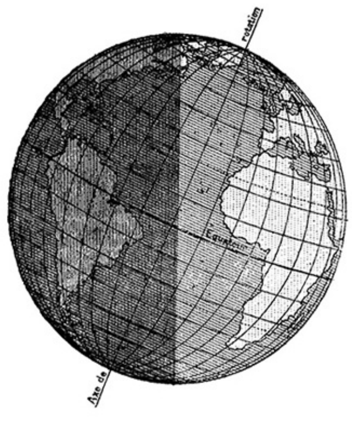
IN THE UNITED STATES, YOU ONLY NEED A FEW HUNDRED DOLLARS TO START TRADING CURRENCIES.

THREE OF THE MOST IMPORTANT COMPONENTS DAY TRADERS NEED TO BE SUCCESSFUL ARE KNOWLEDGE, SUFFICIENT CAPITAL TO GET STARTED, AND STRATEGY.

A CRASH COURSE IN BUYING AND SELLING STOCKS

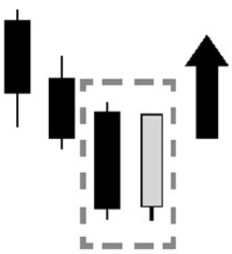
DAY TRADING 101

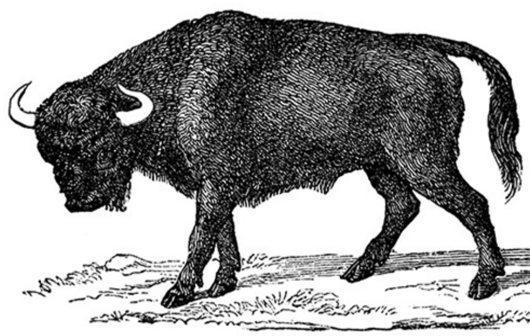
FROM UNDERSTANDING **RISK MANAGEMENT** AND CREATING **TRADE PLANS** TO RECOGNIZING **MARKET PATTERNS** AND USING **AUTOMATED SOFTWARE**, AN ESSENTIAL PRIMER IN **MODERN DAY TRADING**



A CANDLESTICK CHART IS WHAT MOST ACTIVE TRADERS USE TO DETERMINE A BASIS FOR TAKING A TRADE. EACH CANDLE ON THE CHART SHOWS FOUR IMPORTANT PIECES OF INFORMATION: THE OPENING PRICE, THE CLOSING PRICE, THE HIGH PRICE OF THE PERIOD, AND THE LOW PRICE OF THE PERIOD.

DAY TRADING IS DEFINED AS THE BUYING AND SELLING OF A SECURITY WITHIN A SINGLE TRADING DAY.





DAVID BORMAN

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CONTENTS

DEDICATION

This book is dedicated to my mom, Cynthia, and my two brothers, Bill and Ted, all of whom have been there for me during the writing of this and all my other books. They've been there through all my nonstop talk about this or that economic theory, they've been there for countless late-night writing sessions, they've been there through the good times and the bad . . . In short, they've always been there for me.

INTRODUCTION

Just what is day trading?

When people hear the word *trading*, they usually think of the stock market and of the kind of thing that happens with their 401(k) accounts (or other retirement accounts). But that's not really stock trading; it's *investing*. People who trade stocks don't buy into a 401(k) or brokerage account with a preset amount with each payroll check. Instead, they buy and sell stocks in order to make a profit.

Many traders think long term and buy and hold stocks for some time—in fact, sometimes for years. But there's another kind of trading, and that's what we're going to talk about in the following pages: *day trading*.

In one sense, day trading is exactly what it sounds like. Day traders buy and sell stock within a twenty-four-hour period. Sometimes they hold the stock for only minutes, sometimes for a few hours. But in the end, day trading is the process of starting a trading session at the beginning of the day in 100 percent cash, buying and selling securities during the day for profits, and making sure to sell off all the account holdings by the end of the day, thereby returning to all cash at the end of the trading session.

Day traders buy and sell stocks many times in a single day. Their goal is to capture gains and book profits on their trades during the hours the markets are open. Day after day, month after month, they repeat the process of starting in cash, trading, booking profits, and ending the day in cash. Although the profit on each trade is often relatively small, the *volume* of their trades allows day traders to book huge profits on average-sized accounts over the year. As the profits come in, the trader's account grows in value, allowing larger trades.

Another distinguishing feature of day trading is the use of "leverage" to amplify purchasing power. When day traders use leverage (also called margin accounts) in their trading accounts, they are essentially buying stock or securities with credit. This is much like purchasing a house with only a 10 or 20 percent down payment and a mortgage for the balance. In the case of day trading, the trader puts up cash or other securities for the down payment, and the brokerage account lends him money to buy more stock or other securities. This means that with the right management, relatively small accounts can book sizeable profits.

Finally, one of the best qualities of day trading is the availability of twenty-four-hour markets. Day trading can be done whenever the markets are open: for stocks, this usually means 7:30 a.m. to 2 p.m. Eastern US time. But while the US stock market is only open during the day, other markets are open twenty-four hours a day, six days a week. This means you can keep your regular day job while building up your skills at trading in your off hours. You can trade on your own time, whether late in the evening before bed or early in the morning before work. You can even trade on a smartphone or a tablet; brokerage houses offer sophisticated trading platforms for both. Trading can be done anywhere you have access to the Internet: at the coffee shop, at your home office. It doesn’t have to take a lot of time either. You might spend only an hour a day looking for trades and only trade two to four times a week, searching for only the best trades that offer the best profits. It’s really up to you how you want to build your trading business.

This book will walk you through the basic concepts of how to start day trading, from opening and funding your trading account, looking for profitable trades, knowing when to exit a trade for a good amount of profit, and steering clear of bad trades. You will learn the differences between day trading, short-term trading, and investing, and you will see what you’ll need to get up and running in your day trading account to make your trading manageable, enjoyable, and profitable. All it takes is a bit of knowledge and insight, and with a little time and practice, you’ll be able to read the signals of the market, you’ll know how to determine the good trades from the bad trades, and you’ll start booking profits.

Chapter 1

Introduction to Markets and Trading

Trading, day trading, and investing are terms that are used to describe the buying and selling of financial products that are traded electronically. Whether they be stocks, commodities such as oil or gold, or foreign currency, day traders and traders use computers to buy and sell in what is called the financial markets. Most people are familiar with the US markets such as the stock market, but the financial markets are worldwide, and it is possible to trade stocks from a European company, gold warehoused in Asia, or the currencies of developing nations. What ties them all together is that the trading is done electronically and can be done from your home computer or, in many cases, from your tablet or smartphone.

FUNCTIONS OF THE MARKETS

Market Makers and Market Pricing

The markets are the grouping of financial trading people, products, and platforms. By this I mean the market is the loose association of professional and personal traders and investors who carry out both short-term and long-term trades and investments in financial products such as stocks, foreign moneys, and commodities such as gold and oil. These are the market participants, buying and selling electronically or face to face, within the confines of the accepted rules and regulations of trading and investing. Keep in mind that the market refers to the industry as a whole, not just stocks, bonds, or other traded instruments.

Say the word *markets*, and most people think of the tumultuous “pits” that we often see on television and in pictures of the New York Stock Exchange (NYSE). Dozens of traders are closely gathered, waving their hands wildly while yelling out buy and sell orders. These “pits” are on the floor of the stock exchanges. At these locations, the traders are sometimes market makers.

MARKET MAKERS

Market markers are traders whose profit is made from buying and selling all available stock in which they are dealers. They are the first to buy and sell all orders coming through the exchange floor for that stock, and they earn a commission on each trade. The downside of this is that if the market has a bad day, they still have to buy all shares of their specialty stock, whatever the price. This is true even if their order book is full and they have very few buyers. Market makers facilitate the efficient and orderly operation of the investment markets in good times and bad.

Many market makers work for large firms such as Morgan Stanley or Merrill Lynch; others are employed by private account holders who own a “seat” on the exchange. Having a seat allows them to put a person on the floor of the exchange to get in on the trading action.

On the floors of the exchanges, trades are often made in bulk orders of one thousand shares or more, but floor traders can handle smaller trades (hundred-share lots or even smaller). Floor traders trade for their own account or for firms that buy shares for their client's accounts. In either case, the motivation of market makers is the access to all trades that come through the floor and a commission on each trade that they handle for clients. Market makers are strictly regulated by the Securities and Exchange Commission (SEC), the Financial Industry Regulatory Authority (FINRA), and the National Futures Association (NFA). The SEC is the government body that polices, investigates, and prosecutes financial and market fraud in the United States. FINRA and NFA are self-governing industry watchdogs that monitor and regulate all US-based stock, foreign exchange market, and futures professionals.

Fiduciary Care

While market makers are a form of broker, only FINRA/NFA brokers registered to provide "care of custodial control of client accounts" are required to provide a fiduciary service: meaning only these registered brokers are required to put their client's financial needs above their own.

Determining Price

In addition to providing a physical or electronic gathering place for buyers and sellers of financial products such as stocks, foreign currency, and futures, the world's marketplaces help buyers and sellers determine the current price of what's being traded. Trading screens scattered throughout the trading floor of the exchanges show a buy and a sell price for each stock. The prices are updated constantly so that traders can see what a trade is worth moment to moment, allowing them what is called *price discovery*. The buy prices are a bit higher than the sell prices; the difference between the buy/sell is called bid/ask spread.

If you are selling a stock, you'll get the bid price; if you are buying a stock, you'll get the ask price. If you're buying a stock, it will cost more than you would get if you had the same stock and you were selling. The difference between the two prices, the spread, is pocketed by the dealers and floor brokers as their profit for the service of being market makers. Financial products that are traded in massive quantities daily usually have a tight spread: the difference between the buying and selling price is very small, or tight.

For example, if you were to buy one hundred shares of Apple stock (AAPL) at $101.50 per share and instantly sold all one hundred of those AAPL shares, your sales price would be about $101.40. You would instantly lose ten cents per share, for a total loss of $10 on the trade. This difference in price is the amount that the dealer or floor broker makes on the trade. Remember, the floor brokers make money with *every* buy and sell order that comes across their order book—it doesn't matter if you lost money on the trade. Each trading day, there are thousands of buy and sell orders, and the floor brokers earn a small sliver of profit on each trade they handle for their clients.

The volume at which shares or other financial products are traded is referred to as their liquidity. The more liquid a product is (i.e., the more often it is traded), the less the spread. The more illiquid a product is (i.e., the less it is traded), the wider the spread.

Bid/Ask Spreads Vary Widely

Spreads can vary widely between traded products: the spread of an electronically traded futures contract for 100 ounces of gold could be as little as $10. At the same time, the spread of 100 ounces of actual gold bullion from a reputable precious metals dealer could be as high as $30 per ounce, or $3,000.

PRIMARY AND SECONDARY MARKETS

Two other terms you'll hear as you learn more about trading are *primary market* and *secondary market*. The primary market is where new stocks and bonds are first made available for public purchase. When a company is raising cash for operations for the first time, investors can pay cash for an equity ownership stake in the company, which is embodied in shares of stock. In return, the owners of the company give up a percentage of control of their company to the investors. The company then takes the cash and uses the money to grow further. This initial sale of stock is called an initial public offering, or IPO.

Once the stock has been sold, it becomes a part of the secondary market, where it can be traded among investors and day traders with very few or no restrictions. Most times this is done through a brokerage account or an online trading platform. As a day trader, the financial products you will be trading will all be offered on the secondary market—you will be day trading by buying and selling on the exchanges through your brokerage trading platform. Your trading platform will differ depending upon the product you trade, whether it's stocks, foreign exchange, or futures. Not only are these different products, but each brokerage firm will offer its own. The basics will all be the same though: order entry, notations as to avaible purchasing limits, and each gain and or loss of every trade. The displays range from the very simple to the complex. Some professional traders use up to eight full computer screens at once: some for order entry, others for charting and market-related information.

The money paid for a trade is given to the previous owner of the stock, and the purchasing trader receives the stock. The company that originally issued the stock never receives any money from the secondary market. The only time the company receives the money from the sale of stock is when it's initially sold on the primary market. From then on, traders and investors buy and sell stock from their own accounts, and only to each other.

WHO'S WHO IN THE MARKETPLACE

Banks, Hedge Funds, and Trading Houses

Before you start searching the market, looking for trades, and living the often thrilling life of a day trader, it's best to know a little something about the institutions that are integral to the world's stock, currency, and commodities markets.

INVESTMENT BANKS

Within the world's marketplace of stocks, bonds, mutual funds, futures, and currency, there are a few key players. The first of these is the investment banks. These are at the top of the food chain in the trading business. This is because when companies are raising capital for the first time, it is the investment banks that write and prepare the documents, provide advice, and help "place" the initial run of stock that the company will offer. ("Place" in this context means the first listing of the stock on the stock exchange ever, thereafter available to the public to buy in their trading accounts for investment or trading.) As discussed earlier, if the company is raising capital on the stock exchanges for the first time, the first shares of stock sold to the public are called an IPO, or initial public offering. These IPOs are very complex. The company will hire an investment bank to determine how many shares will be sold, at what price, and if any other legal contracts will be tied to the shares. The bank will then use its vast connections in the investment world to find buyers of the stock at the initial price. This is the price it will sell at when the company goes public.

Investment banks have first dibs on the stock and will sell large blocks to their best customers. Many times regular traders can own shares of the new stock after it has debuted on the exchange and is therefore trading live.

HEDGE FUNDS

The second group of players in the markets is hedge funds. These are privately owned trading houses that invest both their owner's monies and their customer's monies at highly leveraged amounts. Not only are hedge funds highly leveraged pools of investment money, but they also use several different trading styles as well. These range from higher-level views of the world's trading environments (such as Global Macro funds), which trade any financial product with a "no restraints" policy on where gains can be captured, to derivative-only funds (managed futures funds) that are designed to make money when stocks go up or down in value (long/short funds), or even special situations funds (leveraged buyouts, or distressed asset funds, which only buy stocks in companies that are undergoing trauma: management takeovers, bankruptcies, fiscal trouble, etc.

Hedge Funds and Regulation

One reason hedge funds are attractive to investors is that they're less regulated by the SEC than many other financial institutions. However, in the wake of several significant scandals such as accusations at SAC Capital in 2010 of insider trading, that situation has begun to change, and there are more attempts by government agencies to oversee hedge funds.

These hedge funds can be massive buyers and sellers in the finance world. They sometimes use both equity and derivative positions to diversify their accounts to a very sophisticated level. These days, most hedge funds also use computer modeling and statistical programs to help determine and capture the best trades with the least trading risk. Overall, hedge funds are managed by the most sophisticated and powerful day traders and position traders in today's world markets. They play often and big. Hedge fund buying and selling can move the markets up or down. People take notice when a rumor of a large hedge fund making a trade is in the news. This is because most hedge funds are very secretive in nature—not only are their inner workings and methods kept quiet, but the fund managers keep a low profile as well—which only adds to the mystique of working for or investing in them.

Hedge Fund Performance

The major wealth management firms heavily recommend hedge funds of all investment styles. Some houses such as UBS and Morgan Stanley recommend that 15–20 percent of an investment portfolio should be invested in alternative investments for proper diversification and risk/reward profile. Of this 15–20 percent, hedge funds are included along with other forms of complex alternative investments, such as private equity and derivative funds.

Hedge fund performance has gone up and down over the years; they generally do best when the world's stock markets and economies are in turmoil. They are designed to offer maximum diversification to an overall investment portfolio and are built with layers of diversification. If the equity markets of the world are all doing well and European, US, and Asian markets are doing well, then traders and investors will most likely earn more and do better with a unidirectional, nondiversified trading strategy. In this market condition, stocks will generally move in one direction most of the time. While there may be up-and-down days, on average the market will move in one direction over weeks and months (or even years!).

In other words, economies that have great stock markets are great for day trading. Not only that, but simpler trading strategies work the best. Unidirectional and nondiversified, long-only equities or equity futures can be the best and highest performing trading strategies. Keep it simple! Buy low, sell high. If the market seems to go up every day, then go long only (buy low and sell higher). This is easy to understand and simple to set up on your trading platform. Currently the markets are conducive to simplified trading strategies. Another thing to remember is that simple long-only trades are cheaper to execute than diversified trades due to commission costs.

PROFESSIONAL TRADING HOUSES

The third type of investor (aside from independent traders) is professional trading houses, such as mutual funds and investment companies. Mutual funds are pools of monies that are professionally managed by fund managers. These investment vehicles are generally long-only equity or bond funds.

If you have a 401(k) at work, you are most likely investing in professionally managed mutual funds offered by mutual fund families. These mutual fund families offer customers professionally managed investments with smaller minimums and excellent diversification. Mutual funds pool their customers' investments. They then take the money and buy stocks or bonds (or both) with great diversification. These mutual funds can hold ten, fifty, or a hundred or more different equity positions of different amounts. The managers will then buy and sell, capturing short-term gains for their shareholders. Shareholders will also capture gains on stocks or bonds that go up in value in the market, even if they haven't been sold yet (these are referred to as unrealized gains). Investment companies such as mutual fund families are one of the largest buyers of equities and bonds in the marketplace due to the vast number of investors—especially retirees—using them.

COMMONLY TRADED PRODUCTS

Different People Trade Different Things

Before you begin day trading, you'll need to know some of the different investment products that can be traded. Some of them are easier to understand and set up as trades but offer less potential for return. Other products require a more complex trade setup but offer more potential to trade at higher returns.

TRADING STOCKS

The most basic type of day trading is trading equities also known as stocks. This is because the basic concept underlying this type of trading—i.e., buy low and sell high—is easy to understand, and online trading platforms such as E-Trade, Merrill Edge, and Scottrade make it simple. Stock trading works well when the world's stock markets are generally going up in value and when the economy is good.

Go Long, Go Short

If you buy a stock expecting that its price will rise, you're taking a *long* position. If you sell a stock in the expectation that its price will fall and you'll be able to buy it back at a lower price, you're taking a *short* position, or *shorting* the stock.

Equity Order Entry

When you're day trading stock, you sign in to your trading platform and type in the symbol of the stock (such as Apple Inc., with a symbol of AAPL). On most trading platforms it will show the current price of one share, along with the maximum number of shares you can afford to buy with the money currently in your account.

The next step is to enter the number of shares (say, ten shares), and then click the "Buy Now" button. Instantly, your trade is entered. You now own ten shares of Apple. If one share of Apple is selling at $100 per share, your total cost of the ten shares is $1,000 ($100/share × 10 shares). The trade has a small additional cost, usually under $10 (in this case, most likely around $5). Your trading platform now shows that you own ten shares of AAPL, with a true cost of $1,005.

Stock Symbols

The website *MarketWatch* (www.marketwatch.com) has a handy service that allows you to look up stock symbols. Just type in the name of the company and you'll find the stock symbol, the current price of the stock, its previous closing price, and other helpful information.

Monitoring Profits

If Apple stock goes up in value, the trading platform will show your trade value moving from $1,005 to a higher figure as each share gains value. If, as the minutes and hours tick by, the price of AAPL goes from $100/share to $102.50/share, your AAPL trade will show a value of $1,025 ($102.50 × $10 shares). Because you've spent $5 to buy the shares of Apple, the trading platform will show the net profit of the trade at $20. As you can see, in one day your trade has turned a $20 profit, or made a 2 percent return for the day.

As we said earlier, day traders close their trades at the end of the day. If they do their job well, they realize a profit and end the day with cash in hand. Closing out your trade will cost you an additional trading fee, typically a flat rate of around $5 for this type of trade. If the Apple trade was the only one you made during the day, this would leave you with a $15 profit. While this $15/trade seems small, it is a trade with very little risk or effort. You're in and out in a few minutes or hours, and your cash is back in your account, safe and sound.

If you made this or a similar trade each trading day, you'd net $225 in profits per month on your $1,000 trading account. This is 22.5 percent profit per month, or about 250 percent per year return on your $1,000 account. These types of trades are safe and manageable, and in this case your trading account would grow to $2,500 by the end of the year with very little effort.