost and alone in the woods, trying to outfox my prey, and ending up more lost and hungry than ever.

Later on, when I'd gained more experience, I began to average-down with success. Eventually I was able to include the device as part of my overall strategy.

KNOW-HOW DOESN'T GROW OVERNIGHT

For over a year I'd been trading a few select, reliable stocks. I was totally in rhythm with them. I was very familiar with their price swings. I knew their reactions to support levels and resistance levels. I had confidence in every trade I made. But I hadn't yet reached the sufficient skill level to master averaging-down.

In Chapter 18, "Paper-Trading Strategy, I stress the importance of trading on paper or demo before going live with what's new. That's true of both stocks and your strategies. I also point out the importance of never trading in large share blocks until you're consistently profitable when trading in 100-share blocks.

After I learned to *just stick to that*, I soon became very successful in trading those 100-share blocks. Then I promoted myself to 200-share blocks. But I had learned to be very careful. I only traded the very familiar, very predictable stocks that way.

The point is that before you try averaging-down, first you must master your ability to trade in 200-share blocks. In other words, don't bother trying to hit the ball until you know you're in shape to run the bases.

For me, a normal averaging-down scenario is 200 shares as my maximum. I start off the trade with 100 shares, and then, assuming the price falls, I purchase an additional 100 shares at a lower level.

Before I enter the trade, I *always* devise a plan, and this takes me seconds to do in my head. I quickly ask myself *why* I want to average-down this trade. Usually it's because, on that particular day, the stock I normally trade in 200-share blocks is being a little unpredictable. So I lower my exposure to it, allowing myself to enter at half the normal risk (100 shares versus 200 shares).

What exactly is the risk I'm avoiding? When I trade the same stock in 200-share blocks I normally allow myself a \$50 loss. So I'm willing to risk \$50 on the trade (200 shares $\times$.25 = \$50). This means if the stock price drops 25¢ I have to stop/loss at \$49.75, assuming I entered the trade at \$50.00.

Now that I know my threshold for risk (\$50 on 200 hundred shares) I can devise an order execution plan. I'll enter the trade when the stock price hits \$50, and at first I'll purchase only 100 shares. When the price drops to \$49.90 (a \$10 loss so far), then I'll buy an additional 100.

Now that I have a 200-share block trade, again I've got to stick to my plan. And I have to do some more quick calculations. When I purchased the second 100-share block, I averaged-down my cost of the position. I paid \$50.00 for the first hundred shares and \$49.90 for the second, so my *average* per/share cost is now \$49.95. I'm used to taking *only* a \$50 loss on my trades, when trading 200-share blocks, so I can allow the price to run down to \$49.70 (\$49.95 – \$49.70 = 25¢).

I'll stop/loss on the 200-share block, if it reaches that low point.

At this point you might ask why I put myself through all that when I simply could have purchased 200 shares to begin with.

Remember, it's all about overexposure. If I feel that the stock is trading unpredictably, I elect to initially trade only half of what I'm accustomed to, in order to cut down the risk. And there's another factor at play there. When a stock is being unpredictable, it's harder to pick support and resistance levels on the charts. Therefore it's wise to allow some extra margins for error.

Using my previous example, for instance, it's easy to see how that works. If you purchase all 200 shares at $50.00, you can only afford the price to drop to $49.75 (not $49.70). This 5¢ difference may not seem like much, but it could be exactly the cushion you need in order to stay in the trade, and that's helpful on volatile days.

I've been stopped out of trades where the price then retraced within pennies of my stop/loss price. If I had skillfully averaged-down, I could have stayed in the trade a bit longer, without losing more than I'm used to (my $50 threshold).

The method I've described is risky, especially when it's hard to have a clear plan of entry and exit. Again, it takes a high skill level to perform this strategy effectively. That's why I urge that you paper-trade this, until you feel ready to go live.

RULES TO REMEMBER

- Never attempt to average-down until you're sufficiently skilled.
- Never average-down beyond your threshold for risk.
- Only average-down on your consistently profitable stocks.

CHAPTER 11

Gambling versus Day Trading

Gambling is the act of placing a bet. What's involved is a system of win-or-lose odds. *Odds* is the mathematical likelihood that an event will or won't occur. Odds are the key to the gambling process. On the contrary, day trading, or intraday investing, involves maneuvers in a much more controllable system. The system itself influences results—and this does *not* mirror the gambler's dependence on hazardous numerical odds.

A casino gambler who decides to try day trading might construe the profession as betting. That assumption could actually be horribly true, if he doesn't know what he's doing. Ask any professional day trader whether he sees himself as a gambler, and most likely he'll respond with this question, *Are we talking about when I was an amateur, or now that I'm much more experienced?*

I will return to that question later in the chapter.

When players stride through a casino, they all have the same chance of winning or losing at any machine or table. They all want to beat the odds. Sure, some players are seasoned, and their skills at prediction are keen; they win somewhat more than the rookies. But even so, they're just betting, they're just casting their fates to the wind, because in gambling, the risk is uncontrollable, it's unswervingly 50-50. With every single hand or roll of the dice or pull on a slot machine, the fulcrum is pure, simple chance. The payouts may vary, but what it boils down to is they walk away either beaming, or trying hard not to cry.

In day trading the chances are apparently the same, but a closer look shows that's not true. The trader does not simply attempt to press his luck in the gambler's inflexible circumstances. He's concerned about how to best minimize his risk. That risk is considerably more complex, and also more malleable, than the win-or-lose stakes at casinos. The professional trader makes it work for him.

Here's the main reason why day trading isn't gambling: The price swings are always evolving. There's no fixed probability. That's the condition that establishes the leeway for consistent, not hit-or-miss, profits.

As soon as you place a casino bet, you're done. All you can do is just stand there and wait to see where the dice stop. But in day trading—even hunch trading—right in the middle of the trade, you have choices. Your advantage is planning, not odds. Therefore the challenge in day trading is to have an accurate as possible system of accurate intraday forecasts.

Day trading pros are a little bit like the psychics at the casinos. When psychics play roulette, they can foresee the outcome. Before the dealer calls out final bets, they're aware of where the ball will stop. They're sure of which number the ball is going to land on, so they bet everything on that number.

Behind the scenes human watchdogs are stationed, on the lookout for those gifted seers. Whenever they zero in on one, they oust him and blackball him!

The day trader isn't a psychic, but he commands some similar choices. He can see the price action moving. It's like watching roulette balls spinning. Though he doesn't have mystical powers, and can never be totally certain of where the price will end up, he can modify the dangers while the trade is in play, while the ball is still rolling.

Let's say that you blindly buy a stock on a hunch. You buy it because you *feel confident* that it will keep rising in price. What you're doing, right then, is like placing a bet. You might as well be at a casino.

But here's what's unique about trading: even when you capriciously hazard a hunch, you have options that are absent in gambling. This is where things get interesting. This is where risk management sets day traders apart.

As I mentioned in Chapter 6, "The Importance of Risk Management," there are several strategic options:

- You can add more money as the price goes up.
- If you find the price going against you, you can take some money off the table.
- You can predetermine your stop/loss and limit price.
- You can change stocks.
- You can **hold** (intraday) until it retraces (note: only experts should try this).
- You can average-down your position (again, only experts should try this).

When asked about gambling versus day trading, the professional day trader will probably tell you that most amateurs basically gamble. He's assuming that they haven't yet mastered the safety-net-strategy options, and they haven't yet profited consistently. He knows their ineptitude regarding risk management is a lot like rolling the dice.

I'm aware that a professional gambler would say something pretty similar. He'd tell you that you need to be focused, working only within a strict budget. He'd be right to say that, but he'd also be revealing the brutal simplicity of odds. He'd have little to say about managing risk, because in gambling, you can't change the odds.

On the contrary, every professional trader has an individualized, strict risk management system. Pros for the most part maintain some consistency in how they evaluate their exposure to risk. Chapter 13, "Trading Consistently All Day," and Chapter 7, "How Overexposure to the Market Can Hurt," both emphasize how important it is to stick to a plan that works.

Now I want you to never forget this: Every time I've lost big in trading, it's because I've been gambling.

And I want to make a confession. I admit that even as a pro, in the past I've occasionally abandoned my own risk management system, and virtually gone for broke.

I'd be trading, as usual, in 100-share blocks, and consistently profiting. Then something would come over me. Be it boredom, or a pressure to make more money, or just a random attack of greed, whatever the cause, it was compulsive. Suddenly I'd opt, against all my rules, to start trading in 1,000-share blocks.

I'd be highly aware that I was overexposing myself to 10 times the risk I was used to. I'd know that I was breaking my tried-and-true, safe and consistent routine—that I was throwing my own advice right out the door with the trash!

But I was hungry for money—much more money. And just then, I didn't care. I didn't care that now I was gambling. And now, just like at casinos, I could lose everything I was betting.

I had sacrificed the strategies listed above, such as averaging down or intraday **holding,** because I'd already gotten in over my head by initially purchasing such a large block of shares. So each time I entered the trade, I hoped and prayed the stock would go up in my direction, before it went against me and destroyed me.

This was pure gambling! A 50-50 chance!

If it went against me I was *in big trouble*. If it went up I was *lucky*.

More times than not, it went against me. I did make a few quick profits, but if the price dropped fast and I had 1,000 shares, then we're talking a $1,000 loss for every $1 drop in price.

I was used to trading stocks that fluctuate $1 every 10 minutes.

Now I might have to stomach a $1,000 loss in 10 minutes.

On the bright side, there is one good thing I learned, even though it isn't worth much: even when I've day traded in that crazy manner, it's still a little better than gambling, because at least I've lost a little bit slower. Think about it: if you place a $1,000 bet on a blackjack table, your money will be gone in less then 10 minutes. It might disappear in the mere 30 seconds it takes for the dealer to deal the cards.

Talk about feeling powerless, the hapless victim of chance! Talk about instant disaster!

That's gambling.

Whenever I've broken my consistency, I've fallen from day trader to gambler. It doesn't matter how many seconds or minutes it took to lose everything; the point is, I slipped into gambling. Never forget this: Luck is a gambler's best friend. *Not needing luck* is the day trader's distinction.

RULES TO REMEMBER

- Learn risk management before you start day trading, or else you're just rolling the dice.
- Hone the skills of risk management during initial live-trading experiences. Always take advantage of the strategic options that day trading offers you—options you don't get in gambling.
- Never, ever ask yourself whether you're feeling lucky today.

PART III

Intraday Trading Truths

This part is a collection of advisories and warnings that can increase your intraday success rate. In order to benefit the most from this part, you must first be familiar with all of the previous chapters.

This part includes chapters that will cover typical intraday trading mistakes. I cover technical issues that revolve around the most basic requirement in day-trading consistency. I also offer a systematic way of acquiring stocks to trade. I end the part by explaining how to deal with news.

CHAPTER 12

Why Some Traders Make More Mistakes

You can hold an M.B.A. in business, and you can go through the intensive and pricey routine of day trading seminar trainings. Do any of those drills make you a day trader?

No.

As I've stated before, your learning internalizes only when your trading becomes very personal, meaning trading with your own money. Your valuable lessons only evolve from your disastrous, though enlightening, mistakes and the disaster-free assistance of a mentor.

It's not just by chance that in the first section, I emphasize emotional pitfalls. I highlight them first because they make you or break you. Mistakes made in day trading almost always involve some self-destructive psychology. Self-discipline is the powerful antidote.

While trading, we all face emotional issues. We all have to calm the interior storms that cause most of our costly missteps, and then we must resolve to continue—even after devastating losses. Our comfort lies in knowing almost every loss is preventable, if only we'd stick to our safeguards. The successful professional trader is resilient. His confidence evolves from his ability to recover fast from his blunders, and his resolve to never repeat them. That force of will hones his victories.

Such professionals, however, do sometimes make mistakes. Some make more mistakes than others, and here we can witness a dramatic example of natural selection. There are two sides to every trade. For every profiteer, there's a loser, and as a matter of vicious Darwinian fact, the market depends on one side to perpetually take heavy hits. Whenever somebody loses, somebody else makes a big profit. Every time you profit from a trade, it's because you just made money from another day trader's error. You picked the just-right price level, but the other guy miscalculated or lagged. His misstep or balk made your profit.

Every time the price moves in one direction fast, the reason is that many buyers or sellers are trading that way, in high volume, and it's up to you to know when this is likely to reverse. So if you buy into selling momentum to the downside, then you'd better pick the bottom correctly.

If you fail to pick the bottom correctly, the money you lose on the trade becomes profit to those who are short-selling past your stop/loss, or those who chose to exit at a minimal loss.

Conversely, if you do pick the bottom correctly, then you actually profit from the short-sellers, because they failed to cover when the price began to go back up.

What does all this have to do with learning from your mistakes? Well, if you find yourself on the losing end you should know what you did wrong, and you should also know what the winners did right. In order to move on and not repeat your errors, you need that two-sided view.

To achieve that, you probe and analyze every one of your losing trades. You ask yourself why you sold or bought at that level, and you determine why others did not. Remember: There are no day-trading conspiracies. There's no little troll in your computer who personally trades against you. The troll is at his monitor, trading the same stock as you. When he trades in the opposite direction from you, only one of you is right.

All day traders are fighting for the best price level to enter and exit a trade. It's your job to make some good judgment calls when competing for the right price. To help you diminish bad calls, here's a list to ponder. These are the areas where traders are most likely to mess up:

- Picking stocks to trade
- Lacking concentration
- Not watching market-moving news

PICK YOUR STOCKS CAREFULLY

When it comes to stock picking, most beginner day traders are pretty much all over the place. Their foundation for determining what makes stocks good to trade is weak and shaky at best. As yet they have no solid trading system. They don't realize that *first* you develop that system, and *then* you select the stocks, because it's all about working with the right stocks for your personal trading style.

Accordingly, if you're accustomed to the rhythm and swings of a stock, and you've traded that stock with success, then you should pick stocks that are similar. (Chapter 14, "Stock Picking," elaborates on this concept.)

Most botched trades are due to beginners who are trying out unfamiliar stocks. I realize those mistakes are hard to avoid. You have to start somewhere, right?

Yes, but that doesn't mean you should be betting the farm without prior monitoring and qualifying. Several times, as an amateur, I learned that the hard way. Most of the stocks I lost money on were stocks I found the night before. Like a fool I went and traded them the very next day. First I should have researched them, and by that I mean for *days or weeks*!

Eventually I learned to carefully limit my exposure to new stocks. Until I felt confident with them, I knew I should take that precaution. Then I *gradually* traded them more actively. Indeed, I now successfully trade many of the stocks that originally broke me. It's been much like learning how to deal with the playground bully. I beat him with my brains.

These days, if I find a new stock with the qualities of my core stocks, I take it slow for awhile. I'm always on full alert, watching it closely but not yet interacting. It's like making sure that the bully is not behind me when I'm standing in the water fountain line. I always keep the danger in sight.

When I finally choose to trade that new stock, I may wait all day for just one trade of just 100 shares, and only make $20. (Of course, I'm simultaneously trading my proven stocks, and doing so much more actively.)

It's critical to be patient with your less familiar stocks. Don't ever capriciously use them to replace your losing stocks. First you must scrutinize them closely. You should treat all new stocks like the bully, or a newly assigned work partner, or even like a first date.

The new stock you're carefully studying might turn out to be a bad stock to day trade. That's why, initially, you should drastically limit your exposure. Stock picking is the arena of many day traders' blunders. Tread very lightly there, comrades.

FOCUS, FOCUS, FOCUS

Lack of concentration is another beginner's weakness. After burning himself a few times, the need to develop great focusing skill gets seared into a day trader. A classic example is when the trader walks away for only a few minutes, maybe to make a quick sandwich, or else to use the bathroom. He returns to his trading station, and finds that in his short absence, his stock has plummeted.

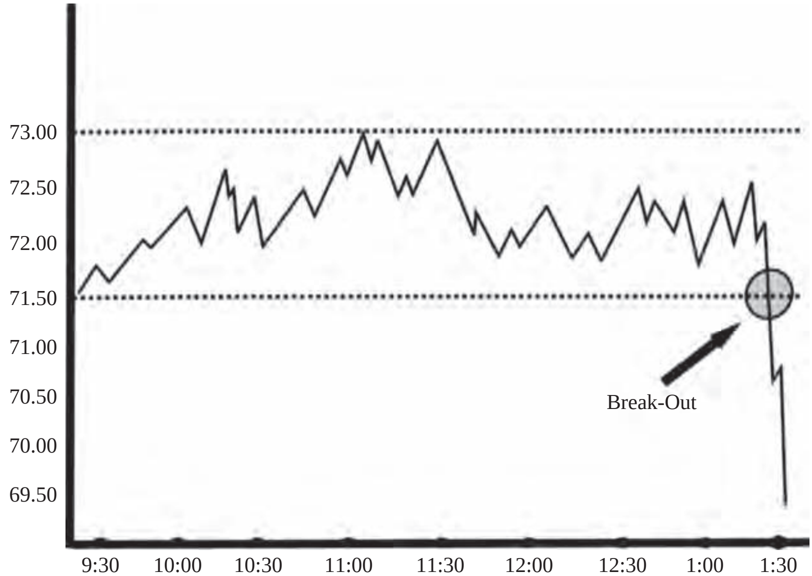


FIGURE 12.1 Intraday 30-Minute Chart: Breakout

In Figure 12.1, the stock was trading in a tight range up till 1:30 P.M., then it quickly breaks out of range to the downside. If you are not watching this quick breakout you will lose very fast. It drops two dollars in under a few minutes.

He should have had a stop/loss in place, right? This is true, but many of the best trades happen when you sit there totally glued, patiently watching for exit points. Not all trades should have automatic stops and limits. Sometimes it's better when you manually place your exits, because you don't have any time to place limit orders. You're only in the trade a few minutes. Plus, sometimes your limit prices never hits at all, so you have to just be there, watching, in order to make adjustments.

Either way you slice it, you should never take your eyes off a trade! Innumerable mental culprits can break your concentration, and all of them try to sneak up. Talking to your significant other, checking emails on another screen, or simply dozing off . . . all of those distractions are concentration destroyers.

While trading, you should be virtually meditating. That is no exaggeration. I really do mean you should be entranced. That state of mind will maintain you in an intimate rhythm with your trades. Every single second, your Level 2 quotes and 1-, 5-, and 15-minute charts are displaying real-time data. That data is speaking to you, and you should be attentively listening. You can't miss one note of that conversation between you and your monitors.

I used to break my concentration for a few minutes at a time. That turned out to be costly. I'd be in a tight-range trade, and I'd find myself getting bored. My mind would begin to wander. I would take a five-minute break. I'd go to the kitchen, or else make a phone call.

And when I returned to my screens, I'd see that the price had instantaneously jumped, and then retraced back to the tight range. So because I hadn't focused on the trade, I'd missed my chance to make money—the easy kind that gets offered on a silver platter.

In Figure 12.2, the stock price trades between $70 and $71.50 all morning. When it breaks out of the tight trading range it quickly shoots up two dollars. It only takes five minutes before it retraces back down.

Lack of concentration will punish a day trader. It's almost as detrimental as being a soldier who's shot because he failed to be vigilant. You should view the problem as a pitfall of being self-employed. There's no boss prowling around you, making you afraid to relax and slack off. You have to remember you're working. Your challenge is to keep yourself focused. No one but you is there to make you concentrate.

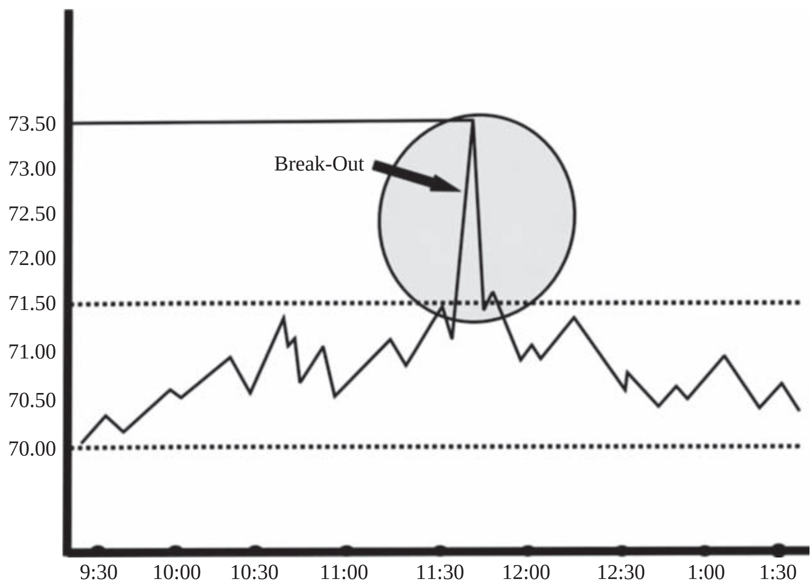


FIGURE 12.2 Intraday 30-Minute Chart: Retracing

PAY ATTENTION TO MARKET-MOVING NEWS

Not watching market-moving news can also impact your trade badly. You can be trading a stock all day, and it will be moving consistently. But all it takes is some company news, or another major market announcement, for your stock to start moving very quickly in one direction, hopefully not against you.

You've got to be prepared for that development.

When the Federal Reserve Board (Fed) announces interest rate drops or hikes, that's when you've got to look out. As a beginner, I had no idea how much the Fed influences the market. Even with a B.S. in business, I was clueless. I'd be in a trade and the Fed would announce its intentions, and immediately the whole market would go haywire. This would last for about an hour. Whatever stock I was in would move too, and it would almost always stop/loss me out of my trade.

Earnings is another kind of stock news that can dramatically influence your trade. If the stock you're trading is coming out with an after-market earnings announcement or the next morning's premarket earnings, either way you'll see a volatility increase. The price direction will be very hard to read. Also, industry leader stocks that have earnings can directly influence your stock. For instance, say you're trading a software company that is mid-cap (mid-range in terms of capitalization), and Microsoft has its earnings released while you're in the trade. Your company will most likely feel Microsoft's earnings effects, and accordingly, your stock's price may jump up or shoot down.

But some news is best left alone and ignored. You should never be trading when news is the major factor in the stock price movements. You should wait to see where the stock settles after the volatility subsides. By waiting, you won't get burned.

How many times have you seen this: Great news comes out and the stock price shoots up 10 percent in the first five minutes? For example, a $50 stock shoots up $5, to $55. Then, in the next five minutes, you watch the stock retrace about $4. You can easily get whiplashed out of those trades. They can instantly turn your hair grey. Why do that to yourself?

For elaboration on all the news issues that a day trader has to deal with, see Chapter 15, "Why News Can Be Just Noise."

Remember: the most valuable lessons you'll ever learn will come from your own blunders. In this chapter I've mentioned some common mistakes. Be aware of which ones you're making: It's up to you to address them. Your missteps are very expensive lessons, so learn from them. Don't shrug them off. If you do, you'll be one of those misfortunate day traders who makes the most mistakes, and makes them the most often.

RULES TO REMEMBER

- Never take your eyes off a trade!
- Log every one of your mistakes.
- Your mistake is another trader's profit, so understand what he did right.
- Focus on eliminating your chronic mistakes.
- Instead of shrugging them off, learn and grow from your errors.

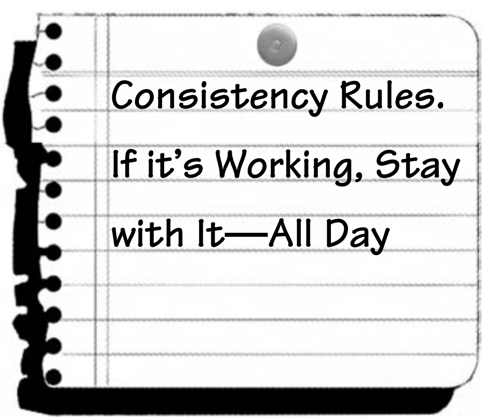
CHAPTER 13

Trading Consistently All Day

There's nothing worse than having a great trading day—all day—and then losing every dime in the last 10 minutes! If there's anything good to be salvaged from that nightmare, it's the easiness of figuring out the *cause* of such a big loss. The probable reason is incredibly simple: You disrupted your consistency.

I know that's been true for me.

Back in the beginning, it took several losses—end-of-day, so cruelly timed—to jerk me awake and make me face my missteps and learn the importance of constancy. Now go and get a magic marker and poster board. Make a sign, a really big sign:



Put this sign on the wall above your monitor.

When I was beginning to trade like a professional, I routinely purchased 100-share blocks of a few select stocks, like Met Life (MET), PepsiCo (PEP), and Amazon.com (AMZN). I only watched the one-minute chart on each. When they reached a support or resistance level, I would either buy or short. I would only try to get $10 to $20 swings—that's 10¢ to 20¢ moves.

For the most part the stocks would always retrace at major support/resistance levels, and I would sell/cover at a $10 to $20 profit. I would do this all day long. I would not buy 200 or 500 shares; I stuck with 100 at a time. If the price went against me for more then $20, I would always sell/cover at a stop/loss. The system seemed virtually bulletproof. It really *was* bulletproof.

But you see, I strayed from it sometimes—and wandered right onto a minefield.

All it takes is *1 mistake* out of 40 perfect trades to lose *all* your profits for the day. I should know. I know more about that than I would like.

When I was trading in 100-share blocks, I would sometimes get anxious and (you guessed it) overconfident, and I'd purchase 200 or even 500 share blocks of the same stock I'd traded all day. I was pumped up, you see, from making perfect trades, while staying with the 100-share blocks.

Almost every time I did this the stock price went against me, and then (you guessed it) I'd **hold.** There seemed to be no way around it—I was quickly exceeding my $20 stop/loss—and then the fear factor kicked in. I figured I'd **hold** until it came back down to at least my break-even point, but it almost never did. I would continue to **hold**, even if it went $1 against me; that's $200 for every 200-share block.

So basically, I'd start the day running uphill, and end the day dead, in a gorge. Starting with 100-share blocks, with an average of 40 good trades, I'd make $10 to $20 profitable trades. I'd be up about $500, but then I'd waste it. All it took to create this disaster was *1* trade of a 500-share block that I allowed to run against me by a full dollar!

The only way I could rectify that pathetic state of affairs was to sell *all* 500 shares at a loss, and get to break even for the day!

Well, in spite of all I was losing, one good thing was emerging: I was slowly but surely developing a *consistent* pattern of sorts. I was constantly fixing my mistakes, and that in itself was a step in the right direction; I had learned very early to stop **holding** overnight, and then I learned to use stop/loss at the end of the trading day. In the process I was gradually becoming an authentic—if battered—day-trading professional.

Now I want you to stop in your tracks right here and read this point, and remember: most amateurs will make almost any excuse to **hold** a losing position, especially overnight. Learning to never do that again is the first and foremost horrible lesson a beginner will stagger away from.

So here's another colorful sign to make and hang somewhere close to your desk; make it big and dead-level with your eyes:

Don't take that sign down until you know you've outgrown it. Then pass it along to your cousin down the street, the one who started day trading last week. But don't give it to your cousin until after you've learned that rule must be unswervingly followed. The tremendous uncertainty of **holding** is why. Instead of overnight **holding**, you've learned to take your losses and move on.

You should *always* sell by day's end. If you're consistent with that rule, you'll be one step closer to becoming a successful day trader.

That sounds pretty easy, doesn't it? Yeah, right. Look out. Beware. Staying consistent with a day-trading method is extremely difficult to master—and the issue here, as usual, is really about mastering *yourself*. Sticking to your system . . . never straying . . . well, for some people that's simple, I guess. The totally one-track minded or people severely inclined against risk might suffer minimal losses. But you're probably a typical random-willed human with an instinct to experiment and gamble. Temptation and greed may start gnawing at you just like hunger pangs, or lust.

I learned it was a two-sided challenge. I had to control myself, and I had to understand the market. Soon one fact became clear: besides finding out that I can profit all day with either 100- or 200-share blocks, I also learned that what's crucial is not the amount of the shares; what matters is the market exposure. The 200-share blocks would expose me twice as much as 100. That means that if I was used to taking $20 losses when trading in 100-share blocks, then I'd now have to get used to taking $40 losses when trading in 200-share blocks.

Every trader has different tolerance levels to stop/loss points, and I don't mean to insist that my personal amount of $20 for 100-share blocks and $40 for 200-share blocks is the level that's right for everyone. What I do mean to emphasize is the importance of consistency, of sticking to a pattern that works.

For example, if you have a percentage system for stop/loss, that can be applied here, as well. Let's say you have a stop/loss and a 10 percent profit system in place. If you purchase a $10 stock in 100 share blocks ($1,000 in security), then you sell once the stock price reaches either $9.50 (a loss of $50), or $11 (a gain of $100).

The thing to do is to get used to your tolerance levels for losses or profits, and then stick to them like glue. In the previous scenario, you have a 5 percent stop/loss in place. If your trade goes against you when you own 100 shares of a $10 stock, it causes a $50 loss. When it goes up, however, your 10 percent profit on the 100 shares of the $10 stock will grant you a $100 profit.

Make sure that you don't change a thing. For example, if you're accustomed to trading a $10 stock, then *always* trade stocks that are near $10 and only trade in 100-share blocks, and you'll never slip into a situation that tests your tolerance levels. You want to avoid that nerve-wracking ordeal—especially in the middle of the trading day.

Here's an example of how day trading can give you gray hair: You're up $300 after about seven successful trades and eight stop/losses (in a consistent pattern, that's $700 in profit and $400 in stop/losses). You then decide to change your stock picks. During the middle of the day, you purchase some $30 stocks. That's three times the value of the $10 stocks that you've been consistently trading. It's mid-afternoon. You're allowing those stocks to move $150 against you before you stop/loss. That's 5 percent of $30 in 100 shares. You're trying to make a $300 profit—that's 10 percent of $30 in 100 shares.

At this point everything seems consistent, but no, take a closer look. What's changed is the amount you'll have to adjust your tolerance levels. When trading a $10 stock, you're used to the $50 stop/losses and the $100 profits. Now, while trading a $30 stock, you're going to subject yourself to three times that amount.

I can guarantee one thing: it will be much harder to wait for those levels to hit, and you'll be very tempted to alter your exit points. Any detour from your system is an inconsistency, and once you lose your consistency, you and your trades will suffer.

Consistency is more than just force of habit, or the principle of sticking to a pattern. It's also about realistic confidence levels, all throughout the day. If you're consistent you're less likely to get yourself into situations where you're anxious, agitated, and dangerously tempted to take dire risks. You can pick any stock price you want. You can have any good system of stop/loss in place. You can trade any amount of share blocks, as long as you're not overexposed. The key to success is: Whatever pattern you choose, keep it consistent throughout the entire day.

RULES TO REMEMBER

- Find your tolerance levels, and adjust your stop/loss and profit system accordingly.
- Discipline yourself to trade the same way, *all day long*.
- Never **hold** a losing position overnight!

CHAPTER 14

Stock Picking: Simplifying the Process

Caution! Do not read this chapter thinking this is all you need. This chapter is about how to *choose* stocks, *not* about how to *trade* stocks. Just the same, amateurs may think stock selection is the "golden goose" of good strategies. Beginners might read my Contents and flip right to this page.

That would be a huge mistake.

Trust me, you need to read the whole book. Stock picking is just a small aspect of the process of day-trading mastery. I'd want you to know, for instance, before you got to this chapter, that your choice of a promising stock doesn't mean you can safely trade in larger than 100-share blocks.

The good news is that the selection of stocks is one of your easiest hurdles. With clearly defined indicators and preconditions, finding good stocks to day trade is a breeze. Dependable analysis brings good results, and to help that process along, I've compiled a list of vital criteria:

- The average daily volume (calculated over the past three months) must be at least one million shares traded daily.
- The stock price must be between $10 and $100.
- The average intraday price swings must be sufficient to trade (as evidenced by chart analysis).
- There must be no stocks affected by government regulations and/or approvals.
- There must be no current news headlines that directly affect the stock.
- There must be no chance, in the near future, that the company will file bankruptcy.

If you apply all those rules, you'll find worthy stocks for your Watch List. You'll be armed with awareness of requirements that enable you to choose your stocks wisely and easily.

Adherence to the rule list results in two benefits. First, the criteria help filter out the high-risk, don't-chance-it stocks and stocks that don't perform well when day traded. Second, and most important, when you stick to such cautious selecting, you're ensuring your continued *consistency* in your current trading system. Think about it. If you constantly change your system of stock picking, then your trading style changes also, and I've previously established why change is not good.

After you look at the list, you might think to yourself, is that it? Where are the earnings per share (EPS), the growth rate, and other fundamentals?

Remember you're not an investor, you're a day trader, and that means you don't **hold** positions overnight. There's no need for you to embroil yourself in the concerns of long-term investors. All that you need to be focused on is what can affect the intraday price movement of your chosen stock.

Let's scrutinize all the criteria.

YOUR STOCK SHOULD HAVE AN AVERAGE DAILY VOLUME OF ONE MILLION SHARES OR MORE

The average daily volume (calculated over the past three months) must be at least 1 million shares traded daily. This is by far the most critical factor. *Make sure* that you study the past three months' average. If you only look at the daily volume, you're just getting a snapshot. The volume may have spiked for *only* that day.

You need to find stocks that have been consistently trading, meaning an average of a million or more shares in volume per day. You can simply look at a three-month chart, and make sure that the volume bars have consistently stayed above 1 million shares, for the entire course of that time span.

If they haven't, then forget it. Just put that stock out of your mind.

I don't care what cool new product the company has coming out, or what is being said about it in the *Wall Street Journal*. Forget about all that until the stock measures up to the requirements on the list. Consider this: if the company is so good, then why is the volume trading so low? Low volume means low interest. You want to be trading a stock that has high interest. Your stock should have at least 1 million shares trading *daily*, and this is because of *liquidity*. Liquidity is an indicator of trading activity, or trading interest. The more liquidity there is, the less are the chances that Market Makers will manipulate your trading activity.

Market Makers (MMs) are traders who buy and sell the majority of the shares on any given stock, on any given day. The best example of their price manipulations can be found in penny stocks. I can't begin to stress how risky things get when you expose yourself to penny-stock trading activity. Just think of the little bit of capital it takes to purchase penny-stock shares. A penny stock may have over a million shares traded, but if each share is only 20¢ then it takes just one MM $200,000 to control a million shares in volume for that day. This means there is very little liquidity. If you come in with your $5,000 capital trade, I can guarantee the MMs will counter your activity, and profit from your losses. This is why you see low-priced stocks (penny stocks and/or stocks priced under $10) fluctuating in intraday value from 25 percent to 100 percent, which is absolutely insane! This is the MMs muscling in and manipulating the price swings to their advantage.

So don't ever day trade penny stocks.

If you have a cartload of money to burn, then sure, by all means go crazy. Maybe 1 out of every 20 penny stocks pops. Then you'll certainly profit. But do you really want such slim chances? Do you want to virtually gamble?

In a nutshell I'd say just avoid low-volume stocks, and/or low-priced stocks with high volume. There's very little interest in the company. If Wall Street isn't trading those stocks in high volume, then you shouldn't be trading them, either—unless you're sure you know something that Wall Street hasn't caught wind of; in that case, all I can say to that is, good luck!

CHOOSE STOCKS BETWEEN $10 AND $100

The stock price must be between $10 and $100. A stock price above $10 usually indicates a company's good health, and tends to indicate healthy/high liquidity.

Most stocks that trade above $10 have a consistently proven track record. Unlike the lower-priced stocks, their price movement history is good; it shows they won't dramatically fluctuate. For example, you rarely have to worry that the stock might lose over 25 percent of its value in one day.

On the other hand, however, stocks priced over $100 tend to be highly volatile, and have more of a chance of retracing. Even when trading in 100-share blocks you can still be overexposed. I suggest that you don't day trade stocks priced over $100—not as an amateur.

Stocks in the \$10 to \$100 range tend to have consistent intraday patterns. You'll find that stocks priced at \$10 to \$30 will usually trade in a 50¢ range all day, and may fluctuate by 10¢ every 10 to 30 minutes. If you want a faster moving stock, try those priced at \$50 to \$100. Such higher-priced stocks usually trade in a \$3 range all day, and intraday they tend to fluctuate by 50¢ in under a minute.

See Chapter 19, "Trading for Skill versus Trading for Income," for a more in-depth discussion on how to treat differently priced stocks. For now, just remember this: Don't add stocks to your Watch List that are priced under \$10 or over \$100.

PICK STOCKS THAT DISPLAY TRADABLE INTRADAY PRICE SWINGS

The average intraday price swings must be sufficient to trade (as evidenced by chart analysis). You have to make sure that you spend enough time studying the intraday chart patterns. You need data feeds that access historical data, for example, the view of a five-minute chart dating back at least three days.

With regard to a stock in question, your goal is to determine whether the intraday price swings are consistently fluctuating. You want the price to be bouncing off the intraday support levels and resistance levels. You want your stock to have lots of intraday price movement. A bad stock will exhibit an intraday pattern of barely discernible activity. A bad chart pattern will exhibit sideways price action all day.

You don't want to get yourself too bogged down by this single criterion, however, so keep it all simple and short: just stay away from stocks that show intraday patterns that resemble a heart patient flat-lining. Always keep in mind that you can't make any money if the stock doesn't bounce intraday.

The stock price in Figure 14.1 stays within a tight three-dollar range over a three-day period. The price is constantly fluctuating, and bouncing off support and resistance levels.

DON'T TRADE STOCKS AFFECTED BY STRICT FEDERAL REGULATIONS

You do not want to trade stocks that can be directly affected by government regulations.

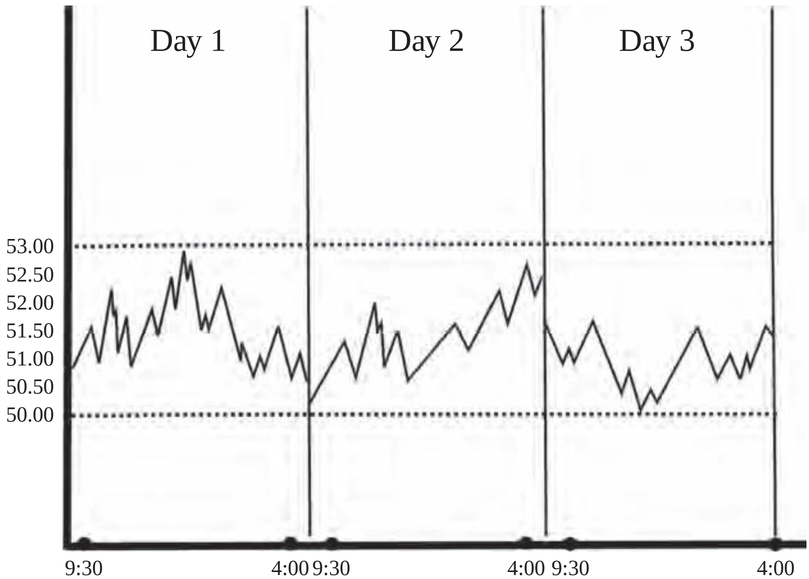


FIGURE 14.1 Intraday 5-Minute Chart

Biotech stocks and pharmaceutical stocks exemplify this bad category. You don't want to be trading a stock when the company is subject to strict regulations that drastically affect their sales. A perfect example is the drawback of U.S. Food and Drug Administration (FDA) approval requirements. Biotech companies must secure that consent before they can launch a new product.

If you're trading a stock and, on that same day the FDA decides more testing is needed and postpones a product's approval, then I guarantee the stock price will plummet so fast that your eyes will instantly cross.

You want to search for companies that sell stable consumer products, such as:

- Retailers like Wall-Mart (WMT) and Amazon.com (AMZN)
- Beverages stocks like Pepsi (PEP) and Budweiser (BUD)
- Tech stocks like Qualcomm (QCOM) and Microsoft (MSFT)

Another situation to dodge is the mergers. Companies that are merging are difficult to day trade. During the merging process, there's choppy volatility and/or sideways price action. Mergers usually have to jump through several political regulatory hoops before they can close the final deal. You don't want to get caught up in that.

BEWARE OF STOCKS DIRECTLY AFFECTED BY CURRENT NEWS HEADLINES

There must be no current news headlines that directly affect the stock.

How do you find out about this? You do good, old-fashioned research. You can learn a lot about your stocks by reading through the news headlines. The less news, the better, trust me.

In the next chapter, "Why News Can Be Just Noise," you will see how distracting and misleading news can be. I'm not saying all news is bad; I'm making the point that too much news can create a cloud of uncertainty.

Uncertainty usually leads to the foggy straits of choppy volatility.

So how do you decipher the news? You read through each headline, if any, on a stock you're thinking of choosing. If you notice that several headlines discuss relevant dates to the stock that aren't earnings dates, then avoid that stock for now. Most likely, until crucial news dates are reached, that stock will be unpredictable. You eliminate that headache by *not*, for the moment, adding it to your Watch List.

If you have a stock that you've been comfortable with trading but it gets into the headlines because of upcoming events, then beware. If you feel you must trade that stock—if you simply can't resist the temptation—then at least be restrained from trading that stock on the day of the announcement and the day just before it. You *do not* want to be in a trade just before the anticipated news hits the wire. You're gambling, not day trading, if you think you can predict how the stock price will react to the news.

There must be no chance, in the near future, that the company will file bankruptcy.

Duh!

Who would invest in a company that has filed or is going to file bankruptcy? The answer may surprise you.

Some daredevil day traders (gamblers) only trade companies under reconstruction. Those same traders usually seek companies that have stock values less then $1 per share. They're trading penny stocks, and I've shown how that's crazy-risky.

Their reasoning isn't quite crazy, but I would call it naïve: they figure they can buy those stocks cheaply and then **hold**. They're anticipating, with extreme optimism, that the reconstruction period will turn out positive. Here we go again. Always remember we're day traders, and we *never **hold** overnight*. Do you really want to be trading a stock that's likely to lose 50 percent or more of its stock value overnight or intraday? Of course not!

Stay away from any stock you've found that is even considering bankruptcy.

Now that you have a reliable stock selection system, you can begin the initial day-trading process. I suggest that you try to find 15 stocks in three different price ranges: 5 from $10 to $30, 5 from $30 to $50, and 5 from $50 to $100. Once you have that Watch List, you can begin to monitor everything on it, and eventually to trade each stock.

Reminder: Do *not* start trading the stocks you've found until you've read this whole book.

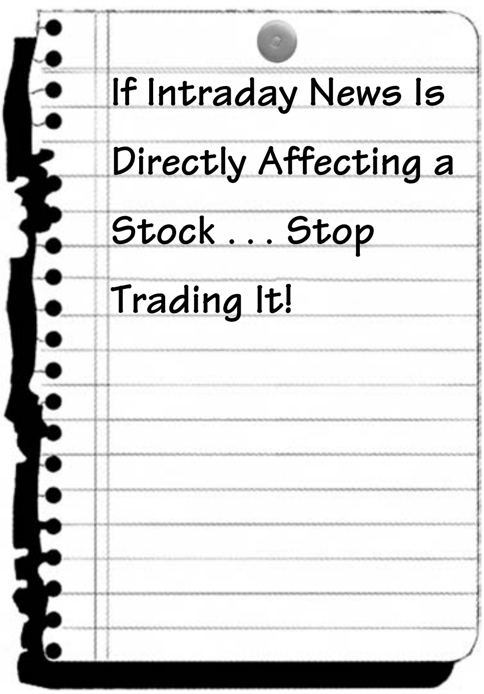
RULES TO REMEMBER

- Even with a good stock to trade, never lower your guard and/or trade in larger share blocks.
- Find stocks that have been trading consistently, over a three-month period, above 1 million shares in volume per day, on average.
- Never trade penny stocks.
- Only add stocks to your Watch List that are priced in the $10 to $100 range.
- Stay away from charts that exhibit intraday flat patterns.
- Don't trade stocks whose companies are dependent on regulations that can drastically affect their product sales.
- Don't be in a trade just before anticipated news hits the wire about it.
- Stay away from any stock that is even considering bankruptcy.
- Read this whole book before you trade stocks you've found.

CHAPTER 15

Why News Can Be Just Noise

As day traders, we *only* need information that *directly* affects the stock that we're trading *intraday*. Here's something else that should go on a big sign:



It's easy to keep an anxious ear on the news that impacts your stock. The tricky part is to know when to listen, and also when *not* to listen. Certain types of news can drastically interfere with the intraday price action, including premarket and after-market action. That's news worth hearing.

The following news items, if related to your stocks, are broadcasts you must keep abreast of:

- Earnings announcements
- Fed interest rate cuts/hikes
- Core product issues
- Merger talks
- Class action lawsuits
- Bankruptcy announcements
- Employee strike threats
- CEO resignations
- Governmental interventions
- Chief competitor advancements

If you fail to get the initial scoop on events like those listed above, then you won't be prepared for the rollercoaster ride that's likely to immediately follow. *Beware!* Most of those items will hit the news wire without any prior warning. If you don't know that they've just transpired, you'll likely get hit with the worst kind volatility, the unexpected kind, right in the middle of a trading session.

Conversely, however, you should totally ignore certain buzzing. Too much buzz about your stock can seriously mar your daily rhythm, and can negatively influence your decision-making process. When it comes to intraday price movement, most of the talking you hear about your stock will not directly affect it.

Maybe you'll be caught up in trading a stock, and a discussion on the relevant company comes at you over the airwaves. It turns out it's a couple of opinionated analysts, debating the firm's future growth.

Depending on what you absorb from their talk, you may feel persuaded to trade either more, or less. Well, because of this buzz that has nothing to do with the intraday price swings, you've just broken your intraday consistency and rhythm.

The skill of news filtering is hard to master. As an amateur you're very impressionable, and you may lack focus. You need to learn which news will hurt you in a trading situation, and which news is dispensable, just noise.

I almost never listen to analysts' recommendations. Remember, we're not investing. It's not for us day traders to care what price the stock may or not be worth, three months down the road.

On the other hand, you should memorize the list I provided at the beginning of this chapter. These are critical news announcements that directly and immediately affect your stock. Most likely the stocks you're trading won't get rocked around by those issues, at least not on a daily basis. (If they do, then you've chosen some bad stocks. Stocks that are constantly affected by the news should not be on your Watch List. Refer to Chapter 14, "Stock Picking," if you need to refresher on that concept.)

A great example of a stock that should not have been day traded was Washington Mutual (WM), during the months leading up to its liquidation buyout by JPMorgan in late 2008. Almost every day there was news debating the bank's fate. The stock exhibited extreme volatility every time analyst predictions hit the wire, especially when Merrill Lynch and JPMorgan analysts spoke.

If you were trying to predict how the stock would trade in such a noisy and uncertain environment, then you most likely were going crazy trying to trade this stock intraday.

Why do that to yourself? Why are you so attached to one particular stock?

There are thousands of stocks you can choose to intraday trade. All I am expressing here is the importance of not trading a stock if it is reacting to news and announcements on an intraday basis.

Simply trade stocks that have low news-related profiles.

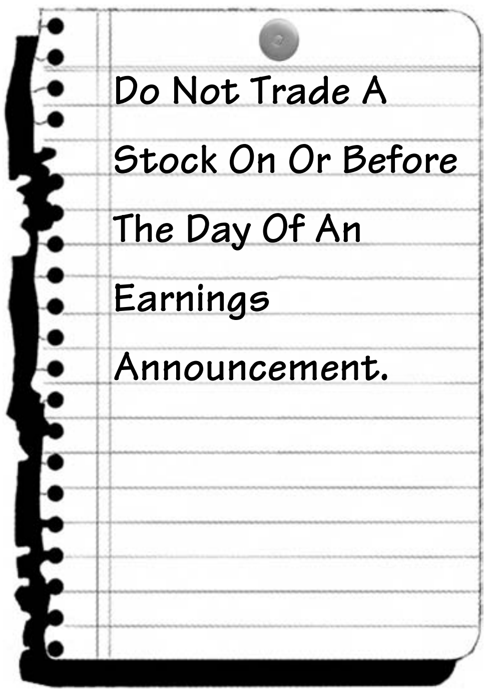
TRADING ON NEWS VERSUS MONITORING NEWS

Even if you've chosen some great stocks to day trade, you should not try to trade on the news; rather you should remain aware of any new and relevant news that hits the wire. You don't want to be in a trade when bad news is released.

There are a couple of ways you can do this. I'm always tuned in to CNBC Business News Channel, which is always broadcasting on a nearby TV as I trade. I have to warn you, however, that CNBC announces important news a few minutes after Wall Street gets it, so it's a good idea to gain access to what Wall Street uses for news wires. I've found that most real-time news feeds, like Market Wire, are as fast and efficient as it gets.

Unless you have chummy relations with relevant company public relations directors, then you need to subscribe to direct access news. Once you gain access you can customize the feed so you only get information that's germane to your stock.

While most of the news on the list I've provided involves items you don't often hear of, the one that you need to be constantly on the watch for is earnings announcement dates. Those dates are always preannounced. You need to have them logged and noted. Since company earnings are released each business quarter, you can easily find out when they are. Simply go to Yahoo Finance. Click "News," then click the "U.S Earnings" tab, and type in your stock symbols. You can only get an exact date once each business quarter. You should know this date like your own birth date. Mark it on your calendar, plan around it, and make another sign to tack up:



Those are the two dates that I can guarantee will be extremely difficult days to trade that stock. You'll see unusual volume and price movement. You can expect the unexpected as well as high volatility. You should not attempt to ride this roller-coaster. Take a break from that stock for a couple of days. You should have other stocks to trade, on or before that date. Besides, when you're on the sidelines, you have a better opportunity to wait for a major gap-up or gap-down.

Now let's return to those other announcements on the list. They're rare, but when they do happen, you won't be able to plan for them. If the news hits the wire midday and it's immediately affecting the stock price, you should just stop trading that stock. Get out of your position quickly; take a loss if you have to. The price could drop 10 times faster then you're used to, and it could do that in seconds. As you would with the earnings announcements, avoid that ugly scene by trading other stocks for the remainder of the day.

Trading on news is very risky and unpredictable. But it's dangerously easy for an amateur to perceive the news as a leading indicator for stock price predictions. If an analyst announces, quite officially and with pomp, that he thinks the price target will reach X amount of dollars, then the amateur might be persuaded to trade in that direction.

Don't.

You should perceive the news as a tool, not an indicator. Then you'll understand that it's a mistake to trade on news. Your stock charts are indicators of where the stock is heading, and the news should only be heeded when it's the type of information that will *clearly* interfere, *intraday*.

Having access to the news is a very useful tool, but remember that it is only a tool. When an earnings announcement gets released by the wire, you should know that within seconds, the charts will go crazy. Other than that and the other items listed, you should ignore all the buzzing and spinning that's part of the endless, cacophonous babble.

RULES TO REMEMBER

- Know which news will hurt your trade, and which news is just noise.
- Always know your stock's earnings announcement dates.
- Do not trade a stock on or before the day of an earnings announcement.
- If the news hits the wire midday and it's immediately affecting the price of your stock, stop trading that stock for that day.

PART IV

The Truth about Training and Preparation

One purpose of Part Four is to help the beginner choose a training program commensurate with his skill level. I discuss both the benefits and the shortcomings of those programs.

My ultimate goal is to have you understand that after you attend a training seminar, you have a lot more to learn. I emphasize the importance of not expecting a lot. But this part is not only for the beginner: I also advise the more experienced amateur on the helpful paths he can take that won't be redundant, and will build expertise.

Furthermore, in Part Four you will find eye-opening information regarding the differences between pay-per-trade firms and pay-per-share firms. You will also find that Chapter 18, "Paper-Trading Strategies," and Chapter 19, "Trading for Skill versus Trading for Income," offer great learning techniques.

CHAPTER 16

About Those Training Programs

During my amateur day-trading years, I was finishing my education at San Diego State. I left, both relieved and exhausted, in possession of a Bachelor of Science degree in Business Marketing. Right next to my collection of textbooks from school, I was building a personal library on day trading. When asked what I wanted for my birthday or Christmas, I requested more titles on the subject.

During that time I also attended several day-trading training seminars.

Everywhere I went, I sought day-trading knowledge. The subject soon came up with anyone I talked to.

I noticed that professional mentors were scarce. I did have a couple of contacts who worked in the stock brokerage industry. Though they themselves didn't day trade, their advice armed and inspired me with a greater understanding of the stock market.

As I struggled past the hazardous amateur phase, I came to see that I learned the most from my actual experience in day trading, and also from those advisors. The day-trading programs and college business courses did teach me good strategies and trading styles, but it was clear that the *real* education was hands-on, when I performed with real money.

Now, please don't get me wrong here. I'm not suggesting that you shouldn't attend any training programs, courses, or seminars—especially if you're a beginner. Amateurs need structured guidance, and that's what such tutoring offers. I feel I must warn you, however, that *consistent* gains come *only* with *experience.*

With that said, I'll now express my opinions of those training programs. There are basically two kinds. There are seminars out there for the greenhorns, and there are quasi-mentorships for the in-between guys, the traders with somewhat more experience, who aren't yet in the major league. I'll start with some thoughts on the outfits designed to instruct and equip the beginners.

SEMINARS FOR THE GREENHORNS

The first thing to consider is the eyebrow-raising tuition, and then what you're going to get for it. Day-trading seminars want your money upfront. After they take it and train you, you're totally on your own. They don't hire you after the program. They don't offer you a position on their trading floor; they don't even have a real trading floor. They also don't have their own trading platforms (proprietary software). For a profit they pump you with strategies and trading knowledge, and then they throw you to the wolves.

If afterward, you fail miserably, that's no sweat for them. They will lose nothing if you do, and they could care less how you end up. Show me a program that will reimburse your fees if you subsequently lose everything, and I'll take my shirt off and eat it.

But you, the beginner, need guidance from somewhere, so that's where you'll likely have to start. The lucky alternative is having a friend who's also a professional day trader, patient as a saint with your greenness, and happy to show you the ropes for a song.

You're probably bereft of that blessing. Many newcomers are. So you'll be forced to seek programs-for-profit.

The key to reaping rewards from those outfits is to hold back your money and ask cautious questions, like whether they teach during market hours. That way, if you decide to sign up, you'll witness their trading system truly put to the test, working in market time. Also: you want to pick programs with coaches who are active day traders themselves. You don't want to be taking instruction from someone who doesn't day trade. Never sign up unless you can prove that they definitely are, and do. At the end of this discussion you'll find a detailed list of helpful questions to ask.

When I was getting started, I took part in a few of those training programs. Soon the pros and cons of it all were starkly evident. Here are some essentials to consider:

Pros

- You're introduced to proprietary trading methods, in a compellingly structured environment.

- A trained staff answers all your questions.
- You get a little hands-on experience, usually some actual trading, during market hours.

Cons

- This is usually very expensive, ranging from $1,000 to $7,000, with absolutely no guarantees.
- The training is usually limited to just one week or less.
- These programs *do not* teach you how to trade with *pay-per-share* brokers.

On the surface, the pros look really good. You're getting some practical training. They teach you how to trade with their system. They show you how to read chart patterns. They cram your brain with information that only Wall Street uses. And yes, you're exposed to several *professional* trading strategies.

Also: most programs limit their class size. They usually have at least two instructors (though not always professional day traders) working with groups of ten to twenty. You feel like you're getting some personalized attention, and to a certain extent, you are; that's one of their selling points.

As I mentioned, most of those programs incorporate some actual trading in their class time. During the first couple of days, they show you how to use their system. After you've learned it, you apply it. Usually they have you pick a stock in accordance with their system, and then you paper-trade the market, or trade on their demo software, using monopoly money.

They look over your shoulder, and they guide you. They effectively ensure that you, their protégé, are applying their system correctly.

So far, that all sounds great!

But now let's discuss the cons.

Well, first there's the obvious negative: those fees. If the cost of those programs is overwhelming, you should hold off until you can handle it. The value you'll get for your sacrifice isn't worth going into hock over.

When you do reach a point where you can throw them some money, or wallop a credit card, then check things out, tread very carefully, and understand all the limits. This is an investment, like college, and it's crucial to choose the right one. The cost is very comparable to state university fees.

You might think, the fee's really worth it, because what you'll learn will make you *big* profits really *soon*. Didn't the sales rep imply that? Didn't he practically *promise?*

But he didn't offer a guarantee, did he?

Now take a look at that time frame. You're supposed to pay through the nose, stay for just a few classes, and walk out of there a pro. You're going to make back the thousands you paid in days, or just a few weeks.

Yeah, right.

You have to become an *experienced* trader to make that much that fast. Remember Chapter 4, "From Impatience to Cool, Calm, and Collected." If you're a beginner, reread it. Revisit my tales of the blunders that keep new guys' gains very small (and that's if they gain at all).

It might take you an entire year to make back the training fee. Or else you just might lose so much, it's like the fee got quadrupled. So here's the most urgent of all my advice: after you walk out of that seminar, keep expectations *low*. That's a reminder of everything I warn about, back there in the first section.

And now for the last con I listed, which is by far not the least: Most training programs completely leave out instruction on pay-per-share trading. I have a problem with that.

In the following chapter you're going to learn that it's much better for a day trader to be charged a commission based on pay-per-share, *not* pay-per-trade. That's because a pro day trader places several executions per day, and he needs to avoid falling into the quagmire of the much, much higher commissions he's charged when he's doing pay-per-trade.

I suspect there's an ulterior motive behind the omission by most training programs of instructions on trading pay-per-share. I suspect it has something to do with the fact that a lot of the training programs have made special deals with the prominent pay-per-trade brokers.

Here's an example. One of the programs I attended is featured in a well-known trading academy with satellites all over the world. A steady flow of new day traders completes their program everywhere, daily.

During our class instruction, we were required to use a prominent online broker with a pay-per-trade commission structure. At the end of the program we were offered this seemingly awesome deal: if we day traded through this broker, then for our first 1,000 trades, we would only have to pay $5 on every $10 trade. That was a discount of $5 per trade, a savings of $5,000 after 1,000 trades.

That would virtually pay for the training! Sounds like a great offer, right?

I never took them up on it. I knew about the better alternative, pay-per-share. I knew about the high commissions imposed in pay-per-trade situations, and I knew that those commissions are much, much less when working with brokers who offer pay-per-share. I knew pay-per-share is the way to go when trading several times daily.

I thought about the newly-trained amateurs who are easily impressed by that so-called discount. I began to get a fix on what *shady practice* means. I realized the seminars are businesses, out for profit like everyone else, but when they deliberately omit information—like the pay-per-share option that saves day traders big money—that made my blood start to boil. The boil started rolling when I considered the fact that day traders are never required to have any certification or proof of high skills, yet pay-per-trade brokers will take all our money without any questions asked.

That alone made me skeptical, especially when I also considered the fact that pay-per-share brokers require some experience in the day traders they take on.

To be fair, some training programs skip pay-per-share info *not* to net beginners into pay-per-trade commissions, but simply because the pay-per-share brokers don't want to deal with the amateurs. Just the same, however, I feel seminar coaches should inform clueless greenhorns about the drastically lower commission fees in pay-per-share day trading.

Then I'll be less suspicious.

So pick your training program, by all means, sign yourself up . . . but go there with your eyes wide open. Don't become just a cracked, muddied cog in the wheel of those corporate deals that just use you.

And now I'll turn my attention to the day trader getting past the neophyte stage.

TRAINING PROGRAMS FOR THE MORE EXPERIENCED TRADER

If you've been day trading long enough to have an advanced trading style, then no one will call you a beginner. It may be just as true, however, that you're not yet professional. You may need additional training, and that's where things can get tricky. You've got to make sure that the program you pick is one that exceeds your knowledge. You've got to take care to match what it offers to precisely your *current* needs.

I can illustrate just how important that is by admitting to a costly mistake I once made. About five years into my trading career, I attended my second training program. It turned out to be a total waste of time. It was $5,000 down the drain! Why? I was much more advanced than I thought I was. The program lasted five days. Every day I heard info and strategies that I already knew.

Imagine how cheated I felt. Imagine how cheated I *was*.

What can *you* do to avoid that?

You can circumvent a disaster like that by gauging the depth of your skill. To review that critical subject, reread Chapter 1, "Truths about Yourself to Know First."

And if you do, then what? You're actively trading every day, you've been doing so for some time, your knowledge exceeds the trainers', yet you feel that you still need some coaching.

What you're ready for is a mentorship program. Such learning is for day traders who would never get a headache while trying to keep up with a pro, and wouldn't be wasting the time of that pro with the questions of a beginner.

A mentor is a professional day trader, who trades actively every day. You could benefit greatly from working with that person—while he trades with his real money.

For you, the experienced day trader, anything else is just fluff.

Mentoring is where pay-per-share brokerage firms shine. Most of those firms have their own trading floor. You can trade on their floor for free, provided you pay per-share. While there, you're exposed to veteran traders, and many of them are natural mentors.

And many of the pay-per-share firms actually offer an in-house classroom. They usually charge nothing for it, and you're learning some valuable info. They want to make you savvy and sharp, a profiting team member that *they* profit from. The better you trade, the more money they make. You're their investment, so they educate you, and at absolutely no cost to you. It's a win-win situation.

If you think that you're ready to day trade like a pro and talk to a pay-per-share brokerage, and if they agree with your opinion that you're no longer green, they'll offer you a probationary training period. This usually involves trading for one or two weeks on their demo software. They'll evaluate your performance and natural trading style. They'll expect you to be consistent and lucrative. If you're not, they'll let you go. They'll pat you on the back and advise you to return after you've gained more experience.

That's why, in spite of the flaws and the scams, I wouldn't advise the beginner to avoid pricey training programs. Again, you have to start somewhere.

Are you getting a sense of a hit-or-miss minefield, in this risky business of training? The potential to lose money or waste it, or else waste your precious time, is tremendous. You should be feeling very wary.

TIPS FOR SELECTING THE RIGHT PROGRAM

In an attempt to help you circumvent those scary possibilities, I've put together a list of questions to ask the purveyors of trainings, before you commit to go. Whether you're a beginner or experienced, getting answers to these queries should help you decide where you fit.

First of all: When researching training programs, make sure that you speak with an actual instructor—not just the sales rep who wants to gouge your card. If you can't get through to a teacher, forget it. If you can, then explain your trading experience, and expect him to patiently listen to every minute detail. Ask how the program can advance your trading style, or how the program *cannot*. Drill him as if you know more than he does. You might just find out that you do.

The Before Questions

- Will I learn about pay-per-share brokers?
- Do the coaches have active day trading experience? If they do, then how much experience?
- What's the coach-trainee ratio?
- What trading software is used?
- Describe the trading stations. How many screens at each station?
- Will there be real-time trading during classes?
- What percentage of the training is live trading?
- Does the program have a large emphasis on risk management? If so, how is it applied?
- How much hands-on mentorship is included in program?
- Why is this program so expensive? (Mention cheaper ones, if you know of any.)
- If I bring a list of questions, how much time will I have to get and discuss the answers?
- Are there any reimbursements or guarantees? (Ask this just to watch their response.)
- Can I use my tuition money to trade your system with? If I lose I don't pay? (Again, ask this just to watch their response.)

I also have a list of "after" questions—concerns you should demand to get answers to after they've taken your money. It's your hard-earned cash or credit that you just dished out to them, so maximize your learning experience with an arsenal of queries like these:

The After Questions

- If it hasn't yet been volunteered, ask for information about pay-per-share brokers.
- Ask the instructor to elaborate on his or her experience.
- Ask how much the instructor is losing that day by teaching instead of trading.
- Ask to be shown how he or she personally trades.

And don't stop with my questions. Make up a list of your own. Bring up the concerns that have been teasing your mind throughout your day trading experience. You should have a ton of questions related to trading scenarios. The more questions the better.

At some point during the program they'll have you apply their system. You'll hunch over a trade station, probably a computer with only one small, flat screen, and that's when you should get a taste of mentorship. Someone should be monitoring your trading activity and giving you structured guidance. This is when you're closest to getting your money's worth.

Whenever I've attended a training seminar, I've been seated at a computer and trading with their demo software, which is basically paper trading. It's always been my habit to grab an instructor and practically force him to stay with me for just as long as I need him. I've noticed how most of the other participants just silently sit at their computer stations all day, trying to trade the new system on their own.

I was just as able to use the new system. It's just that I had a lot of questions prepared, and I wanted them answered while I was actually trading. I suggest that you do the same. Don't feel like you're hogging the coach. If you sense that you're taking too much of his time, then stop right there and go to the administration office or sales rep, and frankly explain your concerns. You just paid a lot of money for this, and you have every right to ask questions, even if it's eating up class time. Make the point that understaffing is certainly not your fault.

Finally, don't view the training program as a place to go and be shown how to day trade from scratch. Even if you're an amateur, you should already know the basics. Don't go there just to take notes. Know enough to get involved in class discussions. Get your money's worth.

Once you leave the program you're completely on your own. You may have befriended a few students in the class, but you're basically just a lone wolf.

In this chapter on training and preparation, there's one last issue to address. Many pay-per-share firms require their day traders to obtain a Series 7 license. These firms are aware that the Securities and Exchange Commission (SEC) may soon enforce the licensure in all new pay-per-share traders.

Your standard day trading academy or seminar won't instruct you in how to pass the licensure test. I strongly suggest that you instruct yourself in it. It's important to recognize that day trading is a profession, and the higher up the chain you go, the more rigorous are the requirements.

It costs about $300 for the Series 7 license study materials. I suggest that when you budget for an expensive day trading course, you also put some money aside for that.

RULES TO REMEMBER

- If you're a beginner day trader, go for some form of structured training.
- Go to training programs armed with questions.
- Don't expect to be a pro upon completion of any short-term program.
- Insist upon information about pay-per-per share brokers.
- If you're an advanced beginner, seek out mentorship programs.

CHAPTER 17

Picking the Right Online Broker

Pay-per-Share versus Pay-per-Trade

There are two types of day-trading options: pay-per-trade and pay-per-share. The one that's right for you depends on how often you trade, and also on your level of experience, and the amount of your trading capital.

If you plan to be a professional day trader, meaning you want to do multiple round-trip daily trades and you'll never **hold** overnight—then sooner or later you'll want to escape the high pay-per-trade commissions. For serious day traders who are in for the long haul, the way to go is pay-per-share brokers.

I have to confess, however, that along with the alternative, I do keep a pay-per-trade account. I've found that the pay-per-trade brokerages are useful for certain things, even for a pro. Traditional online brokers offer crucial stock research tools. They can boast great platforms to trade on, and they impress with slews of incentives, like ATM cards, free checks, and free data feeds. For all of those reasons the pay-per-trade brokers are the place where a greenhorn should start. They facilitate a beginner's transactions. They provide great customer service. They offer the market data that's needed to build a newcomer's skills.

STARTING OUT WITH PAY-PER-TRADE

Here's the most important reason to get your feet wet with pay-per-trade: when you're beginning they'll only let you trade with your actual capital amount. The minimum capital required is usually only $500. That policy effectively diminishes your exposure to perilous market risk.

Think about it. At a pay-per-share firm, usually you're required to open an account with at least $25,000. The leverage you're given may be as much as a whopping 20 to 1. In buying power, that equates to $500,000.

As an amateur, imagine how much trouble you could get into!

Pay-per-trade brokers don't let that happen, and that's all well and good, but remember: I mentioned high commissions. With pay-per-trade brokers you're paying roughly $8 to $10 per trade. That's $16 to $20 per round-trip trade. That's prohibitive!

And it gets worse.

As a beginner I exclusively used a traditional pay-per-trade broker. Everything was fine until I established myself. When I traded more than four round-trip trades in a five-day rolling period (any string of five days in a row), I got sprung from normal trader status to "pattern day trader."

At first I felt good, as if I'd gotten promoted. Then I discovered the baggage. I'd gotten strapped with a bunch of new rules. To maintain my "pattern trader" standing, my account became required *at all times* to have at least $25,000. The good news was the 4-to-1 margin I'd earned, meaning now my buying power was four times more than my balance. That was cool, but then came the kicker: whenever I fell below the $25,000 minimum, my account went into an "equity call." My trading privileges got severely curtailed. I had lost the 4-to-1 margin, and that was painful enough, but here's where things got outrageous: before I could purchase another trade, I had to wait three days for each trade to clear!

Meaning, until I could deposit more money, I was basically unemployed. And if I had nothing to deposit, well, suddenly life really sucked.

I've just gotten started and already you can see that there are mind-boggling advantages and disadvantages to both of the day trading options. I look back and realize how careful I must be in advising a beginner on which type of broker to start with, and especially for *how long*.

Put succinctly, new traders should start with pay-per-trade, and stay there until they get busy, and then they should move to pay-per-share once they decide to start trading full time.

TRANSITIONING TO PAY-PER-SHARE

Pay-per-share brokers have drastically lower commissions, and that will make you want to jump in—but whoa. Take a closer look at this water. It's swirling with hungry sharks. Pay-per-share brokers are generous with your leverage to an extremely dangerous degree. As I've mentioned, they'll leverage your $25,000 minimum to as much as 20-to-1. They'll provide you with a training-probation period, but it's likely to be only a month, and right away they'll probably offer you a leverage of at least 10-to-1. That means they'll be letting you have $250,000 buying power against your $25,000. That's pretty scary stuff.

And then, when you prove to be consistent and profitable, they'll bump your leverage higher. I've seen 20-to-1. For instance, a $25,000 minimum can result in a 20-to-1 leverage maximum. If you add more to your account, the leverage will increase. Usually a $100,000 balance will allot you $2 million in buying power, or a 20-to-1 leverage. Each pay-per-share firm has different policies on leverage allocation.

One good thing about those hazardous straits is that if you have a bad day, you're not made to walk the plank. Well, at least not all the way. If you fall below your minimum requirement, you're not in a bind like it goes with pay-per-trade. With the pay-per-share brokers, there's wiggle room. You can lessen your leverage a tad. Depending on your skill level and your rapport with the risk managers, your minimum account value will vary. For example, suppose you start your account with $25,000, and you're given the normal trial leverage, 10-to-1. If you lose, let's say $5,000, then unlike with pay-per-trade-brokers, you can still trade with what remains. Your leverage will be lowered; you can expect to lose half of your leverage until you've returned to the $25,000 minimum; but at least you're still day trading, there's no immediate equity-call.

And now I'll get on to the hassles of the pay-per-share trading scenario. I'll start with the minor ones.

Pay-per-share brokers tend to be independently owned firms with limited customer service and banking capabilities. Most likely you'll *not* be provided with an ATM card or personal checks. In order to make withdrawals, you'll have to request wire transfers or certified checks. It's a bit of a pain, but the people you work for are likely to make it worthwhile. If you need cash today, they'll probably cover you, even though the pay structure is usually biweekly. These firms aren't big banks with fancy bells and whistles, but they will cover your needs.

After a day of trading, I used to walk around the corner with the principle owner of my pay-per-share brokerage, heading for a bank near Wall Street. We chatted in line while we waited for him to withdraw some cash for me.

I think such rapport, with a real human being, with the New York Stock Exchange (NYSE) in the background, is considerably more inspiring than the impersonal perks of the pay-per-trade giants online.

But now I'll describe the *big* hassle. I didn't start using a pay-per-share broker until after eight years with a pay-per-trade Goliath. For two of those years I was a "pattern day trader," putting up with the terrible penalties. I hadn't yet learned about pay-per-share brokerages that give you those 20-to-1 leverages; most of those firms are in major northern cities.

I, of course, lived in paradise.

Why would I even consider looking over the fence at those winters?

Well, one day I did about 36 round-trip trades. My fees, of course, were insane: $9.99 per trade, with 36 to buy and 36 to sell. By the closing bell I had $540 in profit, which should have been an okay day, but when I included my cost to trade—$720—my profit of $540 became a loss of $180!

I decided that from that day forward, I'd search for pay-per-trade brokers with lower fees per trade.

Then I found out there's no such thing.

Things began to feel pretty dismal. I desperately needed to find a cheaper way to trade, or else I'd be forced to limit myself to only a few trades a day.

Only a few trades a day?

Yeah, right. Ask a Wall Street day trader to do that, and he'll tell you to go take your meds. So I searched for another kind of broker. I went online and found scads of such companies in New York City (of course). That's where I discovered pay-per-share. And that's when I was forced to acknowledge that a switch to pay-per-share might cost me *miles*. About 3,000 miles.

I might have to move to New York.

Most pay-per-share brokers are called proprietary equity trading firms. They have their own trading floors, complete with trading desks, and if you're a beginner at pay-per-share, then they want you right there, at those desks.

I got interested in a firm near Wall Street. I assumed that they wouldn't consider me until I'd traded with their demo software for a probationary period. I figured they'd probably require me to have a Series 7 brokers license, which I did not yet have.

It turned out I was wrong. They were willing to allow me to download their software and trade with them from home, but only with a painfully limited leverage, designed for remote beginners. What they really wanted to do with me was literally watch over my shoulders. I quickly realized that what I needed to do was pack myself up and just *go*.

I won't belabor the inevitable miseries that happened to me next: the anguish of tearing away from the gorgeous, sunny West Coast, leaving lots of people I loved, and also a lot of my belongings. But log this and note it, because you might move, too—if you're serious about day trading, you may have to.

I got to Manhattan and went through the rigors of finding a cubbyhole to live in. Then overnight, I became a New Yorker. God, that process is fast.

Each morning at dawn I showered, shaved, pulled on some warm winter clothes, and joined the subway-crushed rush-hour masses to get to the firm's trading floor. I had sacrificed working at home in my shorts, but I had also ditched the high pay-per-trade commissions, and I soon found myself enjoying the privilege of notably high leverages to work with.

Pay-per-share brokers do charge you a monthly fee, and, depending on what data feeds you require, it comes to $150 to $250. That plus their daily pay-per-share fees may sound like quite a lot, but compare it to the pay-per-trade commissions, and it starts to look like nickels and dimes.

The average per-share cost is between $.0035 and $.0065. That means that if you buy 100 shares of any given stock, you pay only 35¢ to 65¢ cents for that 100-block execution, not $9.99 like with online pay-per-trade fees.

So you can imagine how happy I was with the dramatic fee decrease. If I traded 30 round-trip trades (60 executions) with 100 share-blocks, then my commissions for that day were roughly $30 to $35 (30 round-trip trades of a hundred shares: 60 × 100 = 6,000 shares—6,000 × $.0055 = $33). That same trading day with a pay-per-trade broker would have cost me $600 (60 trades × $9.99)!

So okay, now maybe you're wondering: *What if I wanted to purchase 20,000 shares in one trade?*

That's an excellent question, and the answer is frightening.

With a pay-per-trade broker that would cost you only $9.99, but with a per-share broker it would cost you $110 (20,000 × $.0055 per share). Yeah, that's not a misprint.

The point here is that you should *never* purchase more than 500-share blocks at a time, unless you're a whale trader (professional day trader). To refresh on this critical issue, reread Chapter 7, "Why Overexposure to the Market Can Hurt." That's where I elaborate the danger of purchasing huge share blocks.

As I write this, I remain in New York. Eventually I'll move back to California. I plan on creating my own trading group, back in my beloved San Diego.

Regardless of where I want to live, however, or for that matter where you want to live, I believe that any new trader should come to New York for a while. You should stay for at least a month or two, to thoroughly learn a pay-per-share system, as well as its trading platforms. Later on, when the firm feels you're ready and will give you high leverages remotely, then you can move anywhere in the world and trade with that firm from a distance. The fees and direct access will remain the same, no matter where you are.

But now let's get back to the risks. It's very important to *not* take full advantage of the insanely generous leverage opportunities that pay-per-share brokers offer. Make no mistake here, be certain they will, and it's up to you to decline them.

As it goes with any business, their priority is profit, and it's all off your trading volume (in shares). So when you've moved past beginner status, they'll offer you tons of buying power. The more leverage you have, the more you will trade. They need you to trade a lot.

HIGH LEVERAGE PROS AND CONS

When I first started day trading at my Manhattan firm, they offered me a 20-to-1 leverage. I was naïve, and I took it. I had opened an account with the required minimum of $25,000, so that meant I had $500,000 of intraday buying power.

Going for that much was a huge mistake. I wasn't accustomed to that much buying power, and let's emphasize the word *power*. It was very hard for me to resist using all that leverage, so I placed some really large trades.

My first week of trading with a 20-to-1 leverage was a roller-coaster ride. One day I would make $3,800 and the next I would lose $4200. In some cases the profits and/or losses were only from one trade. It didn't take me long to see that I had to limit my exposure.

I was purchasing 100-share blocks just like always, but then I would also string-trade. That means I would buy 100, then 100 more, then 100 more, and so on. I would do this until I reached my buying power limit. Then, when the trade went against me . . . *ouch!* I had accumulated 5000 shares of a $100 per/share stock ($500,000 worth of equities). I knew I was much too overexposed to the uncertainty of the stock swings.

Don't ever end up there. Avoid being unsure of where things are headed, and at the same time, having too many shares. The way to go is self-limitation. Take only a 10-to-1 leverage until you can handle more. Eventually I figured out what I could handle. When 100 shares moves $1.00 in stock price, I gain or lose only $100. I can take that kind of pressure because the risk isn't bad.

Accordingly, you should know your comfort zone, and never deviate from it. See Chapter 13, "Trading Consistently All Day."

If you're given a lot of leverage, and throughout the day you spread your money over a wide range of trades, you're okay if one goes against you. For instance, if you purchase 500 shares divided among five stocks, and one bellies up, that's no problem. Once you start getting in rhythm with your stocks you can start buying 200-share blocks at a time . . . but don't get ahead of yourself. I will soon be discussing this in greater detail in the Chapter 19, "Trading for Skill versus Trading for Income."

The harshest downside of leverage is when an amateur with no established system falls victim to his own temptation to put all his buying power on the line and buy just *one* security and will **hold** it. I've seen beginners come onto the floor and lose all $25,000 of their start-up cash, all on the very first day. They take the 20-to-1 leverage offered, which is $500,000 in buying power. They purchase 5,000 shares of a $100 stock and then watch the stock go against them, all day. In that situation, it only takes a $5 drop in the stock price to cause them to lose their shirts.

In that case, the risk manager scurries over to their desk and whispers: "You have to sell *now*."

Actually, the trader in that circumstance might not be an amateur. It could be someone well-seasoned in trading, but unaccustomed to so much buying power. Once again, it's all about self-limitation, or else the lack thereof.

I'll conclude this pay-per-trade versus pay-per-share tour by stating that it's essential to use both, to your advantage.

HANG ON TO YOUR PAY-PER-TRADE ACCOUNT

I still have my traditional pay-per-trade account. I still use that firm's site for all the market info and free data feeds. I also still use them for my banking—they have no ATM fees, worldwide. But the main reason I remain hooked up with pay-per-trade is in case of the extremely rare situation where I may want to **hold** for an extended period. Most pay-per-share firms won't leverage you if you're **holding** overnight. You can **hold** overnight with their system, but never with their money. If you have $25,000 in your account, the pay-per-share firms will only allow you to **hold** $25,000 worth of a security overnight.

I assume that you already have a broker, and it's most likely a pay-per-trade firm, and even though I've made it clear that you should eventually move on to pay-per-share, I suggest that for the reasons above, you never cancel your pay-per-trade account. Even if you have a zero balance, most pay-per-trade firms will keep your account open indefinitely. When you're ready to advance to a pay-per-share equity trading firm, you can simply transfer your money from one account to the other.

Be mindful of this, however, before you make the big switch: at pay-per-share firms your account must have a minimum of $25,000, and many require you to have a Series 7 license.

I suggest that you visit some pay-per-share firms in person. Ask those firms whether you can observe their trading floor. Go to each armed with the following questions:

- How much are the per-share commissions and monthly data-feed fee structures?

- Can I trade remotely from home?
- How often can I use withdrawal checks against my account?
- How flexible are you with leverage?
- What are the minimum account balance requirements and guidelines?
- What type of profit sharing programs do you offer?
- What percentage of the traders on the floor are professionals (trading per-share for at least one year)?
- Do you require a Series 7 license?
- What type of *free* group strategy classes or mentorship do you offer?
- What are my choices for trading stations? (For example: how many monitors, what working conditions and atmosphere, etc.).

RULES TO REMEMBER

- Don't use a pay-per-trade broker if you're placing multiple trades and not **holding** overnight.
- Keep your pay-per-trade broker *only* for long-term trades and free resources.
- In pay-per-share trading, be extremely careful of how much leverage you use. Always start small (10-to-1).
- When searching for pay-per-share brokers, visit the actual trading floors and test their demos for at least a few days, and take note of their cost/fee structures.
- Trade remotely from home only after you've traded on their floor for a while.

CHAPTER 18

Paper-Trading Strategy

I'll begin with a formal description. Investopedia.com, a Forbes Media company, defines paper trading as "simulated trading that investors use to practice mimicking trades (buys and sells) without actually entering into any monetary transactions."

Paper trading is day trading without the loss or profit that results from using real money. You do everything you were trained to do when executing a real-time order, but this, of course, is just practice. You note the entry price in a log, on paper. It's all about getting your feet wet.

If you've ever attended a day trading seminar or training program for beginners, then chances are you've been shown how to paper-trade, but you haven't been *adequately* shown. You may not be aware that there are right ways and wrong ways to use this learning tool. There are pitfalls that must be avoided. When utilized properly, however, paper trading helps to maximize your real day trading performance.

In the intro to this book, I referred to my initial paper-trading experience. I painted a picture of the typical novice—me—just back from a three-day seminar. Part of my training had been paper trading. Now I was applying that method on my own. At home, I paper-traded for one straight month. My results were absolutely amazing. I made loads of fake money.

Then came the big transition, the morning I decided to start trading with real money. What happened on that day was pathetic.

I didn't sleep much that night.

You may be able to tell that I'm launching into another cautionary tale. In order to most clearly present to you my warnings and advice, I'll split paper trading into two distinctive stages, the *amateur* and the *advanced*. For each, there are different applications.

PAPER TRADING FOR THE AMATEUR

Most amateur day traders have been mentally armed with professional day trading strategies, but have very little practical experience. That's a dangerous situation. Add paper trading to the new guy's vulnerability, and things get even more dicey. That's especially true when he lacks adequate instruction in how to use that tool.

Here are the crucial things to remember: the method should *never* be understood as a test of strategy. Also, paper trading should *never* be used as lessons in how to day trade without incurring risk. Think about it: those reasons make no sense. How will it help you to *master* your strategies by way of *controlling your emotions* when you start trading with real money?

Most training programs don't stress that point. They bathe you in their proprietary strategies. They woo you with their system in a risk-free environment of paper trading or demo software programs. They give you $100,000 of monopoly money and let you go wild with it. This is how they seduce you to naively perceive that their system of trading works. This is basically a ploy to inspire the novice to sign up and fork over thousands in fees. I've learned to be sickened by that.

Let's compare that situation, for a moment, to a gambling scenario.

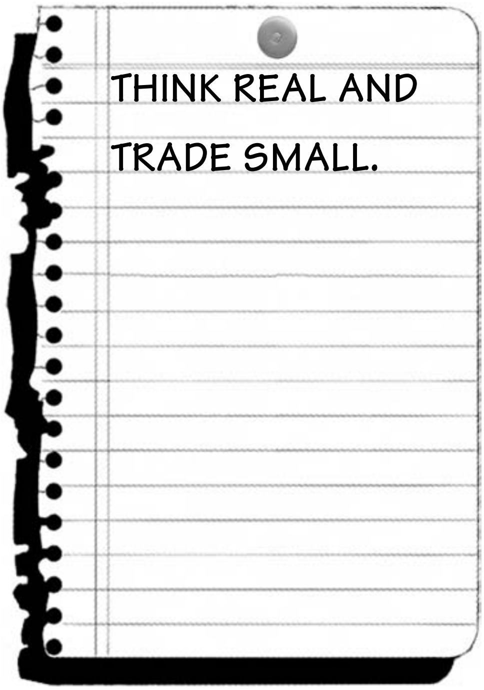
You walk into a casino. The floor manager comes at you with fake chips to play with, and sure, you go for it, why not? You've been given $100,000 in fake chips, and someone whispers strategies to you. You place $50,000 on the betting line, on the very first roll of the dice. You win three times in a row.

Wow, you think. *This system really works!*

Then you lose, and what does it matter? You walk away saying, *That was fun!*

My point is that after all that risk-free paper trading, day traders haven't adequately learned to be careful. They're so wowed by their successes with paper trading that they can't wait to strategize with real money. Like the gambler at the casino who's turned $100,000 in fake chips into $1 million in fake bucks, there's a good chance they're a little too confident.

With that human weakness in mind, I've devised a simple safeguard for amateurs to follow. Go get the poster board and markers out again, and find another space on your wall. My primary paper-trading rule is:



By now you know the drill, the biggest maxim of all: even if you've learned to find a perfect stock to trade, until your skills have improved, you should only trade in 100-share blocks.

But it's just so easy to forget that precaution, whenever you paper-trade. It starts at the training program. The instructors there taught me their professional strategy. They put me on their demo software, and had me place paper trades.

At first, I did it all properly. I kept to 100-share blocks. So far, so good. But soon I was purchasing 1,000-share blocks and/or rashly averaging down, on each and every trade. I remember how gloriously stress-free it was, whenever a trade went against me.

No problem, I chuckled. *This is only practice.*

If I found myself in a bad trade, I would just average-down. It was only paper money, after all. I could simply buy more stock at lower levels. I did this every time the price dropped against my initial entry price. I would start off with a 100 shares, and if I was wrong on the entry price and the stock dropped precipitously, I would then buy an additional 100 shares, at a lower level. If it continued to drop further, I would buy even more shares at even lower price levels. The lower it went, the larger the share-block size I purchased.

This would go on until the price reversed in my direction. Because I had accumulated so many shares during that one trade—usually over a thousand—when the price went back up I would go into the green, and recognize a profit.

This scenario is very typical in paper trading. It sounds like a great strategy, right? Just keep on averaging down until the price reverses in your direction.

Sure.

If you're not sure why that strategy is foolish beyond belief, then refer back to Chapter 10, "Averaging-Down: Skilled Strategy."

The problem with paper trading that way is that two fundamental emotional issues are getting overlooked. First: each time you overexpose yourself with a too-large block of shares or average-down, you're not experiencing the real, raw fear that goes with your reckless risk with real money. Secondly, when averaging down you're assuming that the price will most likely retrace, and that's your own worst enemy coming around to get you; that's your own overconfidence. Too much lack of caution, combined with way too much nerve, are the hazardous day trading practices that paper trading can cause.

But take heart. There's a practical, simple mantra you can say to keep this from happening. Once again: Think real and trade small.

I know it seems hard, but just do it: convince yourself fake money is real. Paper-trade exactly the same way you would if you were trading for real.

If you fail to impose those mental measures on yourself, you may become much too complacent, not glued enough to the screen. That can make you lose focus. You might walk away for a few minutes, or have a long discussion on the phone. This may seem insignificant, but the trouble is, you're not preparing. You're failing to get accustomed to the concentration you'll need, when you start to trade with real money.

It's hard to just sit there, *all day*, watching the charts *every second*, especially when you're only pretending. But in real day trading, that's exactly what's required. That's why I'm pounding it into your brain to paper-trade like it's a real trade. For instance: when you enter into a paper trade, make sure that you're watching the Level 2 chart. Get into the pattern of noting the bid/ask price. *Never* use the *market* price as an entry price, because when you're trading for real, you'll have to pay the *ask* price when *buying*, and then the *bid* price when *selling*.

I've designed for you a practical tool for proper paper trading. See Table 18.1 for a data-entry form to use as a paper-trading log.

TABLE 18.1 Paper-Trading Log

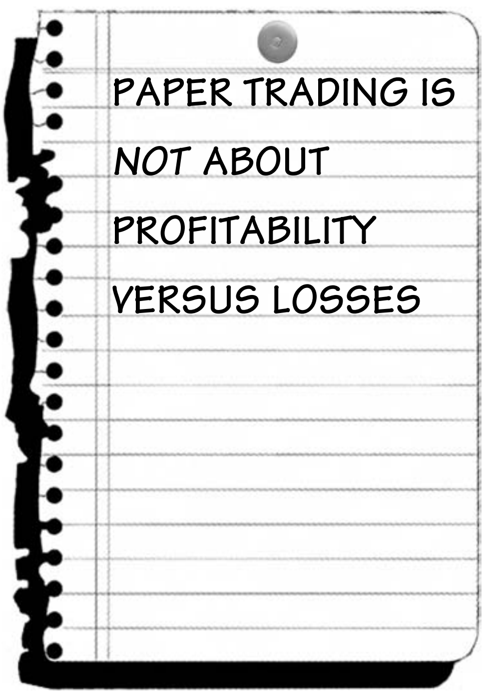
Symbol Symbol	Number of Shares	Long/ Short	Price In	Time In	Price Out	Time Out	Stop Limit	Profit <Loss>

This form can be easily duplicated in the Excel program, or else you can have it photocopied. You need at least one fresh form for every trading day. Note that the form has all the important factors that must be logged for each trade, such as stock symbol, number of shares, price entry and exit, time of entry and exit, long or short position, and profit/loss amount.

The point of logging all that information is *not* to gauge your profits. You should be logging the info so that later, you can research each trade. You can always find things to learn from on the log sheet, whether you profit or lose.

With all the collected data, you can glean statistical trends. For instance, you may find that a certain stock is best traded after 1:00 P.M., or that some stocks take longer periods to hit price targets. You may find that certain stocks reverse before or after major support/resistance levels. You may also conclude that certain trades should have been **held** a bit longer, before stop/loss or profits.

As you can see, the trading log is a learning tool. It broadens your perspective and skills as a day trader. It should *not* be viewed as a proof of your profit-making abilities. Here's something to remember. Tack this motto up, too:



I can almost bet that you'll profit more in paper trading than real trading. It sure was that way for me. Don't be foolish like I was. I didn't bother to log the trades that would have wiped me out, had the trading been real. I chose to ignore the bad trades. That was typical amateur behavior.

I would enter into a trade with 5,000 shares, and then go to the store for lunch. I would come back and see that the stock dropped $2, so now I was down $10,000. I would blithely dismiss it as a botched trade, saying to myself, *If I'd been here watching it, I would have sold at a small loss*

. . . and then I didn't log it.

But if, on another occasion, the stock went up $2 and I profited by $10,000, then of course I proudly wrote it in there! Consequently, I learned nothing. All I did was acquire bad habits, like walking away during a trade, getting myself grossly overexposed, and getting myself overconfident.

Whenever paper trading, you should always disregard how much you're making. Focus instead on the underlying reasons for every aspect of your performance. You'll learn more from bad trades than good trades. Unless you're the superstar of all Wall Street day traders, you're going to trade like a normal amateur and make a lot of mistakes. You can count on that, but you can also learn from that.

Now I'll move on to the *advanced* stage of paper trading.

A WORD ABOUT ADVANCED PAPER TRADING

If an experienced day trader hasn't been consistently profitable, then some paper trading can help. Like an amateur he can use it to analyze his mistakes, and he can also use the method to safely test new stocks. As someone who's learned from his blunders as a greenhorn, he knows that you don't just dive headlong right into any new stock.

The seasoned day trader also knows that paper trading can be a great tool to get him through rough periods. He knows, for instance, that whenever the stock market gets extremely volatile, it's wise to take some days off.

But that doesn't mean he's on vacation. During the high-risk days, he takes time to paper-trade. That way he learns, in a zero-risk environment, how to trade in a high-volatility market.

Both amateurs and experienced traders can both get to a point where they simply need a break. During those periods, it's wise to paper-trade. It can be very therapeutic. Refer back to Chapter 5, "Knowing When to Take a Break," to review this vital point.

RULES TO REMEMBER

- Think real and trade small when paper trading.
- Paper-trade *exactly* the same way as you would when doing real trading.
- *Do not* construe paper trading as a way to gauge your profits.

CHAPTER 19

Trading for Skill versus Trading for Income

If you're an amateur with no formal training, quit trying to go it alone. Quit day trading, right away. Review Chapter 16, "About Those Training Programs," pick a class or mentorship setting that best fits your level of skill, and get yourself there *yesterday*.

But if you're an amateur who's already experienced some training or mentoring, then by all means, please read on. I'll start with the most rueful, head-shaking confession that's made by professional day traders. They confide that as beginners, when they'd finished a class, they *immediately* traded for primary income. After spending all their savings on that pricey seminar, they were gung-ho to *immediately* make those bucks back.

Does that sound like you? Is that what you're doing? If so, then I repeat: *don't stop reading!*

The truth is, your biggest investment in know-how is *not* the training programs. It's the losses you're going to incur while developing into a pro. I highlighted the scary truth in Chapter 12, "Why Some Traders Make More Mistakes."

My goal in this chapter is not just to warn you, but to thoroughly and safely equip you. Here I show how you can minimize your post-graduate training fees—that is, your live-trading losses.

BUILDING A FOUNDATION OF TRADING SKILLS

For starters, you need to internalize this crucial, unshakable truth: as a greenhorn, you should be trading for skill. You should be focused on skill building, not money making. Trading for income comes later. You should remember that patience is paramount. You should never try to rush the process of becoming a professional day trader. If you thoughtfully read Chapter 1, you may have realized that you're definitely not highly skilled. Face it, you have a lot of learning to do, so you need to hang back like a student and sit there and take lots of notes.

Back when I was an amateur, I wish someone had grabbed me by the scruff of my neck and forced me to understand that. Back in the day, as a greenhorn, I would return from a training program, or finish a strategy manual, feeling pumped like a boxer on steroids. I was itching to throw down with the big boys. Didn't I possess the proprietary information that Wall Street traders commandeer? I was certain that I had just mastered the golden goose of day-trading expertise. I felt ready to make big moves, big trades.

The truth is I did have some great information. I'd been shown how to trade like a pro. The one thing I lacked, however, was applied experience. I also lacked an awareness of the deadliness of that shortcoming.

It was like I'd been watching a video on how to build beautiful houses. After the lights came back on, and I actually went to a work site and actually swung a hammer, I found that this wasn't as easy as I'd thought. I was miserably learning what the video couldn't teach me: that I needed not only to read blueprints and hammer, but I also had to deal with the relentless pressure of deadlines, and the deep-body stress caused by hot or cold weather. (That's why I respect carpenters, like my brave brother Adam in Buffalo, New York, who works outside all winter.)

The day trader's hammer is his finger tips. His nails are the keys on his keyboard. Like the builder, he needs to tread carefully, especially as a beginner. Though he won't smash his thumb or take a fall off a roof, or freeze or pass out from hot sun, he might hurt himself even worse . . . by the wallet.

It's not all bad news. On the contrary, I have some good news. I've worked out a system that allows you to *safely* train with real money, with minimal market exposure. Before I worked out my system, I was floundering in day trader hell. My problem was that I thought I was a pro. Just because I made several trades a day with tens of thousands of dollars, I thought I had it all figured out.

After my many losses, which were also painfully hard lessons, I found myself doing more homework and research. By necessity, I was becoming more patient. But I still hadn't yet realized my biggest misstep: I was trading to earn, not to learn.

You should only trade *to earn* if your profits are consistent.

You know by now mine were not.

One day I glumly just slumped there. My monitors glowered before me like unreachable, imperious gods. I'd been day trading for over five years.

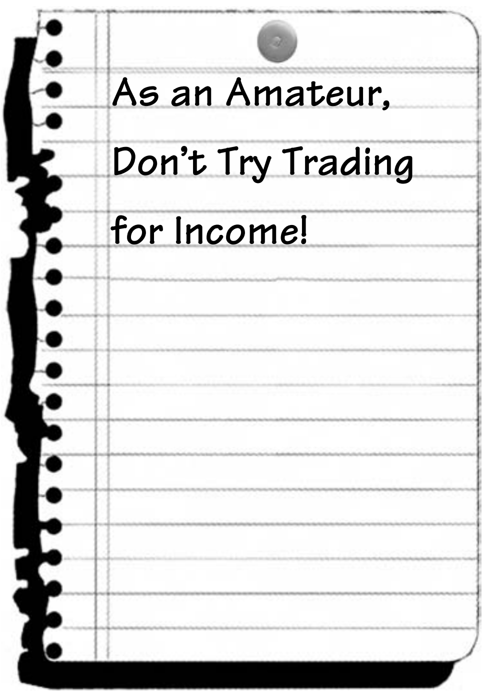
I'd been having a very hard time. I felt like a pitiful loser, and it was the closest I'd ever come to throwing in the towel. But on that day I somehow managed to perk myself up, and continue. I figured I'd just have to change things. I'd have to redo my approach.

That was my moment of conception. Up to that point I'd had some really good trades, along with the really bad ones. Over time, I'd broken even. The reasons I'd survived those five years were my start with a healthy capital base, and my absolute will to improve.

(Warning: Please note that term above, *healthy capital base*. If you don't have one, or if you plan on investing more than half of your life savings, then by all means start highlighting in yellow.)

On that day I realized I should go back to the basics, back to square one, like in training. I should no longer stress myself to make money. I should focus on a method that creates consistency, and for now, just forget about earning.

Now maybe you're thinking: *That's crazy. It's absurdly counterproductive to* not *be focused on gains.* Well, profit is the end goal, of course, but crawling precedes walking and walking precedes running, that's a universal rule. So let's get even crazier. Let's make a crazy sign.



Hang the sign up today. Take it down when your profits have been consistent for at least one straight month (20 full trading days).

I admit there's a downside to my system I will be explaining in a moment. It's the dismally miniscule profits. You won't make enough to call it income. It's true that you'll be trading with bucks, not with paper, but I'm talking about very few bucks. You'll need to be willing to gain satisfaction from the frequency of profitable trades—*not* from the dollar amounts.

But here's the point: Even if you only make two dollars on a trade (after commissions), what's important is that you'll be learning how to profit consistently. You must achieve that consistency. Then, and only then, should you budget for bigger trades. My system is a careful progression. You start off paper trading. Then you graduate to real money—just a little bit of money at a time.

My system consists of three levels. But before we launch into those levels, however, review the following chapters:

- Chapter 1, "Truths about Yourself to Know First"
- Chapter 4, "From Impatience to Cool, Calm, and Collected"
- Chapter 7, "How Overexposure to the Market Can Hurt"
- Chapter 8, "Knowing Your Financial Limitations: Budgeting"
- Chapter 14, "Stock Picking"
- Chapter 17, "Picking the Right Online Broker: Pay-per-Share versus Pay-per-Trade"
- Chapter 18, "Paper-Trading Strategy"

With that done, you're ready.

FIRST LEVEL

Assuming that you know how to read charts and how to place a trade, find a slow-moving, low-priced stock. That is, a stock with an average daily price range of 50¢ from the high of the day to the low, with stock price ranges from $10 to $30.

Paper-trade that stock for one week straight. Trade it throughout the day. Make enough on each trade to exceed your future commissions, when you trade with real money. In other words, if you're trading through a pay-per-trade broker, then you want to make at least a $20.00 profit on *each* trade. That more than covers the round-trip commission fees, usually $9.99 per trade. If you're trading through a pay-per-share broker, then to break even you only need to make $1.00 or so profit on the trade.

- You've seen this before: trade *only* in *100-share blocks*.
- Paper trade that stock consistently all week. Make *at least 10 trades per day*.

- Set proper stop/losses and limits. Don't worry about your intraday progress; just focus on trading for experience.
- At week's end, you should have five full days of active paper trading experience with just *one* familiar stock.
- Keep well-documented records of each trade. You should have notes explaining your reasons for entering and exiting each trade, and your state of mind in each trade.
- After this full week with one stock, if you feel confident to trade the *same* stock with real money, then the following Monday morning, you should begin real trading.
- Otherwise, you repeat one full week of paper trading.
- You switch stocks *only* if your research and experiences indicate the stock is a problem. (If you've read Chapter 14, "Stock Picking," however, it's doubtful that will happen.)
- If you choose to trade with real money, then take care to engrain these rules:
  - Do exactly what you did while paper trading.
  - If you're making mistakes that you didn't make while paper trading, *stop trading.*
  - Go back to paper trading until you get your confidence back.

Most likely you'll quickly get bored with the First Level, even when trading with real money, because you'll make or lose very little. Trading with 100 shares of a slow-moving, low-priced stock is very unexciting. This is where your patience comes in. During this time you learn valuable lessons, but thankfully, not by risking a lot.

As soon as you feel confident trading with real money during the First Level, now you have two choices: you can promote yourself to the Second Level, below, or you can increase a First Level stock by *100 shares at a time.*

If you choose the second option, then increase to 200 shares, then to 300, then to 400, and finally to a maximum of 500 shares per trade. Test each increase first with a full week of paper trading.

Your average First Level stock will only allow you *10* good trades per day. Each trade will take more time to reach your price levels than a Second or Third Level stock. This is why you have the option of increasing your shares per trade up to 500 shares.

When you trade in 100-share blocks, it may take the stock 30 minutes to move 25¢, so you'll either profit or lose $25 on each trade. The same trade with five hundred shares will still take 30 minutes to move 25¢, but you'll be profiting or losing by a factor of five. On average, with 500 shares you'll profit or lose $125 on the trade.

Again, it's all about baby steps and patience. *Always* start with 100 shares and gradually work your way up.

SECOND LEVEL

This procedure is identical to the First Level, except for one differential: your stock is in a different class. Find a medium-moving, medium-priced stock; that is, a stock with an average daily price range of $1 and stock price ranges from $30 to $50.

Paper-trade that stock for one week straight. Trade it throughout the day for at least 30 round-trip trades. Make enough on each trade to exceed your real-money commissions. Paper-trade that stock consistently all week. Make at least 30 trades per day, and of course, with only 100 shares at a time.

Set proper stop/losses and limits. Don't worry about your intraday progress; just focus on trading for the experience. At week's end, you should have five full days of active trading experience with just *one* familiar stock.

Keep well-documented records of each trade. You should have notes explaining your reasons for entering and exiting each trade, and your state of mind in each trade. After this full week with one stock, if you feel confident to trade the same stock with real money, then the following Monday morning, you can begin real trading. Otherwise, repeat one full week of paper trading. If you choose to trade with real money, then take care to engrain these rules:

- Do exactly what you did while paper trading.
- If you're making mistakes that you didn't make while paper trading, stop trading.
- Go back to paper trading until you get your confidence back.
- Increase the share size to 200 only after you've proven your performance with 100-share blocks, and you've tested the 200-share blocks for a full week of paper trading first.
- You can switch stocks *only* if your research and experiences indicate that the stock is a problem.

The Second Level differs from the First Level in that the stock you pick exhibits more movement and volatility. I set up those levels to create a gradual exposure to more risky trading experiences. When you trade at the First Level and then upgrade to the Second, I'm certain you'll see a huge difference. You'll find that the stock may move in one direction twice faster than you're used to.

This is why you should always start trading in 100-share blocks per trade. You should never trade a Second Level stock with more than 200-share blocks per trade. Remember to paper-trade it that way for one full week beforehand, and then move on to real money.

Your average Second Level stock will allow you more trades, per day, than a typical First Level stock. You should be able to execute at least *30 trades per day*. This is productive, yet scary. Before you increase your share size per trade, you should take more time getting to know your stock than you would with a First Level stock. I suggest that you trade it in 100-share blocks for at least one month, before you increase to 200.

When trading in 100-share blocks, it may take the stock *3 to 10 minutes* to move *25¢*; therefore, on each trade you chance to *profit or lose $25*. If you're in the same trade with 200 shares it will take the same time to move, but you'll be profiting or losing by a factor of two. With 200 shares you chance to profit or lose $50 on the trade. Therefore, if you're not ready for a Second Level stock, placing 30 trades per day can get very ugly.

Again, it's all about baby steps. With this Level, I repeat: *always* start with 100 shares and work your way up to 200, but *never exceed* 200 shares.

THIRD LEVEL

The Third Level is identical to the first two, but once again your stock is in a different type of class.

- Find a fast-moving, high-priced stock; for instance, stocks that have an average daily price range of $3, and price ranges of $50 to $100.
- Paper-trade that one stock for one week straight. Trade it throughout the day for at least 50 round-trip trades. Make enough on each trade to exceed your commissions.
- As always, your goal is to paper-trade consistently all week. Make at least 50 trader per day, and you know how few shares at a time.
- As always, set proper stop/losses and limits. Focus on the experience, not the progress.
- At week's end, you should have five full days of active trading experience with that one stock.
- As always, document your reasons for entering and exiting each trade, and your state of mind in each trade.
- After your one-week experience paper trading, start trading the same stock with real money, if you feel confident.

- If not, then repeat one full week of paper trading.
- If you choose to trade with real money, always remember the rules:
  - Do exactly what you do while paper trading.
  - If you're making mistakes that you didn't make while paper trading, stop trading.
  - If you're producing more losses than profits, go back to paper trading until you get your confidence back.
- As always, you can switch stocks only if the stock itself is the problem.

The Third Level is going to exhibit maximum exposure. *Never* trade with more than one hundred shares per trade, even when you've proven consistent. When overexposed to a Third Level stock, it's much harder to handle the swings.

You will never need to trade such stocks more than a hundred shares at a time. When trading a Third Level stock, you can easily profit or lose \$25 every 10 seconds to 3 minutes! (Third Level stocks quickly move 25¢, and you have a 100 shares).

Because this level involves 50 or more trades per day, there's a potential of \$1,250 in profits or losses per day (50 trades × \$25 profit/loss).

So make sure you don't get greedy. Bad things happen when you get greedy. Stick to a maximum of 100 shares per trade, and *never* average down. If you follow that advice, you should be off to a great start when trading a Third Level stock.

SUMMARY

Paper trading is strictly for learning, but you shouldn't just do it randomly. I devised the levels with paper trading in order to slow you down and to condition you to research your mistakes. Your completion of each of the levels prepares you to trade live, armed with a risk-free experience in virtually every class of stock.

Always paper-trade any new stock that you've added to your stock list. You can always net profits with a First-Level stock while you paper trade and research a Second- or Third-Level stock. Eventually you'll be able to trade multiple stocks during the trading day. But hold off on that until you've proven that you can profit from one stock at a time. When you feel sufficiently ready, you can always increase the recommended share sizes (but stick to the maximum allowed), and/or start trading more than one stock in each level.

The key to the system is baby steps. Don't ever start trading in more than 100-share blocks without paper trading, first, the same amount for a

TABLE 19.1 Three Levels of Stocks

	Profile	Average Price Range	Average Intraday Price Range	Max. Shares Traded (Per Trade)	Duration of Each Trade (25¢ Moves)	Average Trades (Per Day)	Potential Profit/Loss (Per Trade)	Potential Profit/Loss (Per Day)
First Level	Slow moving, low priced	$10–30	$0.50	100–500	10–30 minutes	10	$25	$250 10 × $25
Second Level	Medium moving, medium priced	$30–50	$1	100–200	1–5 minutes	30	$25	$750 30 × $25
Third Level	Fast moving, high priced	$50–100	$3+	Max 100	10 seconds–1 minute	50	$25	$1250 50 × $25

week. And *never* trade a Third-Level stock with more than a 100 shares per trade—with no exceptions!

I want to stress that this system is not a complete day-trading strategy; it's not even close. All this system is designed for is to keep you in low gear. It's designed to give you a structured training mentality. It's not to be relied on for earning, but it *is* to be thoroughly relied on for the best chance of future success.

For your convenience, use Table 19.1 for reference.

The chart is designed to give a quick reference for all three levels of stocks. The "risk" is determined by how fast the stock price can move in a given period.

RULES TO REMEMBER

- Always start with a First-Level stock, then progress upward from there.
- *Do not* trade with real money until you've been consistently profitable with your stock for a week straight in paper trading.

CHAPTER 20

The Perfect Trading Day

Here's a list of the factors behind the perfect trading day, from the time you wake up until the evening.

- Your broker is pay-per-share.
- Your premarket prep has been thorough.
- All day you've been strategically consistent.
- At day's end you've closed all positions.
- You're not **holding** overnight.
- You're thoroughly prepared for tomorrow.
- . . . And of course, you've made a good profit!

My goal in this chapter is to vividly illustrate the optimum day trading experience. To facilitate this, here's an in-depth description of an ideal day from my life.

EARLY MORNING ACTIVITIES

First I should mention that occasionally, I kick back and take a day off. It's never an impulsive decision; I've known since the day before. The reason is either the market conditions, or I've planned on a very late night.

Today I'm not taking off.

Depending on whether I'll be trading from home or going to my group-trading floor, I roll out of bed at either 5 A.M. or 7 A.M. (If I'll be heading out for the floor, which is located way down by Wall Street, I have to be up before dawn. The entrance to the subway is about three city-blocks away, and once I get down in that packed, massive cavern, finding a train with room to cram into can take up even more time.)

It doesn't matter what the clock says when I first open my eyes: I want a sweet rush of caffeine. Whether swarming humanity is where I'll end up, or just to my home-based quiet trading desk, the first thing I do, every day, is make coffee.

After I'm ramped from my hot liquid fix, I do my stretching routine. Then I check out the weather. If conditions in New York are inviting, or at least not intolerable, then I grab my mug of brew, exit my building, and take a brisk walk through a lovely little slice of the 843 acres of Central Park.

But if the weather is lousy, and it's wrecking my plan to enjoy some deep breathing in that gorgeous and grand green oasis, then I drop to my living room floor. I do multiple sets of sit-ups and push-ups.

This is all to get finely tuned. Such rigorous morning physical preps are indispensable. They boost mental clarity. They enable me to deal with the stress, at the market opening bell, when at 9:30 A.M. sharp, my heart jolts. They help me to keep myself calm through the day, when I'm hunched up and clenched, concentrating.

And now it's time for the cerebral part of my pre-market a.m. tuning.

Back while I was sleeping, the global money machines were not. I'm aware that momentous things could have happened, while I snoozed. Now that I'm awake and fully energized, I must make myself adroitly cognizant. Though my individual stocks may not be in the news, they can still be affected by global events, and I need to know all about those events, before I begin to trade.

So before I even brush my teeth, I boot up my computer. I begin the market news research. For my general market news, I use some major websites, like Bloomberg.com and the Yahoo Finance section.

Next I click on my TV. I tune into the CNBC business channel. I'm looking for breaking headlines—the stock-impacting kind.

Remember waking up to the shock that Washington Mutual (WM) was closed by the government, in late 2008? That was the largest bank failure in United States history. Its assets were sold to JPMorgan Chase & Co. at an absurdly low price, causing the stock price to plummet to pennies . . . all in just one day. And I hate to make you do this, but as a day trader, you must: think also of the 9/11 attacks and their effects on the markets. I keep scanning for anything earth-shattering, hoping there's nothing out there.

As soon as I've seen that there isn't, and I've decided that today may be relatively normal, I begin a more focused news research. In the Yahoo! Finance section, the *Economic Calendar* is an extremely valuable resource.

It lists all the reports that will be released today, and about what time of day.

I just can't stress it enough. If you want to have a *perfect* day trading, you've got to glean beforehand what reports may hit the news wire, later when you're deep in your trades. And if you deem it news that just might affect your stocks, then already you know that during the day you'll need to approximate the time of that release, and close your positions a few minutes prior.

After my general market research, I begin to research my stocks. I focus on about ten. That doesn't mean, however, that I'll be trading them all; the reason for my eyeballing of that many stocks is to give myself plenty of options. I usually have at least one stock from each major market sector. This gives me flexibility. For instance, if the Financials are volatile today, I can choose my alternatives, Utilities and Energy.

I research each stock for a couple of minutes. I input each stock symbol and look for news info that might be relevant. I read through the articles and I try to discern whether news about my stock should concern me.

At this point I'm fully tuned in to the market. I switch from watching the news to preparing my entry/exit plans. Such planning is all about technical chart analysis. My system is crude, but effective. I go through each stock and I log the prior day's high, low, and closing prices. I'll say more about that later. For now I want to convey that those are the support and resistance levels to rely on for the time being.

I usually also have plenty of notes from the previous day's homework analysis. I go over them as well.

As soon as I'm armed with all the documented levels for each of my stocks of the day, I'm ready to start trading and/or monitoring the premarket trading activities.

PRE-MARKET TRADING

Pre-market is 8:00 A.M. to 9:30 A.M., before the opening bell. Most pay-per-share firms allow you to place trades (direct order executions) during that hour and a half. On the contrary, most pay-per-trade brokers (traditional online brokers) won't fill your order right away. Meaning, you can place an order at 8 A.M., but it won't get processed until after the bell.

You'll recall that I've stated that the factors that make the day *perfect* include a pay-per-share broker. The above is a big reason why. Imagine you've placed a market order during premarket trading, which won't get filled until later, and during the interim you can only sit and watch the price balloon!

Premarket trading is risky; you've seen me stress that before. In the past I've had ridiculous premarket losses, but at this point I know how to prevent the nail-biting caused by uncertainties. These days, if I do trade premarket, it's just to test the waters, and (you guessed it) I only use 100-share blocks.

You can easily predict what I'm going to say next: Don't trade premarket as a greenhorn! Just the same, however, you should definitely observe it, because it can teach you a lot.

I usually use this period not to trade, but to warm up. I continue my technical analysis and chart watching. As I've mentioned, I'm armed with my three important price levels, the previous day's high, low, and closing prices. Most important are the *high* and the *low*. I'm monitoring the volume levels as well, watching their affect on price directions.

Whenever you view this early a.m. trading, you'll notice larger than usual gaps between the bid and ask prices. You'll notice abnormal volatility. To make things even more confusing, the support and resistance levels are sometimes getting broken, with very little volume.

What the heck is going on here? Several different things. The overnight news from around the world is catching up to the market. Premarket economic reports are being released to the public. At the crack of dawn there was little, but now the news floods in.

Right now it's important to monitor how Wall Street reacts to this.

This is when I usually take a 15-minute break. It's time to just pause and watch the Street. You should always remember that Wall Street is smarter than your own intuition. After the release of a major report, let those guys decide what direction the stock should take. Don't ever try predicting it yourself. Ever!

After my break I might notice that one of my stocks has just broken through the previous day's high or low, with unusually high volume. The need for a new intraday resistance level or support level has just presented itself, and I'm glad that I caught it now, not later during regular trading hours.

The following is important to note and to remember.

The pre-market price levels are not logged on Level 1 and 2 charts for the present day's price movements. For instance, if your stock drops to $50 during pre-market trading, then rebounds to $51 by the opening bell, then the market indicators will only reflect the opening price level of $51. The low of $50 is not recorded, unless of course it hits again during regular market hours.

Meaning, if you're not paying attention to the premarket activity and taking notes, then you may be using the wrong intraday support and resistance levels.

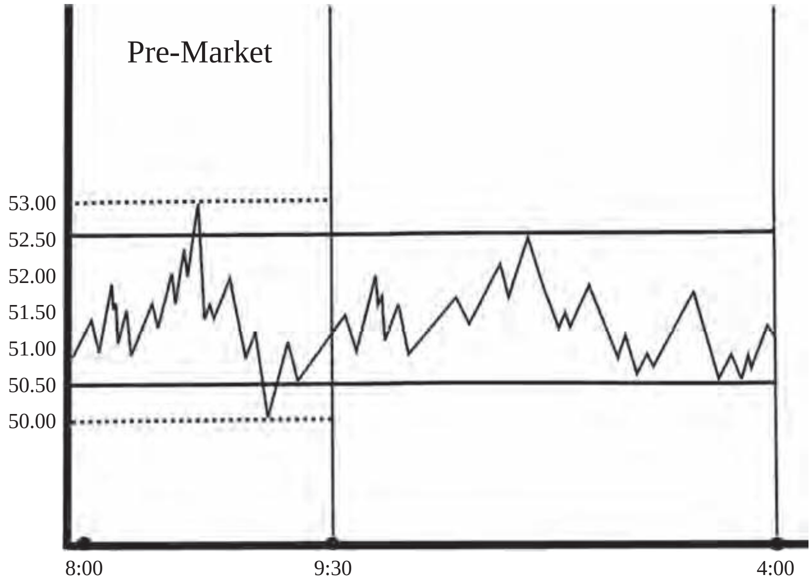


FIGURE 20.1 Intraday Chart

Refer to Figure 20.1, which shows a premarket low of $50, and a premarket high of $53. The price never hits either level throughout the entire day. The market indicators will only show actual low of $50.50, and actual high of $52.50.

At this point, at about 9:00 A.M., I'm honing in on the stocks that I plan to begin trading when the bell rings. The ideal situation is stocks that have been trading as usual during the premarket period. They display normal volume levels and react to the major support and resistance levels. They behave like tame tigers in cages. The animals are pacing back and forth, repetitiously wall to wall, rhythmic and predictable and tranquil.

Suddenly one tiger starts roaring at passers-by, and maniacally trying to gnaw its way out. In other words, one of my stocks is showing abnormal activity. That's usually a clear indication that I missed some important news, and my stock is now acting crazy, agitated like the beast.

The time to discover this is during premarket, before I've started to trade. So I utilize the premarket trading hours as a time to feel out the market, and to note what price action transpires.

Whether I'm home in my shorts or downtown fully dressed, during the final minutes before the opening bell I do one last stretching routine, and I get a fresh cup of coffee.

THE OPENING BELL

When the bell rings at 9:30 A.M. sharp, I'm fully prepared and calm. I know what price levels to watch for, on every stock I'll be trading.

This is all about focus and waiting.

Most training programs and manuals dictate to never trade during the first 15 minutes. That's an excessively risk-adverse advisement, but a rule to consider if you're new to this biz. As an amateur I suffered through many bad days because of botched trades in the very first minute.

The brief time that follows the opening bell is volatile and hectic. I've learned to trade during the first 15 minutes with only my most proven stocks. I know those stocks like I know my own face. I know how they are in the morning; I know all the ways they react; I know all their breaking points.

Trust me: if you're not in total rhythm with your stocks, then don't try to trade them at the opening bell. On certain days, during the first few minutes, I've seen stocks shoot over $10. Do you really want to pick bottoms or tops on stocks not familiar to you?

The opening bell is like the start of a horse race. The thoroughbreds ferociously blast from their gates, and each tries to head the stampede. The initial burst takes only a moment, and then a clear trend begins. Some horses are firmly in the lead, while others are lagging behind.

Horse racing is gambling. Day trading is not. At the track you're required to place your bets before the horses bust out, long before you can see what develops. Conversely, in day trading, you don't have to act beforehand. You can wait to see what trend your stock is setting for the day.

Because I'm no longer a rookie, usually I let myself enter a trade within minutes of the opening bell. But I never enter a trade until my predetermined price levels hit, and soon enough, they do. At least one of my stocks hits a price level that's making me lick my chops.

I also watch for new intraday trends. My initial predetermined price levels (calculated during my premarket research) usually only reflect what will be my first trade of the day. If I make a quick profit or loss (10¢ to 20¢ moves), then I'll continue trading that particular stock for the remainder of the day, but most likely I won't be reentering at the previous price level.

What matters is that each time I enter a trade, I have firmly in mind the price levels I've decided upon just before. I know the price to enter and I know the price to exit, whether it's a profit or a loss.

Having begun my trading, I'm now glued to the screens. I won't leave my station for anything. I will not take my eyes off the screens.

MIDDAY ACTIVITIES

By 10:30 A.M., I've executed about 30 trades. That's about 15 round-trip trades. That's a lot, and it's no accident, I like those high-energy launches; they build great momentum for the day.

I'm not yet concerned about how much money I've made or lost so far. I'm focused on control of my emotions. I'm busy with the mental concentration of finding quick intraday setups.

I usually enter and exit a trade about every one to five minutes. I'm looking for quick 10¢ to 20¢ moves. That translates to making or losing $10 to $20 on each trade, in the same amount of time. Per day, that's potentially 100 round-trip trades. I bang out most trades in the green, making $10 to $20 a trade, and losing $10 to $20 on a much smaller number of trades gone into the red.

Right about now you might wonder, how much capital do I need to purchase all those securities? The answer may surprise you. In previous chapters I mentioned that most pay-per-share firms require a $25,000 minimum balance. When you open your account with them, they usually give you buying power of $250,000 (depending on your skill level), which translates to 10-to-1 leverage.

Here's the part that may raise your eyebrows.

When I trade in hundred-share blocks, I usually only need $5,000 to $8,000 to purchase that security, because most of my stocks range from $50 to $80 per share. My multiple positions don't exceed 10, because I only watch 10 stocks per day. So at most I'm using $80,000 of my $250,000 leverage (10 stocks at $80 in 100-share blocks), at any given time throughout the day.

The point is I'm not trying to maximize my intraday buying power. Available capital doesn't mean that I should be using it all. You know I've learned that the hard way. In this book I've shown you can find trouble fast if you use all your buying power.

Think about it: If you're using more than 100,000 of buying power, a couple of things are going on: you're either buying stocks in 1,000-share blocks, or you have a lot more than 10 positions to trade, all at one point in time. Either way, you're seriously overexposed.

So there you have it, the quintessential truth about day trading stocks is to be a professional day trader, you don't need millions of dollars. All you really need is the minimum $25,000. And to those of you to whom $25,000 may seem like an awful lot, I would say think of this: it often costs people much, much more to get any small business started.

My trading style is called scalping. Scalping capitalizes on the numerous intraday price swings, on any given stock. I ferret out those quick 10¢ to

20¢ moves, ride them like a subway train, and get off at my predetermined stop.

And here I'll point out another reason why hitching up with a pay-per-share broker helps make for a *perfect* day. If you trade through a pay-per-trade broker, you can't afford to scalp only 10¢ to 20¢ cents without getting drastically overexposed. No such hazard will plague you when you trade the alternative way. I pay a commission of 35¢ for every 100-share block. That translates to about 70¢ for the entire round-trip trade.

So I can afford to make quick $10 to $20 profits on my intraday trades. If I profit $15 on a trade, with a pay-per-share commission structure I only lose 70¢ on the trade. Do you see how $15 per trade can seriously add up? I usually place over 100 round-trip trades per day. That's a potential for $1500 per day in profits. But, evevn on a perfect day you still lose on some trades, it's expected. Today is the usual perfect day for me. I will place 80 percent of my trades in the green. That means I can make about $1,200 in the green (80 trades at $15 profits) and I can lose about $300 (20 trades at $15 losses). So usually, on a *perfect* day, I net about $1100 in profit (after pay-per-share commissions).

During midday, I maintain a consistent profit by only trading 10 stocks, by knowing them very well, and by never trading a new stock either heavily or often. I remember the virtues of prudence (no matter how distasteful that word is). I don't stray from the system that works.

I quickly and decisively stop/loss. I enter each trade knowing when I'll sell at a profit or a loss. Without such self-disciplined, automatic reactions, I might start **holding** all day.

You lose some and you win more, that's the name of this game. My job is to log more green trades than red, and to almost never **hold**.

Emotions hurt your performance. They never help you win. I keep myself completely emotionally detached, even on a great day. I'm supposed to make money, that's my job, after all! Why should I get all excited? Don't get me wrong though, I'll celebrate later, when I've closed all positions, with a profit.

But at midday, I'm nose to the grindstone.

After sitting at my trade station for a few productive hours, I exit all my positions and gauge my performance. For the first time today, I look over my *profit/loss*. I already know I've made more green trades then red, but I want a little peek at the numbers.

Then I focus on which stocks are giving me trouble and which stocks are giving me love. I don't take my lunch break until I've determined the best stocks to focus on, when I get back. There are usually two or three. By best stocks I mean those that aren't in the news, are trading uniformly, and are reacting to intraday support and resistance levels almost as predictably as clockwork.

After lunch I do a quick chart analysis, especially of the best stocks. I adjust my screens so only their charts are showing. I'm digesting my food, it's 1:30 P.M., and the afternoon slump has set in; at this point I'm burned out, and I need to limit my stock watching, because my job gets a whole lot easier when I only watch a few.

This is when I allow myself a little more dicey risk. I'm tired, but I've narrowed my focus, and that makes things fairly safe. I start trading the predictable, reliable stocks in 200-share blocks, or I average-down, if that maneuver is needed.

By 3:00 P.M., the start of the final trading hour, I've usually logged close to 90 round-trip trades, or 180 executions. Most of the trades were in 100-share blocks; that's roughly a total of 18,000 shares traded.

At this point in the day I start to gauge my commission fees, feeling glad I don't do pay-per-trade. Do the math yourself. If I were using a pay-per-trade broker my commissions ($9.99 per trade) would be insane.

Once again I go to my net profit/loss calculations, and this time I eyeball them closely. Of my 90 round-trip trades, 75 were in the green and 15 were in the red. That translates to a gross profit of $900 (75 × $15 – 15 × $15). I subtract my commission fee of $63 (18,000 × $.0035 per/share), and I'm left with an intraday net profit of $837.

So it's late in the day and I'm up $837.

Not bad.

THE LAST HOUR OF TRADING

Now the market tends to pick up volume and volatility. During the last hour of trading, I'm always on high alert, just as I was in the premarket period.

Mostly I'm focused on making sure that I don't get caught up in any trades that may cause me to **hold** into after-hour trading. By the closing bell at 4:00 P.M. sharp, I want my positions closed out.

On a *not-so-perfect* trading day, right now I'd be struggling with my worst inner demons, greed or fear or both. The final hour is the time of day that can dramatically make you or break you, especially on a bad day, because on a bad day you might be tempted to spend it trying to make something back.

But on a *perfect* trading day like this one, with that $800+ profit, I'll spend the last hour cool, calm and conservative, which means without fear and greed.

I find myself in the green, right to the very last minute. On this day I would have placed an additional 10 to 20 more trades in the last hour, which lifts my intraday net profit to a lovely round number of $1,000.

This is how it goes on a day of *perfection*: one prudent strategy has led to another, and so on and so on.

During the final countdown, I'm looking to exit all my trades. I'll remain in a trade, however, if I want to **hold** until the final 10 seconds, or if I plan to sell it during after-hours trading.

In case you weren't aware, you can sell your positions in after-hours.

THE CLOSING BELL

Ding-ding-ding-ding!

Its 4:00 P.M. Eastern Standard Time, and all U.S equities markets are closed. The work day must be over.

Wrong!

I almost never stop working at 4:00—not unless I have a life-threatening emergency. There is so much left to do. I usually expect to be busy for at least a couple more hours.

I'm not in any after-hour trading positions. On a *perfect* day like this one, that very rarely happens. I take a quick break, about 15 minutes, to clear my mind and stretch. If I'm trading on the floor downtown with my fellow private equity traders, I slide over to them, and mingle.

Everyone's letting his guard down. Everyone's loosening up. After market is the only time I can approach the pros with my questions. I can always tell who wants to talk. Usually traders only like to talk when they've just had a great day.

Well, today *I* have a lot to say!

After the break, I have two choices. I can continue trading after-hours, or I can begin my homework. I usually make this decision within 20 minutes of the bell. I like to allow time for my stocks to show any signs of irregular activity. Most likely if they're heavily traded this late, it's because the traders are reacting to an after-closing news release. For example, a stock's after-market earnings release will create a high interest in trading after-hours.

AFTER-MARKET TRADING

If I've chosen to trade during after-hours, then soon I'm right back in the saddle. At most pay-per-share firms, after-hour trading ends at 8:00 P.M. EST. I never trade that late. For the most part I trade after hours if I messed up really bad, and I'm **holding** a large position. If that's the case, then I try to get rid of the remaining shares, quickly, by continuing to trade after four.

Sometimes the price retraces fast after-hours, and then I'm able to revive myself from a "near-death" trading experience.

That's depending on luck, of course. That's gambling. That's not how a *perfect* day ends. Once in a while there can be some great after-hours trades. In order to be worthwhile, the stock has to be trading with the same volume, or more, as it did during regular market hours. Again, this usually only happens if some major news is hitting the wire.

If I do enter such a trade, I'm looking for the same support and resistance levels that existed at the close. After-market trading usually stays active (worth trading) only until 6:00 P.M.. It really dies down after that. After the major news hits the wire, the stock will jump in either direction, but then it will level off and trade in a tight range until the final close, at 8:00 P.M..

Another reason why I never enter a trade after 6:00 P.M. is because it can be very difficult to exit before 8:00 P.M. The difference between the bid and ask prices can be very large, and simply not worth trading if the volume dies down.

Once I'm completely done trading for the day, and I've closed out all my positions, then I begin my homework.

HOMEWORK

Whether I'm actually home or working downtown, I like to call it homework. No matter where the location, when I'm done I need to recap.

I focus on the best and the worst trades of the day. I print out a list of all my trades for the day, or I simply view info on my screens. The list will include the following essentials:

- Stock symbol
- Amount of shares
- Long/short position
- Time of entry
- Time of exit
- Profit/loss
- Number of total trades

I keep both mental and written logs of what I've learned today. For instance, if I find that after 3:00 P.M. one of my stocks became extremely volatile and difficult to trade, then I note on paper to stop trading it the following day after three. I have a habit of keeping note pad reminders all over my trading station. Tomorrow when I begin my early-morning activities, I will see them there.

Taking time to recap is crucial. It makes me slow down and think about my trading style. Trading styles have to be constantly updated, just like a computer. If I'm not paying daily attention to my trading performance and trends, then I risk falling into that dark and murky place that I like to call spaced-out land.

In spaced-out land, *perfect* days like this one start to dwindle.

As an amateur I suffered due to lack of end-of-day recaps. Whenever I took big losses, I was so sick to my stomach that I didn't care to research the cause. I figured I simply entered the stock at the wrong price level, or I simply shouldn't have been trading that particular stock on that day. But in fact there were deeper lessons to be learned, lessons that would only be realized if I scrutinized my intraday activities. For instance, most likely I lost big because of overexposure. If, at the end of the day, I had gone over each trade, I would have noticed that I was string-trading and not waiting for proper set-ups. I would have realized I was trading on emotion, and letting it all slip between my fingers.

In order to be able to gauge your trading performance, you must go back and research what happened at the time you executed the order. These days I research my intraday trades and focus on a few essentials. I primarily like to know this:

- Which stocks was I trading the most, and why?
- Which stocks did I profit the most from on that day, and why?
- Which stocks did I lose the most on that day, and why?

Upon answering those three basic questions, I walk away feeling more in control of my trading style. Now I can relax and enjoy my evening, feeling better about my performance.

Homework is an investment in another *perfect* day.

CHAPTER 21

The Worst Trading Day

When you've started in the morning with no premarket preparation, you're trading on pure emotion, and your analysis and maneuvers are about as consistent as the capricious Northeastern weather, you're about to have your worst trading day.

I've had days like that as a greenhorn, and I've seen them happen to others. While trading near Wall Street I've witnessed lone rangers come onto the trading floor, and get wiped out in just a few hours. As incredible as that may sound, it happens all the time. It's possible to break every day trading rule in one single trading day, and I'm going to show you how.

One exemplary trader I saw especially sticks out in my mind. To me he's like the memory of a crazy car accident scene. Although he's an actual person, he and others like him remind me of the character called Quick-draw McGraw. Remember the Hanna-Barbera cartoon with that hyper, temperamental little gunslinger?

I'll call this trader Quick-draw McLoser.

The following is a description of what I'll assume has been a day in his life.

EARLY MORNING ACTIVITIES

It's dawn.

Quick-draw might be prostrate, balled up in bed, hiding deep under his covers. Or maybe he's wired and pacing his floor. Either way, this guy's a mess. He's so depressed and worried that he's sleeping way too much, or else he's insomniac.

Quick-draw has recently lost lots of money. The prospect of trading today makes him scared, and very rightly so; in his state of distraught exhaustion and fear, things will only get worse.

He'd be better off staying home, in bed, lying in a fetal position. He'd be better off sucking his thumb. That way he won't create any more damage than what he's already done.

Most likely his losses were yesterday, or over the past few days, because of huge over-exposure. Maybe last night he took a losing position and **held** it until this morning.

Maybe he's praying it will save him today by taking off like a shot.

Good luck, Quick-draw. You'll need it.

On days like this he completely abandons what the pros have all advised him to do. He doesn't even think about exercise. He doesn't care to scrutinize the market news. He doesn't even care to watch other stocks that can potentially gain him some profits. His only concern is whatever price his **held** stock will start to trade at, when premarket opens at 8:00 A.M.

If I'm wrong, and Quick-draw's not **holding**, then maybe his cliff-hanging, frayed-nerves condition is from trading for four days in the red. Today, which is Friday, is his last chance for the week, and even though he's fearful to day trade anymore, he's desperate to finally make a profit.

Can you see the gambling mentality emerging? It doesn't matter which strategic fiasco has caused Quick-draw's distress. What matters is that today, if he trades it will be on sheer emotion.

PREMARKET TRADING

It's a few minutes before premarket. I've arrived at the trading floor downtown. Quick-draw's already in position at his trading-desk, and he's noticeably nervous and pale. He looks even worse than he did yesterday, and yesterday he looked pretty bad. He always trades close to my station, so I observe him from time to time.

I'll return now to Quick-draw's perspective.

The hour of 8:00 strikes. The premarket data has started its dance across his glowering screens. He feels like he's watching a casino roulette ball bouncing on the spun wheel.

Then suddenly, the world's in slow motion. Quick-draw has just seen his death. Since the close of yesterday's after-market trading, his **held** stock has dropped three more dollars.

Quick-draw is in big trouble.

Should I buy more at these lower levels? That is, keep averaging down? Or should I cut my losses and stop/loss?

Quick-draw can't decide what to do. It's head-bashing hard to think straight. Panic starts biting all through him, just like a rabid dog. And then he goes numb. He just stares at the screen. He takes on the look of a zombie. He wants to plunge back into bed to the comforting escape of his sweet-dreams fortress. With a little bit of luck the stock just might retrace in his direction. But he's comatose, with no plan of exit.

Then a spark of adrenaline zaps him. Quick-draw snaps out of it. He straightens up in the chair. He realizes he needs a plan. At this point, any plan.

Like a typical gambler who's counting his chips, the only thing Quick-draw considers is the amount of his buying power. He checks out how much remains. His choice is quintessentially reckless: he'll average-down until the bell. With this ludicrous scheme he's desperately betting the price will retrace at 9:30 A.M.

And there we have it, folks: that's the hallmark casino decision.

The most notable issue is his judgment. It's taken a hike from his brain. Quick-draw is completely uninterested as to why this stock is dropping. He's ignoring the tell-tale signs of trending. He's failing to observe that the stock just broke through a major support level (30-day moving average), and with extremely high volume.

Quick-draw just doesn't care!

He's chosen to battle this out. He's going to stand and fight. The specter of the glazed-eyed Eternal Casino Addict is hovering over his shoulder.

So now he buys some more shares. He feels brave for showing up to his trading desk near Wall Street, and refusing to retreat to his bed.

His only hope is for the market to lend him mercy. What, has he forgotten?? The market has no mercy.

Let's assume that yesterday he bought XYZ stock, at an average price of $50 per share. He ended the day with 1,500 shares (total accumulated shares), and the price closed at $46.50. Then he **held** the losing positions overnight.

Next morning, today, at 8:00 a.m., the stock opened at $43.50, down another $3.00. So he's down $6.50 per share. That's equivalent to being in the red by $9,750 ($6.50 × 1,500 shares). Every $1 drop in price means he's losing $1,500!

With $250,000 leveraged buying-power, Quick-draw does the math. The fifteen hundred shares at $50 per share took only $75,000. On the bright side, he still has plenty of muscle.

But he's down almost $10,000!

Again Quick-draw considers his options. *I can go back home to bed and wait until the price goes back up later, I can stop/loss right now and take the $9,750 loss, or I can average this baby down, and rodeo-ride it back up.*

Quick-draw chooses the Wild Bill approach. *Eee-Hah!*

THE OPENING BELL

Its 9:30 A.M. There goes the bell. He's watching only that stock. He could care less what the rest of the market is doing. His only concern is riding that stock back to at least break-even.

He notices the stock price dropping further. So he purchases another 100 shares, and then another, and another. Now he has 2,000 shares of this stock, which is showing no signs of retracing.

Once again, Quick-draw feels the terror. The more he averages it down, it seems, the faster it wants to drop.

He now has roughly $150,000 of buying power left. He currently owns 2,000 shares at an average paid price of $49.75. The current market price is at $45.75, after hitting an earlier low of $42.75. So his updated *loss* is a little bit less; it's down to $8,000. By recklessly averaging down, it seems, he's actually gained something back.

Without a real plan of exit, however, those gains will be short lived. All it will take is an 80¢ cent move back down, and Quick-draw will be right back to his original $9,750 loss. And now he's **holding** 2,000 shares, instead of the original 1,500.

Overexposure has tightened the strangle.

MIDDAY ACTIVITIES

I get back from lunch and I notice that Quick-draw's in the exact same position he was in before I walked out the door. It's like he never got up for the break. I'm guessing he never ate lunch.

I'll return now to Quick-draw's point of view.

He refuses to acknowledge that his buying power is his worst enemy. He still has plenty of leverage that can sink him even further, or else pull him out of this mess. Well, he's trading on emotion, so he's flagrantly, crazily betting; he desperately believes that his buying power will sooner or later save him.

All afternoon he rides this stock, watching it go up and down. He's **holding** and frantically praying. Suddenly the stock goes all the way up to his break-even $49.75. "Oh, *yeah!*" he cheers, casino-style, startling everyone on the floor.

Then it rapidly retraces back down, to the low $47 range.

This has happened unbelievably fast—too fast for Quick-draw to react.

Quick-draw now gets very quiet, but I can see he's more agitated than ever.

He never sells any positions. The reason is he wants to make some money on this hell-ride. There's that, and then there are the destructive emotions of overconfidence and greed. He's allowed those emotions to make him believe that the price will move higher than the break-even point.

It hasn't.

Instead the price has continued to tank, and it begins to break through the original intra-day low of $42.75. Now he wishes he'd sold when it teased him, back when it reached his break-even $49.75.

Quick-draw feels beyond stupid. Oh, *yeah.*

But it's not over yet.

The price drops to $42.50, so he averages down some more. Quick-draw is stir-crazy now. He's laughing and crying all at once. He's getting a little delirious, convinced that the stock is an entity, aware, doing this to him with a vengeance.

He averages down some more, and then he does it some more.

It's near the last hour of trading. Quick-draw has ridden this roller-coaster since dawn. He has not once looked at the market indexes, or at any other stocks. He's been fixated on this one trade.

He just keeps on averaging it down.

LAST HOUR OF TRADING

It's 3 P.M. and Quick-draw has accumulated 5,400 shares. He's had to stop there, because he's reached his maximum buying power of $250,000.

At this point in the trading day, his average price paid has been $46.25. And the stock price is about to hit a new intraday low of $42.00.

Can you stomach doing the math? He's down $4.25 per share (on average). That translates to an intraday loss of $22,950. There are 60 minutes left before the closing bell, and then there's after-hours. But Quick-draw is willing to wait this out. Isn't that all he's been doing?

Now enter the powers-that-be.

Recall how your pay-per-share trading firm deals with your leverage. The managers require your $25,000. Your money, upfront, is their cushion. It insures that they won't lose a dime on your negative trading activities. They don't mind lending (leveraging) you their $250,000, but as soon as you run deep into your collateral—the $25,000 you brought in—red flags go up at their monitors.

When there's only 10 minutes left to trade, and Quick-draw's own funds are gouged right down to a measly $2,000, the risk managers jump into action. What they do is called risk-management-intervention, or to put it more bluntly, forced selling.

(I'll never forget the sight of the risk manager walking over to Quick-draw's station. I felt his embarrassment as if it were my own. I knew that very soon my peer would be taking that miserable Walk of Shame.)

"We need you to sell all your positions right now," the risk-manager whispers discreetly.

It doesn't matter what the charts read or what price leap he thinks will happen; Quick-draw has to do what he's told. He's bought thousands of shares with the firm's money. The firm won't risk letting this stock plummet after-hours, or far worse, overnight. Not with *their* money, they won't!

So he miserably sells all 5,400 shares at an average of $42.25. The risk manager makes sure that he's done this, and then he pats him on the shoulder. Now the intervener walks away. The firm's assets are safe.

But all is not cool for our buddy. Quick-draw paid an average of $46.25 for all those thousands of shares. He sold all at $42.25. He lost $4 per share. His total loss on that trade—his *only* trade for the day—is $21,600.

THE CLOSING BELL

(I couldn't help peering at him. Having been there myself, I understood exactly how he felt. All of us pro traders can relate to what Quick-draw was experiencing).

For the rest of the trading session, he slouches. He's trying hard not to sob. He can't stop his mind from constantly replaying every maneuver he made. He feels like he;s going to puke.

AFTER-MARKET TRADING

Now Quick-draw can get some perspective. Even though he feels so low that he wants to crawl home to bed, he hangs around for a while.

He wants to keep an eye on the stock that just killed him, and only because he's curious. After getting mercilessly gutted and flayed, it's only natural to want to understand the dynamics of your destroyer.

Soon his curiosity turns into excitement. While he's watching the after-market price action of his money-munching XYZ stock, he notices a huge spike in volume and a major drop in price. It happens within mere seconds.

What in the world is going on?

It turns out that the stock has had its earnings release after the market just closed. The stock has reported miserable earnings, so it's dropped precipitously.

Quick-draw watches it tumble all the way down to a horrifying $34.50.

What if he were still **holding**?

He'd have lost an additional $8 per share!!!

I guess that means the risk manager really saved his ass.

You'll recall that when he woke up today, Quick-draw neglected some things. For one thing, he didn't check the news on his stock. If he had, he would have known that today it was releasing its quarterly earnings report.

Doesn't he know the ironclad rule? You *never* trade a stock on the day prior to or the day of a major news release! It must have slipped his mind.

HOMEWORK

The only homework for Quick-draw tonight is the attempt to budget himself out of this crater that he just sank himself into. He can't resume trading until the firm's group trading account gets a deposit of $22,000.

That's a lot of money for McLoser.

CONCLUSION

Parting Words

You'll recall that in Chapter 5, "Knowing When to Take a Break," I stress the importance of staying involved, even though you've briefly stopped trading. My writing of this book is an actual example of how I remained in the loop, during a hiatus of my own.

But why did you take a break? you might ask me. *Why did you stop and turn writer, when you were making so much money?*

I would respond with the reminder that day trading is a process that requires both rest and reflection. In that process, you can't skip steps. You can't be trading in hundred-share blocks, and on the next day start trading in thousands. You need some downtime in between that share increase, in order to study and learn, or you'll never become a professional, consistently profiting trader.

Even a pro needs some time off. It may be just to rest. It may be to play, to kick back, have fun . . . or even to brainstorm a book . . . but always with an ear on the market, every day, from the opening bell to the closing.

And the day trading process has setbacks, even for an expert. As usual I can best illustrate this by conveying my personal experiences.

Each time I advanced to a higher trading level, at first things always got rough. One such progression was my arrival at the conviction that I needed a pay-per-share broker. You'll recall that I'd been very actively trading with a traditional pay-per-trade broker, enduring prohibitive commissions. I cautiously traded in hundred-share blocks, looking for quick 10¢ to 40¢ moves, making $10 to $40 per trade. That was fine, because I was placing over 100 trades per day, but I was getting hit with a whopping $10 commission per execution!

So naturally I began seeking out firms with a pay-per-share commission structure. That was the logical and smart thing to do, but it also became a setback. Why? It was a whole new adjustment. There's the minimum $25,000 to become an associate pay-per-share trader. And then there's that move to New York.

After living in sunny San Diego for nine years, and day trading most of that time, I didn't go home to my cheap, familiar, easygoing western New York; I headed straight for the Big Apple. As you know, I had no choice. The pay-per-share day trading firms are concentrated there, most of them near Wall Street.

I was ready for that trading scenario, but I wasn't well-prepared for the hurdles. On the one hand, my ducks were expertly lined up: high leverage (20 to 1), a professional environment (trading floor), direct access (Level 2 and "fast-key" order execution), and of course my own extensive trading history. But the overall shock of moving, combined with the completely new system of trading, put a toll on my trading psychology. My comfort zone was obliterated. My normal rhythm got lost. My previous profit consistency dwindled. Basically, I had to learn how to day trade all over again. Though I was finally getting exposed to professional day trading and day traders, and I could see that my move to Manhattan was the best move for my career, it was going to take time to adjust.

During that time, I lost money. In an extremely expensive town!

The good side was working right next to some seasoned independent day traders. Those guys were mostly older, in their late 40s and 50s. They traded consistently profitably in 500-share blocks or more. They were what you call whale traders.

Taking peeks at their trading screens throughout the trading day, I was constantly blown away. Their daily profits (and losses) typically exceeded five thousand dollars.

What really got me, however, was all of their personal sagas. They emphasized their terrible trials while struggling to become professionals. As each and every one of them told similar horror stories, I listened with growing enlightenment. All of them had suffered great losses. For instance, most of them had remortgaged their houses—at least once—to recover. A few had to file bankruptcy. Many of them told me how they used to live like rats, eating peanut butter and jelly for a year.

Unfortunately, in this business, it can cost a lot to progress. They emphasized the importance of never losing your drive. They knew that each time they'd lost big, they'd also learned a huge lesson, something to add to their repertoires of growing expertise.

Their point, and the point that I'm making to you, is that this career isn't glorious, at least not right away. In accordance, I've refused to sugarcoat anything, because that would be criminal. The truth is you could lose both your mind and your shirt in the process of learning how to day trade as a pro.

My move to Manhattan involved sacrifice. In order to raise capital, I sold everything I owned. As I settled in the city, in the process of progressing, I suffered another round of agonizing losses. But now I can reap the rewards of the process. Now I'm a professional day trader.

For me, taking a break to write this book has been a fulfillment of the process. There's more to success than making money. I like being able to mentor. This book is an offering of rules and strategies that an amateur might forget. You have my blunders to learn from, and that makes my blunders worth something.

APPENDIX

Rules to Remember

This final section is designed to be a quick reference list. I have simply gathered each rule from each chapter and placed them here. Also, it is crucial that you first read the entire chapter that corresponds to the rules. The rules by themselves are not meant to teach you, they are meant to remind you.

CHAPTER 1: TRUTHS ABOUT YOURSELF TO KNOW FIRST

- Increasing your skill level is a gradual process; never fast-track it without the help of professional mentorship or in-house training.
- A Series 7 license doesn't mean you're a professional day trader. You still need to be trained.
- Always remain active in day trading. That's the key to increasing skill.

CHAPTER 2: HOW EMOTIONS CAN DESTROY A TRADE

- If you feel yourself being controlled by your emotions—reduce your market exposure immediately.
- Stay consistent *all day* while trading—stick with 100-share blocks.
- Set realistic profit goals, and create a realistic budget.

CHAPTER 3: PREVENTING OVERCONFIDENCE

- Confidence is an emotional tool, and you must harness and control it.
- Never enter a trade without knowing your exit points.
- Once you've predetermined your exit points, always stick to them.

CHAPTER 4: FROM IMPATIENT TO COOL, CALM, AND COLLECTED

- Never pick entry or exits point when feeling out of control and impatient.
- Find stocks that move at least 25¢ cents every five-minute period.
- Do not trade more than 100-share blocks per trade until you become more advanced.
- Don't expect to make a lot of money in the beginning.
- Finish reading this book before you begin or go back to day trading.

CHAPTER 5: TAKING BREAKS

- Don't take time off just to get more cash.
- Gauge your performance at the end of each trading day.
- Log in the reasons why a trade went wrong.
- When things get consistently inconsistent, stop and take time off.
- During your time off, actively research your mistakes. Mentally prepare yourself for the return.
- Plan a budget for the inevitable—the times off.

CHAPTER 6: THE IMPORTANCE OF RISK MANAGEMENT

- Trade only the amount of shares, in one particular stock, that won't exceed the risk you can handle.
- If you're an amateur, always trade in 100-share blocks.
- If you're feeling stressed out, get out of the trade.
- Until you're highly skilled, don't trade until after 9:45 A.M.

- Practice learning your tolerance levels in low-risk (low-exposure) trades.
- Never overexpose yourself in any of the ways we've discussed.

CHAPTER 7: WHY OVEREXPOSURE TO THE MARKET CAN HURT

- Always trade stocks that are new to you in amounts no larger than 100-share blocks.
- Until you're consistently profiting during regular hours, avoid pre-market and after-market hours.
- When you're feeling completely lost and are most likely overexposed, stop/loss immediately.

CHAPTER 8: BUDGETING: KNOWING YOUR FINANCIAL LIMITATIONS

- If you're planning to train on your own, save up to prepare for three months of unemployment. If you're planning to be professionally mentored, save up for one month of unemployment.
- Don't try to trade for income until you're consistently profitable, after three months of training on your own or one month of mentoring.
- If you quit your day job, make sure you can get it back. Or, as an alternatiave safety net, bolster your day trading training with mentoring.
- Always have cushion money set aside for both your training and your active trading.
- Never keep your cushion money in your trading account.
- Use budgeting software to keep your accounting up-to-date and available.

CHAPTER 9: MINIMIZING YOUR RISK WITH STOP/LOSS

- Learning how to properly stop/loss is a process of trial and error. So again: trade in small hundred-share blocks.
- Never try gauging a stop/loss price until you've determined the support and resistance levels for that day.

- Before you even try to gauge what price level you want to sell at a stop/loss, know your financial limitations for that day.
- On every trade you enter, always stick to your predetermined stop/loss exit price.

CHAPTER 10: AVERAGING-DOWN: A SKILLED STRATEGY

- Never attempt to average-down until you're sufficiently skilled.
- Never average-down beyond your threshold for risk.
- Only average-down on your consistently profitable stocks.

CHAPTER 11: GAMBLING VERSUS DAY TRADING

- Learn risk management before you start day trading, or else you're just rolling the dice.
- Hone the skills of risk management during initial live-trading experiences. Always take advantage of the strategic options that day trading offers you—options you don't get in gambling.
- Never, ever ask yourself whether you're feeling lucky today.

CHAPTER 12: WHY SOME TRADERS MAKE MORE MISTAKES

- Never take your eyes off a trade!
- Log every one of your mistakes.
- Your mistake is another trader's profit, so understand what he did right.
- Focus on eliminating your chronic mistakes.
- Instead of shrugging them off, learn and grow from your errors.

CHAPTER 13: TRADING CONSISTENTLY ALL DAY

- Find your tolerance levels, and adjust your stop/loss and profit system accordingly.

- Discipline yourself to trade the same way, *all day long*.
- Never **hold** a losing position overnight!

CHAPTER 14: STOCK PICKING: SIMPLIFYING THE PROCESS

- Even with a good stock to trade, never lower your guard and/or trade in larger share blocks.
- Find stocks that have been trading consistently, over a three-month period, above 1 million shares in volume per day, on average.
- Never trade penny stocks.
- Only add stocks to your Watch List that are priced in the $10 to $100 range.
- Stay away from charts that exhibit intraday flat patterns.
- Don't trade stocks whose companies are dependent on regulations that can drastically affect their product sales.
- Don't be in a trade just before anticipated news hits the wire about it.
- Stay away from any stock that is even considering bankruptcy.
- Read this entire book before you trade stocks you've found.

CHAPTER 15: WHY NEWS CAN BE JUST NOISE

- Know which news will hurt your trade, and which news is just noise.
- Always know your stock's earnings announcement dates.
- Do not trade a stock on or before the day of an earnings announcement.
- If the news hits the wire midday, and it's immediately affecting the price of your stock, stop trading that stock for that day.

CHAPTER 16: ABOUT THOSE TRAINING PROGRAMS

- If you're a beginner day trader, go for some form of structured training.
- Go to training programs armed with questions.
- Don't expect to be a pro upon completion of any short-term program.
- Insist upon information about pay-per-per share brokers.
- If you're an advanced beginner, seek out mentorship programs.

CHAPTER 17: PICKING THE RIGHT ONLINE BROKER

- Don't use a pay-per-trade broker if you're placing multiple trades and not **holding** overnight.
- Keep your pay-per-trade broker *only* for long-term trades and free resources.
- In pay-per-share trading, be extremely careful of how much leverage you use. Always start small (10 to 1).
- When searching for pay-per-share brokers, visit the actual trading floors and test their demos for at least a few days, and take note of their cost/fee structures.
- Trade remotely from home only after you've traded on their floor for awhile.

CHAPTER 18: PAPER-TRADING STRATEGY

- Think real and trade small when paper trading.
- Paper trade *exactly* the same way as you would when real trading.
- *Do not* construe paper trading as a way to gauge your profits.

CHAPTER 19: TRADING FOR SKILL VERSUS TRADING FOR INCOME

- Always start with a First-Level stock, then progress upward from there.
- *Do not* trade with real money until you've been consistently profitable with your stock for a week straight in paper trading.

About the Author

Josh DiPietro has been day-trading stocks for 11 years. He operates a web site, www.daytraderjosh.com, and provides mentoring programs for aspiring day traders. His trading approach involves making many trades every day, taking small profits, exiting losing trades quickly, and minimizing commission fees. He is a critic of the educational paths offered by the established trading industry and is dedicated to providing an alternative education approach for aspiring traders.

Josh is 33 years old and resides in New York City.

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The Truth About Day Trading Stocks

A realistic guide to day trading today's stock market

"Josh does an outstanding job of capturing all his trading experience into an invaluable memoir detailing specific rules for both the inexperienced and experienced trader. Anyone interested in trading professionally should read this book as they will learn invaluable lessons."

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"Having been a trader for over twenty years myself, I've read my share of books about the financial markets. Josh's book is one of the few which doesn't sugarcoat the fact that successful trading is both hard work and takes a long time to master. These lessons and guidance are drawn from real-life experiences, not hypotheticals, which simply adds to their weight. Active traders who are serious about their success need to read this book."

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"A brutally honest depiction of the reality of trading. Great stuff. If you're new to the trading game, this book will shorten your learning curve and—if you take its lessons to heart—it just might save you money and grief."

—Jason Alan Jankovsky, author of *Ā e Art of the Trade* and
Trading Rules that Work

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