Jens Clever

# Mastertrader

# Contents

## *Introduction:*

This book is designed to introduce you to the exciting world of active trading. Active trading means to actively participate in everyday price movements of the financial markets. Active trading enables you to actively manage risks and to participate from both rising and falling prices. The trades I am describing in this book can be from as short as a few seconds to as long as a few days. Many of the strategies can be applied to various timeframes. The difference between active traders and investors is that active traders trade the actual price movement versus investors who make their decisions based on the anticipation of future price movements. I made this book as complete as possible. However, you will find as many strategies as traders. As you gain more experience you will realize that most strategies are based on the same basic principles which are all described in my book.

I have been trading and coaching for many years now. The need to be independent certainly was the biggest reason for me to enter the world of trading. In what other job do you have the freedom to work from anywhere in the world where you have access to the Internet? I started with investing but always felt that there has to be more to the stock market. That’s when I started watching quotes in real time and realized how big the profit potential must be if I could just cut out a small piece of the everyday movements. There are many obstacles to conquer in order to get to a consistent success. A solid strategy, a neutral state of mind and rigid risk management are only some of the key traits needed to be successful.

Whether you are planning to trade full time or just part time, this book will give you very valuable insight into the whole business. Even if you are just planning to invest you should read this book and take some of the basics of technical analysis into consideration when making your next decisions.

***Philosophy:***

Personally I don't think trading needs to be complicated. Keeping it simple is the way to success. I have seen that with all of the worlds leading traders. They only use a few basic strategies in combination with simple tools and indicators.

That does not mean trading is simple. There is great room for failure when it comes to staying neutral and to discipline.

You don't need to know everything. The key is to find a few solid strategies that work for YOU and master them. My goal is to help you on this search.

I believe the most effective way to become successful as a trader is to learn directly from a pro who as already made his mistakes and been thru the struggle one faces when starting out.

In my career as a coach I met many traders that were confused by all the tools they were given. Basically they had all the knowledge they needed, but no one told them how to apply it to real trading. This is why I started one-on-one coaching.
For more information on coaching please see www.daytradingcoach.com.

***Trading strategies – an overview:***

There are as many different trading strategies as there are traders. Generally they can be distinguished though by the time frame in which they take place. I suggest that every trader experiments with different strategies and then decide for himself what he is most comfortable with.

A) **Longer term strategies** (from a day trader perspective)

**Investing**: Investors buy shares of a certain company because they believe in its long-term growth perspective. They have little interest in most of the daily price movements and are looking to hold their shares for several years.

**Swingtrading:** Swingtrading means to hold stocks anywhere from one to five days and sometimes more. Swingtraders try to take advantage of certain “key” situations in a stock price’s movement. Such a situation would be a buy after a pullback into solid support during a longer term uptrend. Swingtrading belongs to one of the easier to implement strategies and is excellent for people with small accounts.

**Overnight trading:**

B) **Short term strategies**

**Momentum trading:** A momentum trade usually lasts anywhere from 30 seconds to about 1 hour. Momentum trading is based on strong price movements and counter price movements often caused by news.

**Breakout trading:** breakouts (breakdowns) do occur in any time frame. Popular charts for breakout traders are 5 minute and 15 minute charts. The holding period is anywhere from a few seconds (breakout scalp) up to the end of the day.

Breakout trading means to buy stock after it has broken out above a certain price. Vice versa for shorts.

**Pullback trading:** Pullback trading is the opposite of breakout trading. Pullback traders are looking for stock prices to pull back a significant enough amount (usually into support) in order for them to justify an entry (vice versa for shorts). Personally I am more of a breakout trader since I like the confirmation of the stock prices' movement that I get thru the breakout; although pullback trading often has the smaller stops though. The holding period is usually a few seconds up to an hour.

**Scalping:** Scalping describes "ultra short term" trading. Scalpers try to take advantage of very small price movements and sell their shares immediately when they have a big enough profit or the stock isn't moving in their direction or goes against them.

**Cutting the spread:** Cutting the spread can be seen as a scalping variety. Cutting the spread means to take advantage of the spread (the price difference between the bid and the ask price). It means to buy a stock on the bid side and to sell it immediately afterwards on the ask side for a small profit. Since the decimalization of the markets this type of trading has certainly become much more difficult because spreads have gotten much smaller, however I still see traders implementing this strategy pretty successfully.

**Please note** that the strategies presented in this book are by no means the "holy grail". Trading setups have to be monitored and adjusted continuously. I did try to cover all the major strategies though in order to give you a sound insight into how traders work.

***Introduction to direct access trading:***

Direct access trading has revolutionized trading in the late 90's. Many traders are still not aware of  the tremendous advantages it offers, especially for the active trader. Imagine being able to place an order with the push of one button and to get executed instantly. This is what direct access trading is all about.

The traditional way to route orders was to call your broker, who would then send your order to his person on the exchange floor or to the market maker to actually execute your order. After that is done the whole process reverses in order confirm what happened with your order. If you are lucky this process will only take a few minutes, but in many cases it takes much longer. For some time now people have used online trading, which in most cases is not much different to the traditional way, with the exception that your order gets sent electronically to your broker who then processes it.

With the introduction of direct access trading order execution has improved dramatically. **You are now able to route your order directly to the exchange without any middlemen involved.**  Access to the market that was formerly only available to institutions is now available to everyone. **You can decide which way your order is going to be routed and you can change or cancel it at any time in an instant.**

On your level 2 screen you can see all the competing bids and offers for any stock listed at the Nasdaq. **Every market maker and every ECN is displayed in the level 2 window and you can directly trade with them.** Think about how fast your voice travels over the phone? This is the speed you can use for routing your orders. It works solely electronically and there are no middleman involved.

There are different order routes integrated into every direct access trading platform, which allow you to send orders to the various market participants.

***The US stock markets:***

**The NASDAQ is a computerized exchange without an actual trading floor.** Orders are executed thru a complex computer system. You will find 2 types of market participants on the NASDAQ, Market Makers (MM) and electronic communication networks (ECN's). There are various different Market makers as well as ECN's which all interact thru computer systems.

**The NYSE is a centralized exchange where shares are traded on an actual exchange floor.** Every stock traded on the NYSE has it's own "specialist" who is responsible for maintaining a fair and orderly market in that particular stock.

On the NYSE only the specialist has insight into the order book, which holds all the orders for the stock he is responsible for. Let's assume you are trying to buy XYZ for $15 but the best seller wants at least $15.25 for XYZ. In this case your order will be placed in the specialist's order book on the bid side and will be executed once a seller is willing to sell you shares for your limit price. The information in the order book can be very valuable since big buy or sell orders are points of support/resistance.

*Bids and offers:*

**The 2 main forces in the markets are supply (bid) and demand (offer/ask).** It is basically a very simple concept. But many new traders are irritated by it

There are two ways to trade stocks based on bids and offers:

**Passive:**

**Passive buying**

Passive buying means that you are trying to buy a stock at a price that is lower than the current best ask price. Therefore your order cannot be executed immediately (since you are not agreeing to the seller's price) and gets displayed on the bid side of the level 2.

**Passive buying means to place a bid and to wait for a seller to sell you his stocks.**

**Passive selling**

When selling passively you are trying to sell a stock at a higher price than the current bid price. Your order won't be executed immediately and gets displayed on level 2.

**Passive selling means to place an offer (ask) and to wait for a buyer to buy shares from you.**

**There is no way to ensure that your order gets executed when trading passively, since there might be no one willing to agree to your price.**

**Active:**

**Active buying**

Active buying means to **buy shares from an existing seller** who has an offer in the market. You are agreeing to someone else's  price offer.

**Active selling**

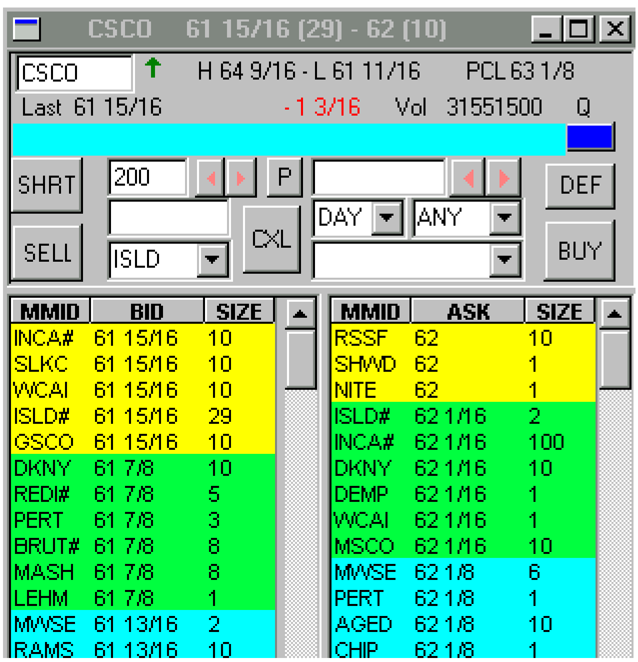
Active selling means to **sell shares to an existing buyer** who has a bid in the market.

**When trading actively you are most likely to get your order filled immediately, unless someone else steps in front of you.** Remember that you can only get filled for as many shares as the counter-part is willing to trade. Therefore you might get partial fills.

*NASDAQ and level 2:*

**Level 2 is a quote screen that displays all the competing bids and offers.** These bids and offers come from big institutions and banks as well as individual traders displaying their orders thru ECN's. There are over 400 registered market participants who are able to place bids and offers in every single stock listed on the NASDAQ. Level 2 trading literally revolutionized the markets. The NASDAQ stock exchange was the first to introduce level 2. Meanwhile there are a few international exchanges following.

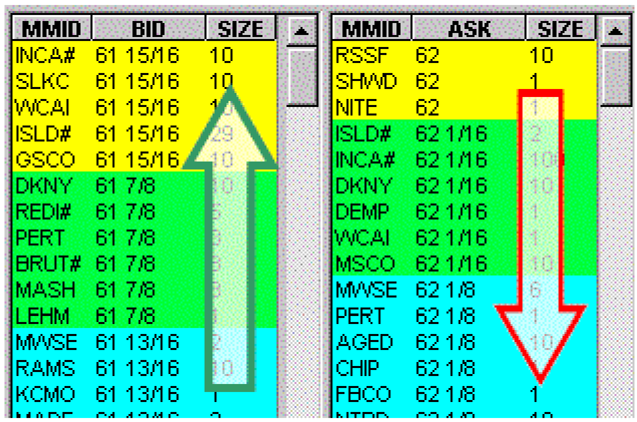
Here is a look at a level 2 window that also has order entry implemented:




The upper part of the window gives you some basic information about the stock, i.e. the current price, the highest price of the day, the low of the day and the total volume traded.

The next part of the window is used for order entry:


Here is the part with the actual level 2 quote information:




The **left column** displays all the **buy orders**:

**The higher the price that people are willing to pay for the stock, the higher the entry in the left column.** The price on top is called the “best bid”. Each different color displays another price level. There is no other meaning to these colors.

The **right column** displays all of the **sell orders**:

**The lower the price that people are willing to sell their stocks for, the higher the entry in the right column.** The price on top is called the “best ask.”

The prices on top of the two columns are the best prices available at the moment. They are referred to as the “inside market.” These prices will be the ones you can find in regular level 1 quotations.

Let's take a little closer look at the ask side of our level 2 window:

| MMID | ASK | SIZE |
|---|---|---|
| RSSF | 62 | 10 |
| SHWD | 62 | 1 |
| NITE | 62 | 1 |

The first column (MMID) gives you information about the market participant. The second column (ask) tells you what price the participant is willing to sell the stock for. The third column displays the size at which he or she is willing to sell. You have to multiply the number by 100, so 10 would mean that there are 1000 shares for sale. In the screen above, RSSF for example, is trying to sell 1000 shares at a price of $62.

***The New York Stock Exchange (NYSE):***

**Every stock listed on the NYSE has it's own specialist. He is responsible for maintaining a fair and orderly market in that particular stock.** If you send your order to the NYSE via a direct access trading platform it will be send (via SuperDOT) directly to the specialist's order book for execution. **The specialist is the only one who has access to the order book.** Orders are executed strictly on a first come first serve basis.

It is the specialist's responsibility to maintain a fair and orderly market. One example of this would be a situation where there is a huge sell order coming into the market but there are almost no buyers - without the specialist's help the stock price would dump irrationally. It is his responsibility to buy the stock in this situation and to keep the stock at a "fair" level. The specialist is therefore always the buyer of last resort.

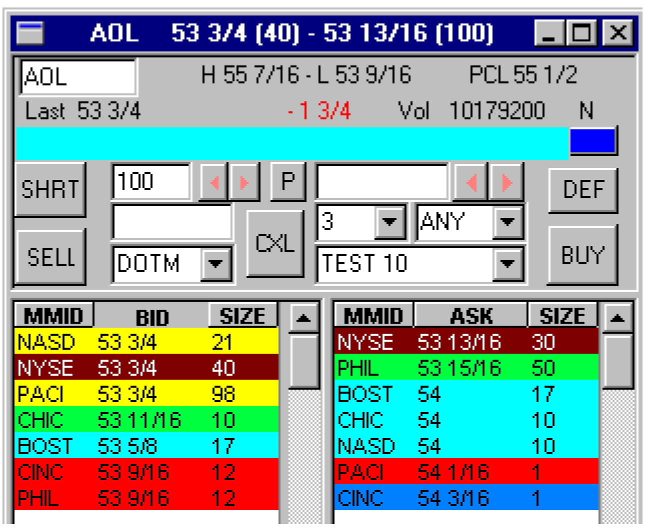
**Every order on the NYSE has the chance to receive price improvement.** For example if you are trying to buy XYZ for 100$ and someone is entering a sell order with a limit of 99$ you would end up buying the stock for 99,5$.

Since the NYSE is not fully computerized you will notice a difference in the speed of execution versus Nasdaq orders. This applies to the cancellation of orders as well. Even though it is slower I usually never wait longer than a few seconds for my order to get executed; only if there a buyers/sellers at my price limit of course.

***NYSE stocks in the level 2 window:***

If you place an NYSE symbol into a level 2 box you might be confused since there is more than just the NYSE displayed. This is because **most of the stocks listed on the NYSE are also traded on various regional exchanges**. Even though the quotes you see are in a level 2 box they are all level 1 quotations since they only display the inside market (best bid and ask).

Here is an example:




I highlighted the NYSE quotes in this example. The NYSE quotes are almost always the most important since the major market participants use the NYSE for executions. Other market participants here include “BOST” (Boston stock exchange) or “PHIL” Philadelphia stock exchange.

### *NYSE stocks on “Island”:*

Many of the mayor NYSE and AMEX stocks are no longer only traded on the traditional exchanges. They are now being traded thru ECN’s as well, with Island “ISLD” being the most important.

### *The basics of Nasdaq order routing:*

Placing trades on the Nasdaq is a little more complicated than doing so on the NYSE. There are different order routes available. Those are Selectnet, SOES (small order execution system) and ECN’s (electronic communication networks).

**Selectnet can be seen as the center of the Nasdaq market** even though it is only the second choice at best for most active traders. Access to Selectnet allows you to send your order to every available market participant. It is also possible to place bid and offers via Selectnet.

**SOES was implemented as a system for non-professional traders** and allows them to execute their orders against market makers. SOES only sends the order out to market makers, not ECN’s. It’s mandatory for market makers to fill orders sent to them thru SOES.

**ECN’s are electronic networks that allow traders to execute orders against other ECN’s** as well as to place their own bids and offers. Trading thru ECN’s is the fastest order way available since there are no middlemen involved and the ECN’s computers are usually very very fast. My ECN orders usually get filled immediately if I am agreeing to someone else’s bid or offer.

Order routing can get pretty complex since there are different rules and limitations for each route. Luckily there are intelligent order systems out there, which take a variety of order systems into account and do the work for you, making order routing pretty easy for the most part.

I will explain order entry in more detail later in this book.

*Short selling:*

**Short selling allows you to make money on a falling stock price. When selling short, you sell a stock that you don't own** (you borrow it from your broker) **and try to buy it back** (covering) **for a lower price.** For example you sell 100 shares of XYZ short for a price of 10$ per share. This will ad 1000$ to your account. No, the money does not actually get credited to your account since you are only borrowing from you broker. If you buy those 100 shares back for 9$ per share that will mean you have to pay 900$ for that transaction, leaving you with a 100$ gain**. When you are shorting a stock, your potential risk is unlimited** since a stock can go up more than 100% but sink not more than 100%. Therefore I would stay away especially from small stocks (they often rise dramatically in price) when shorting!

**Short selling rules**

Short selling is a little more complicated than regular buying because the short selling rule (up tick rule) prohibits you from selling into an already falling stock price and therefore making an entry more difficult. **In order to short a stock the current bid and ask prices must be on an up tick**, meaning they must be higher than the previous price. Your order entry software will automatically prevent you from violating this rule. You will usually find an arrow in the upper part of your level 2 window that tells you if the stock is on an up tick. **Even if the stock is not on an up tick you will always be able to short it on the ask side.** When there is a lot of selling pressure though, chances of getting a fill on the ask are slim.
**Furthermore the stock you are aiming to short has to be available for borrowing from your broker.** Your broker will hold a list of stocks you can almost always borrow and has a short lookup tool. I have had very good experiences with the availability of stocks for shorting.

***Basic rules for using technical analysis:***

**Multiple timeframes**

Most traders use technical analysis as their primary tool to find potential trades and to determine entry/exit points. Only momentum traders and scalpers might only look at the stock movement or the supply and demand they can see on the level 2 screen.

**When using technical analysis it is very important to get the bigger picture of the stock's price movement.** That's why you should always have a look at multiple timeframes of charts before making a trade. Imagine a stock is looking ready to go up on the 5 min chart but is running into strong resistance on the daily chart. You don't want to get caught buying it here but rather wait for it to break that resistance before entering a long position.

**I always try to look at least one intraday chart as well as the daily chart. Previous days highs and lows are always points that are every important.** Other timeframes that I like to look at are 5min and 15min charts.

The perfect setup shows the same "picture" on multiple time frames. Here is an example of a stock that is breaking down on the intraday chart as well as on the daily chart:

Please see next page.


## Market and sector analysis

**The overall market is most likely to determine how strong the stocks you are watching might move. Make sure to not trade against the overall market and know what to expect every day.** I use the same tools and patterns for market analysis that I use for stock analysis. The most important thing for me to look at is the previous day's range. The previous day's low will serve as support to the downside and the high will serve as resistance to the upside. Besides analyzing the overall market you should also know what the individual sectors are doing to further increase your success rate. A good top down approach would be too look at the overall market first, then to determine what the general direction is most likely going to be and to look for sectors that reflect that direction the best, and finally filter out stocks out of that particular sector that provide interesting set-ups.

## Indicator analysis

Besides the price patterns described in this book there are various technical indicators that you can use in conjunction with them. The simplest technical indicators are moving averages. Others include stochastic, money flow, rate of change etc. Generally speaking, the more indicators that confirm your setup, the better. I only use moving averages and stochastic for my trading. Technical indicators go along with everything described in this book; they should be seen as additional tools. However, some trades might only use certain indicators and make trades based on them. I will not describe all the technical indicators in detail since it would be too much to fit in here and most likely just be confusing. I would rather refer to the link section on my website for further reading on technical indicators.
www.daytradingcoach.com

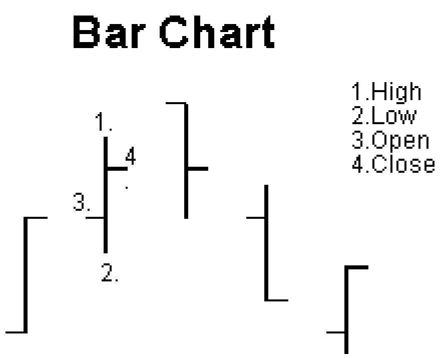
## Setup prices

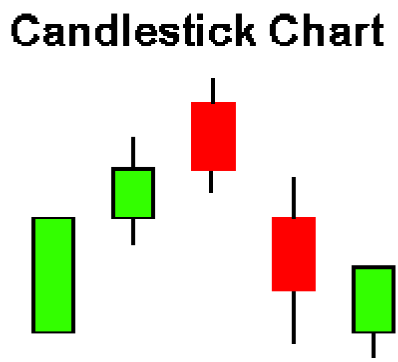
A setup price is a predetermined price where you are looking to enter a position. **Make sure that setup prices get broken significantly before you enter your position.** For example if I am looking at a buy above $50, I would wait for the stock to break that price by approximately 5 cents. This varies though, and depends a lot on the stock I am trading. The important thing is that there are trades being made ABOVE the setup price in order for the setup to be valid.

**Also make sure, that the stock actually trades above the setup price.** This can be problem with low volume stocks where the inside market (best bid and ask) changes without any trades taking place.

***Types of charts:***

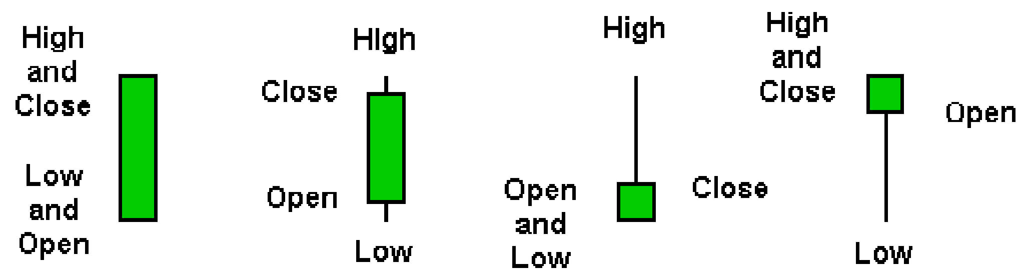
The most common way to display charts is the line chart followed by the bar chart. **In the bar chart the vertical line marks the high and low, the left horizontal line marks the opening price and the right horizontal line marks the closing price**. If you selected a 5 min chart, that means that each bar reflects the price movement of only 5 minutes. In a daily chart each bar/ candle displays one entire days movement.



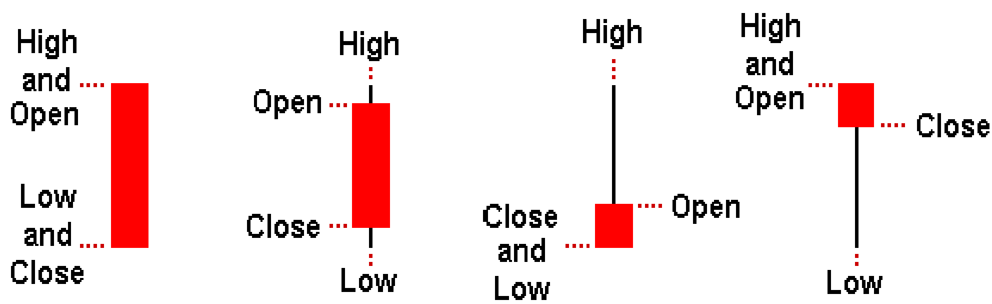




**The type of chart used most by active traders is the candlestick chart.** This type of chart has been in use for over 100 years and has its origin in Japan. It is also referred to as a Japanese candlestick chart. **The color of the candlestick itself tells us if there was an up - or downtrend** in that particular timeframe and makes reading them very easy. There are also numerous indicator based on the shape of the candlestick itself. I will talk about the most common ones later.

The following candlesticks **are open candlesticks, meaning that their opening price was lower than the closing price and therefore reflect an overall uptrend** in the timeframe you selected. The color used here for an open candlestick is green; sometimes people will use white instead.




**If the opening price was higher than the closing price you get a closed candlestick that reflects a downtrend.** The colors used are usually black or red.




**The vertical line on the top of the candlestick is always the high, no matter what color the candlestick has. The line on the bottom always marks the low.** These lines are also called shadows (upper/lower) or tail. There might be no shadows at all if the opening price marks the high and the closing price the low or vice versa. **The colored part is always referred to as "the body" of the candlestick.**

***Development of trends:***

There are 3 trends a stock can move in:

a) Uptrend
b) Sideways trend
c) Downward trend

**a) An uptrend is a series of price advances followed by price declines that don't violate the prior low (higher highs and higher lows). In an uptrend the prior low serves as support and the last high serves as resistance.** The best trade during an uptrend is of course a long trade.

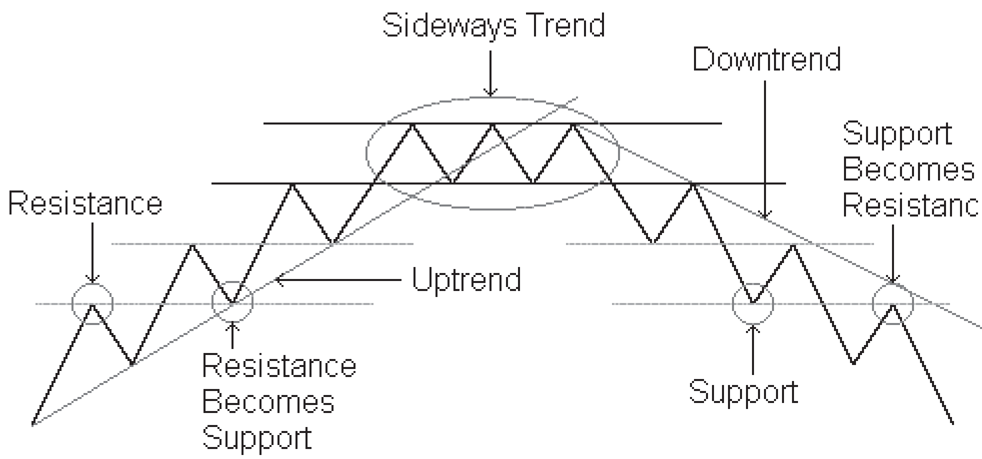
At some point after a rise in price the stock will be "tired" and has to "relax" a little to gain strength to make a move again. This is when a sideways trend (consolidation) develops.

**b) In a sideways trend highs and lows are approximately on the same level. The highs mark resistance and the lows serve as support.**

After a long sideways trend stocks often reverse the prior direction and fall in to a downtrend (in case the prior trend was up).

**c) A downtrend is a series of price declines followed by price advances that don't violate the prior highs (lower highs and lower lows).** The prior high serves as resistance to the upside and the prior low serves as support to the downside.

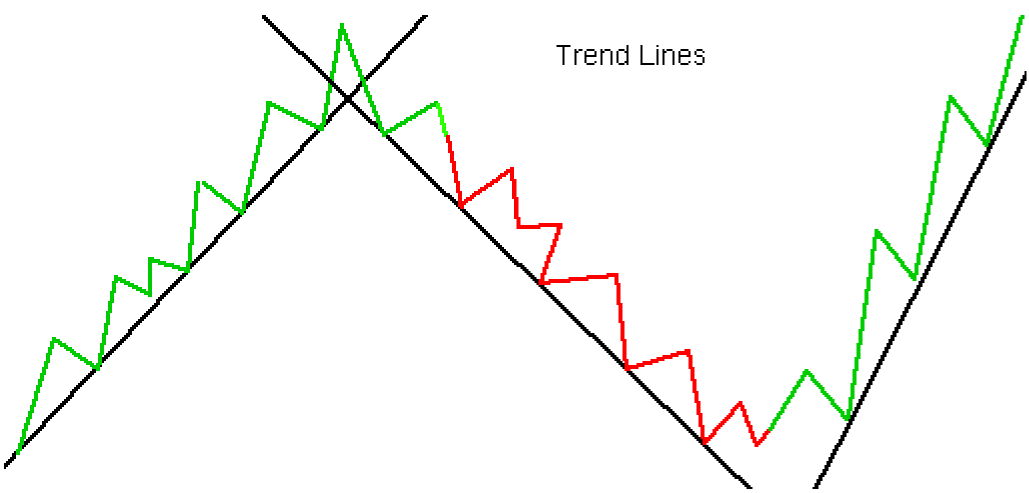
On the next page you will see a chart displaying all the trends.



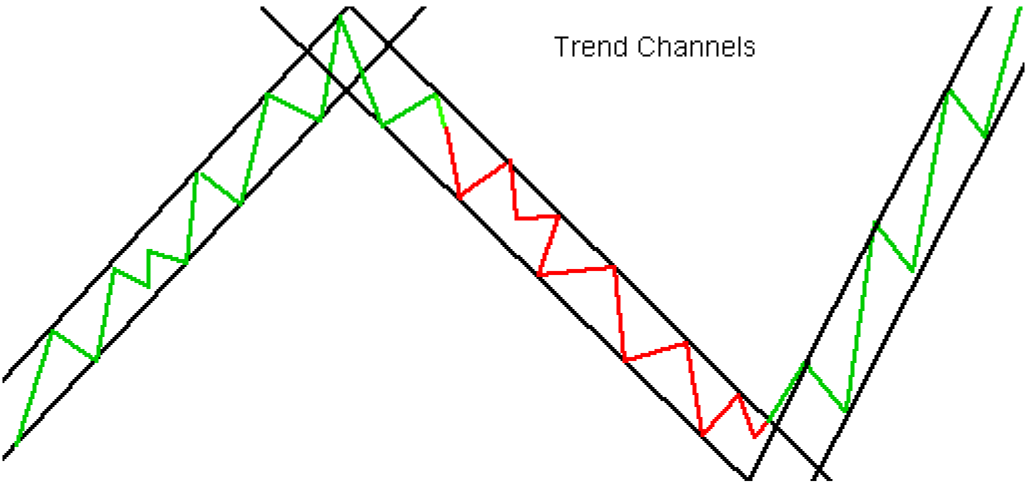

***Trend lines and trend channels:***

Trend lines and trend channels are a very important part in technical analysis since they define the trend itself and show you important areas of support and resistance. I use them mostly for the longer-term analysis based on daily charts.

**In an uptrend a line is drawn below the "major" lows of the trend. The uptrending line shows you relevant support. The opposite is done in a downtrend; you draw a line above the "major" highs of the trend**. As with many things in technical analysis it is much easier to see what I am talking about by looking at an example:



**Trend channels occur in stable trends when you can draw a second (parallel) trend line in addition to the one we talked about before.** This time we will also draw a line above the highs of the up trend and vice versa for down trends. By drawing this line we have established a trend channel that not only shows us support, but also **shows the most likely range the stock will be trading in,** thus us very nice entry points at support (referring to the core swing trading buy setup) and profit targets at resistance.




***Moving averages:***

Moving averages are probably the most widely followed and therefore most significant indicators. And yet, they are very simple to use.

Moving averages have multiple functions. **They serve as important areas of support and resistance and give trade signals if a stocks' price is crossing above or below them. If a stock trades above the moving average line it serves as support to the downside, if it trades below it will serve as resistance to the upside.** An example would be the 200MA, which is often used by fund managers. A stock that is trading above its 200 day moving average is generally a good long position, as long as it holds that moving average.

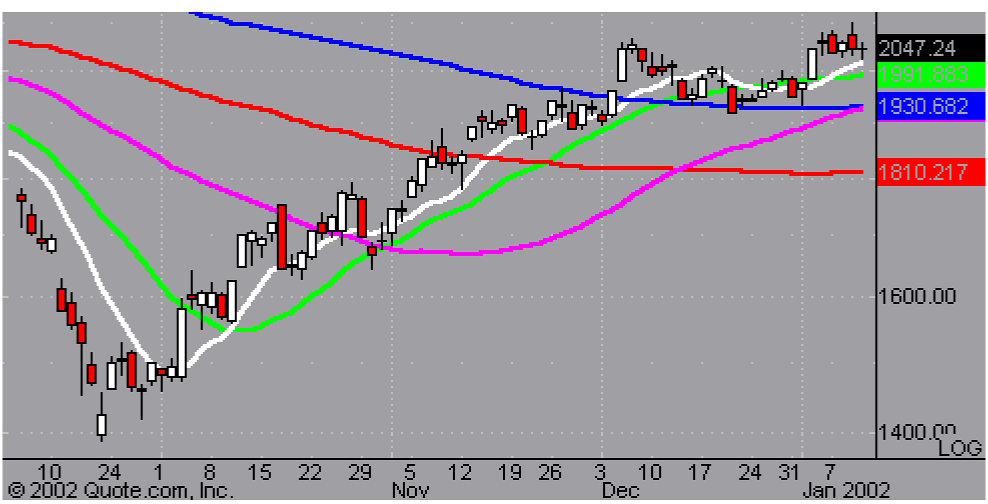
A break below the 200MA would signal a sell or short entry.

**A crossover of 2 moving averages itself is often used for entry / exit signals**, i.e. a fast moving average (10MA) crossing over (from below) a slower moving average (200MA) is used as a buy signal. Furthermore they smooth the often very volatile price movements and therefore make it easier to see the direction of the trend in the chosen period of time.

**A moving average tells you the average price over the chosen time period and length.** For example the 200 day moving average shows you the average price of the last 200day and a 5 min 200MA will show you the average price of the last 200 5 min periods. It is usually calculated on the value of the closing prices.

I use various moving averages in my trading: 5MA, 10MA, 20MA, 50MA, 100MA and 200MA. The 200MA will react much slower to changes in price than the 10MA. When I talk about different setups I will tell you which MA is the most relevant for that particular setup. In general the 20 and 200MA's are the most important and can be used in any timeframe.

The following picture shows a chart with various moving averages:



There are different types of moving averages:

- Simple moving average (SMA): does not weight the prices
- Exponential moving averages (EMA): gives more weight to the recent prices
- Weighted moving averages (WMA): uses a system that gives more weight to recent prices

The moving averages that are most widely used are simple moving averages. **All of the MA's I refer to are simple moving averages.**

***Volume:***

I use volume in conjunction with all of my setups to confirm my entry as well as to find exit points. For example after entering a breakout setup long I want to see a volume increase and a lot of trades on the ask side. Trades on the ask side indicate that there are active buyers in the stock and the stock is likely to continue higher. For shorts I want to see trades on the bid side of the market. Stalling or even declining volume after my entry indicates that the stock will be rather trend less and therefore I don't expect much from the trade and might raise my stop rather fast or exit sooner with profits. Dramatically increasing volume/activity very often signals the end of the move as the mass of people is getting involved; therefore I use these points to take profits. The chapter on tape reading describes the use of volume as an indicator in more detail.

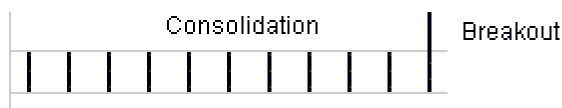
***Breakouts:***

Note: all the examples are written for long setups; just apply the opposite for shorts.

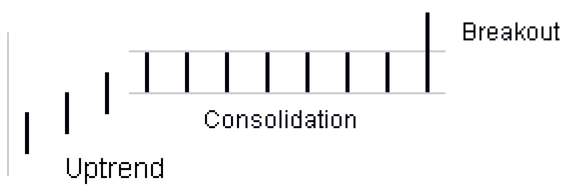
The breakout setup is one of the core setups used in trading. Breakouts occur all the time on every timeframe, i.e. breakouts to new 52 week highs, daily highs or above trend lines. **It is a trend following setup that is confirming the prior direction.**

The type of breakout I will be talking about is the breakout out of a consolidation, also referred to as a core breakout. **I am always looking to trade a breakout in the direction of the prior trend.** Meaning, **I want to trade a stock long that is consolidating after an uptrend. I will enter the trade once the high of the consolidation is broken.**

The Basic Breakout Setup




The Core Breakout Buy Setup

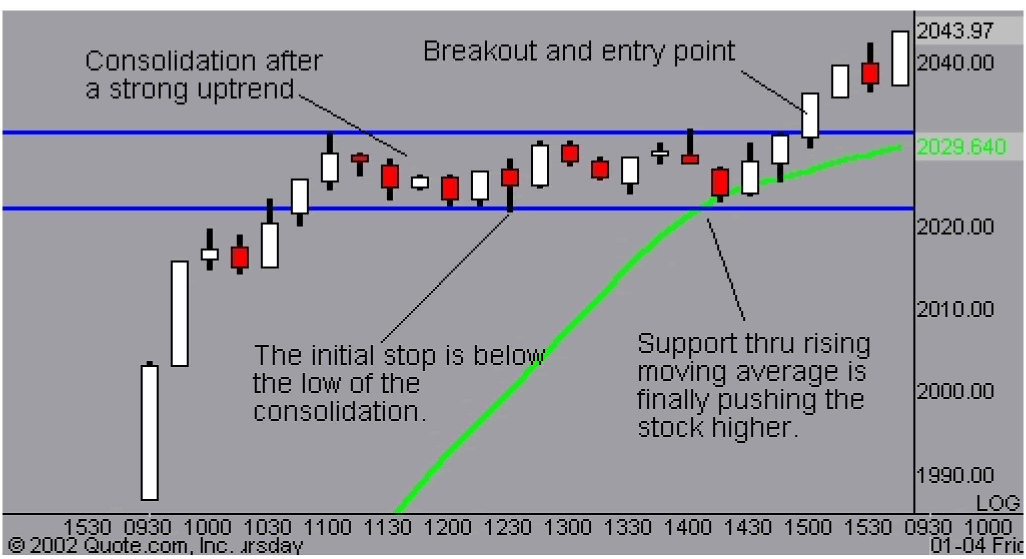



The stock should consolidate for a significant amount of time i.e. after an up trend that lasted 1 hour I would like to see a consolidation of at least 15 minutes before the stock resumes its up trend. This is just a rough figure and depends on many factors such as the strength of the trend. A better guidance are moving averages. **The most important thing to consider before entering a breakout trade is where the initial stop is. I will set my stop just below important moving averages or the low of the consolidation.**

Therefore it is true **that the tighter the consolidation is, the smaller the initial stop will be.** For this setup I like to work with 3 min charts in conjunction with the 15MA for my stop or the 5 min chart using a 20MA for my stop. Note: A very long consolidation in an up trend is often a negative sign, especially when moving averages are not able to “push” and leads to a trend reversal.

What you will often notice is that a stock is moving sideways and gets pushed higher as rising moving averages near. This often creates a very powerful move and is my favorite setup. **The ideal breakout also occurs on multiple time frames i.e. a stock is consolidating at the intraday high, which also happens to be the prior day’s high.** If a breakout occurs here that will bring in momentum from both the intraday breakout and the breakout on the daily chart. Recently I have been only playing breakouts to new daily highs only, since pure intraday breakouts have not provided enough consistency.

Make sure the stock you are about to enter has no immediate resistance to the upside. I would look at least at the daily chart and look for resistance in form of old highs or moving averages. Here is an example of a “nice “ breakout that occurred on a 15 minute chart:

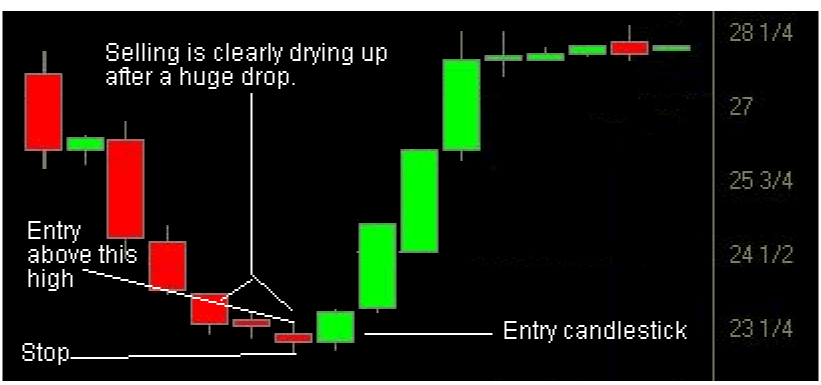


***The pivot setup:***

The pivot setup is a reversal setup that I am looking to trade long (buy). It is taking place on a 15 minute chart. Once in a while I will also trade it based on the daily chart. I am looking for a stock that is in a strong intraday down trend that extends over a few 15 minute candlesticks. After this sell off I will be looking for a consolidation marked by one or more candlesticks with a tight range. Preferably there will be a doji candlestick (see candlestick indicators) forming, which is a reversal indicator itself.

**My buy entry criteria is met once the high of the current candlestick goes over the high of the previous candlestick. The initial stop is set below the low of the previous candle-stick, which is ideally the intraday low. The more narrow the range of the candlestick prior to the entry candlestick is, the smaller my stop!** I will only trade this setup if the stop is small enough for my risk tolerance.

Sometimes the chart can be a little irritating. Make sure that the stock has actually fallen a significant amount to justify an entry and there is enough potential. My criteria is that the stock had at least a $2 sell off, unless it is a low priced stock. Remember, a $2 sell off leaves you with $2 room to the upside whereas a $0,5 sell off only gives you that amount. In case the stock is not re-versing it might also be shorted (see continuation pattern).



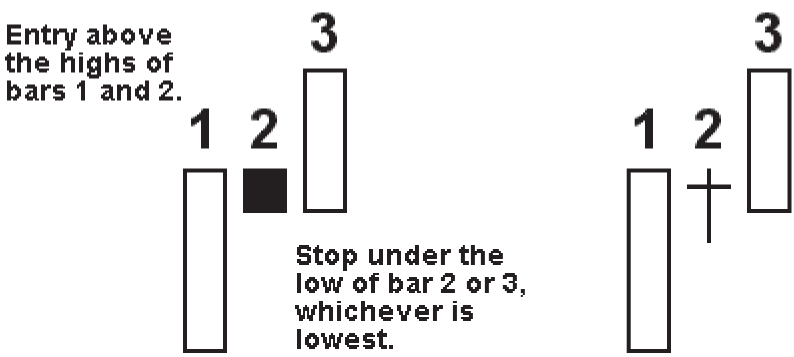
### *Continuation patterns:*

Continuation patterns are trend-confirming setups. They can occur in virtually every timeframe. I was especially successful using this setup based on 15-minute charts. **Continuation patterns allow you to find an entry in stocks that are already in a trend and moving.** I find the pattern equally interesting for both longs and shorts. My example here describes a long setup. Again, vice versa is true for shorts. **The pattern consists of three candlestick bars:**

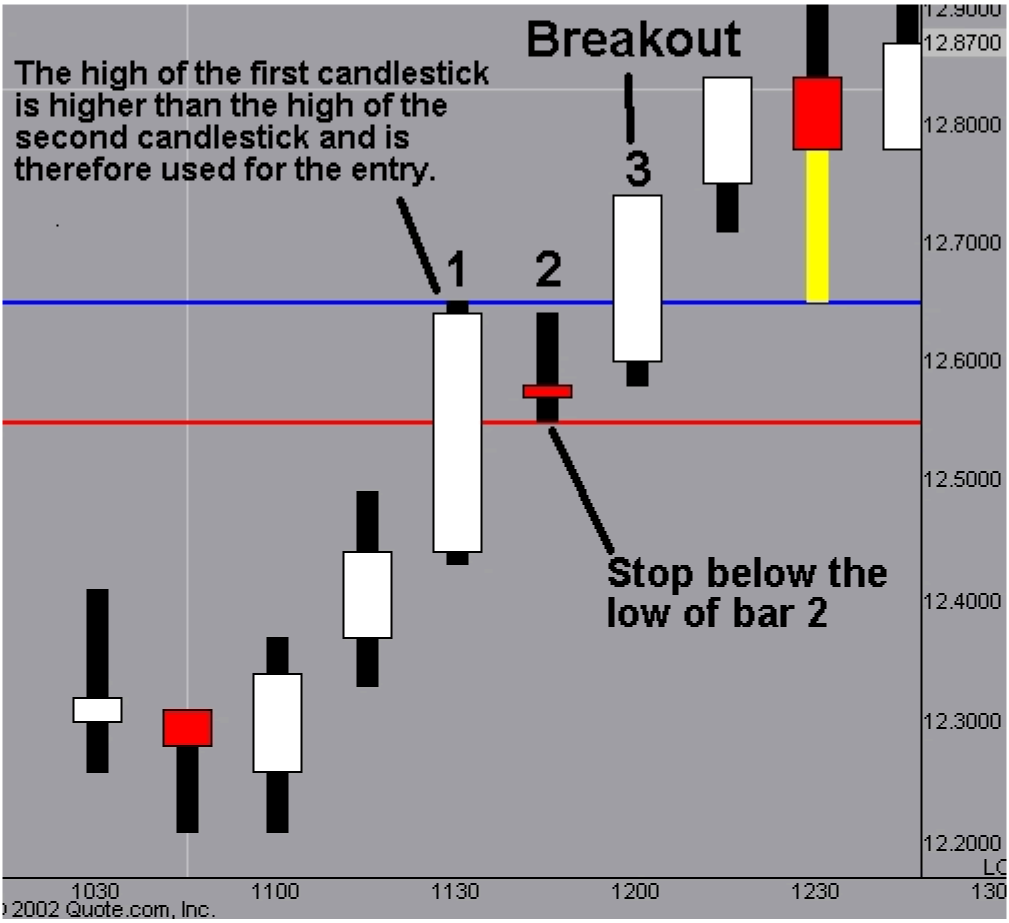
1. **A wide range bar** (a candlestick with a relative large range in which the lows are near or at the open and the highs near or at the close of that particular time period).

2. **A narrow range bar** (a candlestick with a small range). The candlestick has to be in the upper half of the first candlestick and the high can only be slightly higher than the high of the first candlestick. Ideally, the range is in the upper half (or higher) of the first bar and builds a doji candle, which serves as an additional continuation indictor in this example.

3. **A breakout bar** that breaks above the highs of bar 1 and 2 and signals the entry.



I enter the trade once the price of the third bar breaks the high of bars 1 and 2. My stop is placed below the low of the second bar. Once the third bar is completed, I quickly move my stop below the low of that bar.



***Stochastic and moving average crossover reversals:***

Stochastic and moving average crossover reversals are ideal for very short term trades when they are based on a 1 min chart. **With these setups I try to take advantage of short term overbought and oversold conditions.** Such conditions occur frequently at the market open when individual stocks receive strong movements to the upside as well as the down-side. Basically on the open, the reversals can be played in both directions. I strongly advice you though to look at the overall market strength, i.e. if stocks in general are making higher highs in the first half hour or so I would only look to go long after pull-backs. To make it even more general - **I only trade reversals in the direction of the stocks overall trend, i.e. a stock that is trending up can only be played long after sudden pull-backs.** Personally, I like this type of trading the most after the open, since I am watching other things at the open. **I scan intraday for stocks that had sudden sell offs or gains.** I see traders using this strategy very efficiently when they are only watching a basket of stocks, meaning they are watching the same stocks every day; sometimes this is only one stock. This has the advantage that you get more familiar with the way your stocks move and it will be much easier for you to trade them.

**Stochastic reversals**

The stochastic oscillator is a momentum indicator that shows the location of the current close relative to the high/low range over a set number of periods.

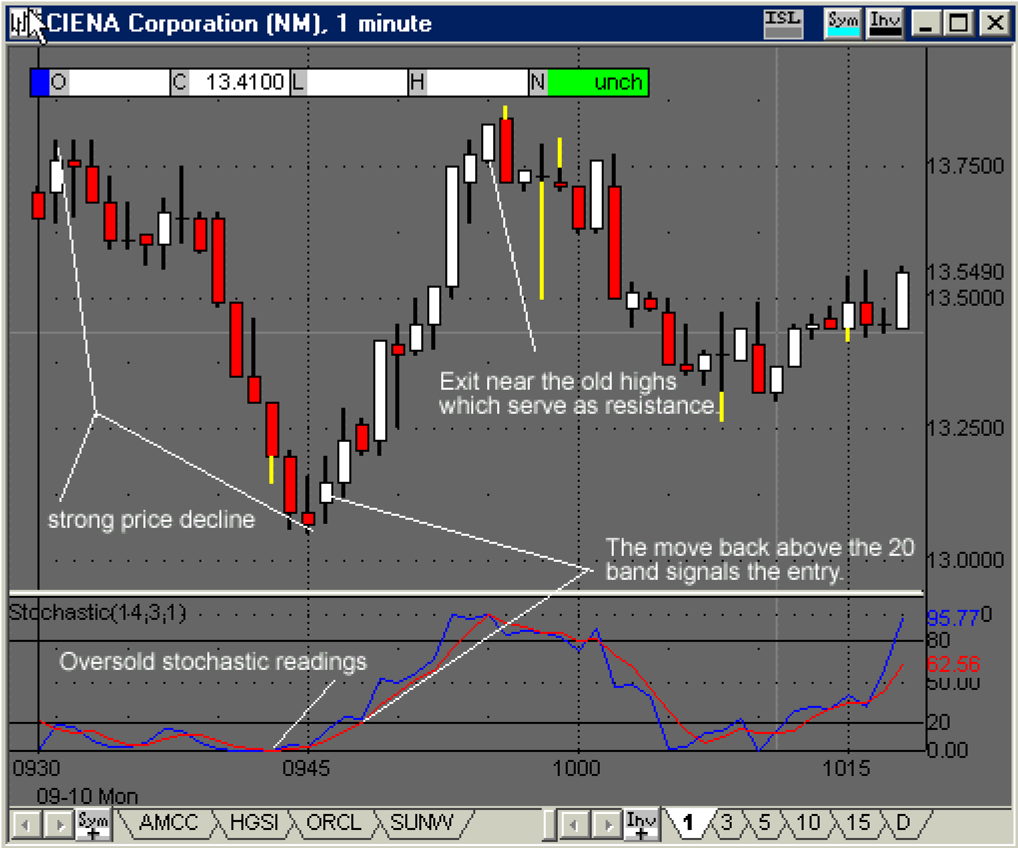
For the stochastics, I use the standard settings 14,1 and 3. You can imagine the stochastics like a rubber band that when stretched has to bounce back. The more stretched (oversold/overbought) it is, the stronger the reversal will be and the more precise.

I am looking for situations where the stochastic indicator has been below the 20 band (trigger line) for an extended period of time (a few minutes on a 1 min chart would be extended). Readings at zero or just above are the best, because they indicate a very oversold condition. If the stochastics then reverse and cross over the 20 band (sometimes even the 10 band) that signals that the stock seems to have found a bottom ad is likely to reverse. The bigger the sell off was before the reversal, the more potential to the upside there is. Please experiment for yourself with the trigger lines and settings. **For shorts, I look for situations where the stock has been close to or at the 100 band for an extended period of time. A cross below the 80 band will be my sell trigger.**

The following example is for longs:

CIEN dropped from about 13.80$ to about 13.05$ in less than 15 minutes. What is of most importance is that this drop happened in one move and not in a stairstepping pattern. The stochastics were holding near the zero band for an extended period of time. The reversal above the 20 band gave an entry signal. I would have taken at least partial profits near the prior highs that serve as resistance. The stop for those setups always has to be very small since they are more scalp oriented. **I would use a stop just below the low of the pullback or a stop based on my entry price, i.e. 15 cents below my entry.**

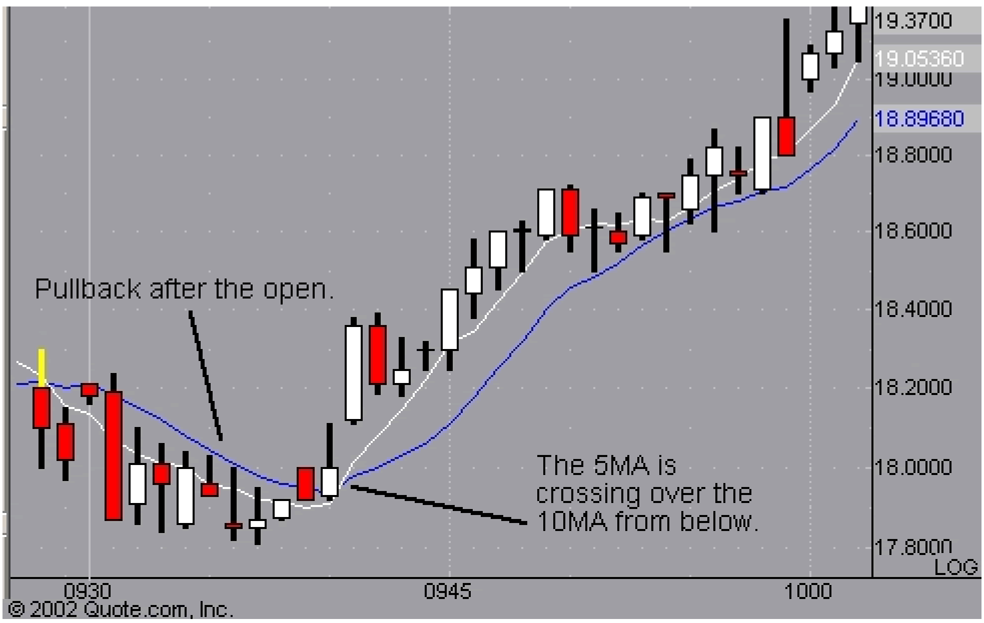
Please see the example on the next site.




## Moving average crossovers

I use moving average crossovers in pretty much the same situations as the stochastic reversals with the exception, that MA crossovers work better for me in slower trends. **I use the 1 min chart in conjunction with the 5MA and the 10MA. If the 5MA is crossing over the 10MA from below, that is a long entry signal; vice versa for shorts.** Again, for longs, the stock should be in an overall up trend and the pullback has to be significant.

The following example shows a stock that is very popular as a basket stock since it usually provides very nice swings during the day. It had a strong day on the day before this example, and I was expecting it to continue higher. After the open it pulled back about 40 cents. The market was pretty strong so a recovery in the stock was to be expected. I was looking for stabilization and a crossover of the 5MA above the 10MA. The crossover happened just below 18$ and my stop was below the intraday low at 17.81$. Partial profits should have been taken near the previous days high at about 18.43$. After breaking the previous days high the stock gained initial momentum.




Note: I strongly urge you to experiment with the settings described in this chapter. You might want to try trading the moving average reversals of a 3 min chart for example or use other settings/timeframes for the stochastic reversals. Not every setting works well in every market.

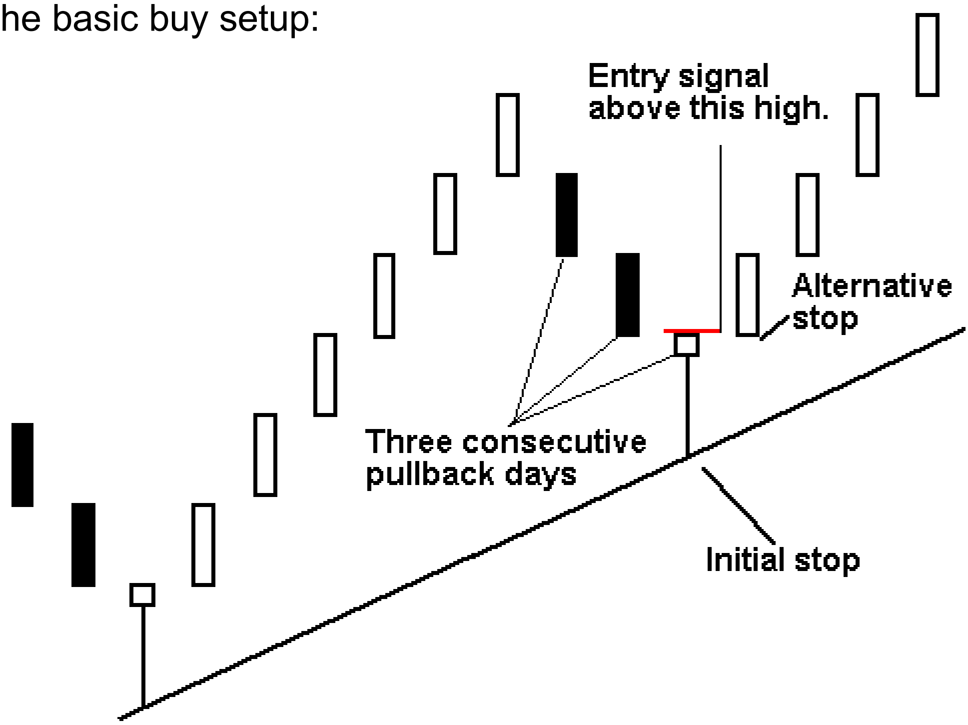
## *Basic swingtrading setups:*

### Buy setup

**The basic buy setup is a pullback into support within an uptrend. It is very important, that the pullback is significant. Ideally, there will be at least three consecutive days of lower highs and lower lows**. The support can have many forms. I like to focus on moving averages as well as trend lines and sometimes Fibbonacci retracements. **This setup is taking place on a daily chart.** The example I used earlier for the hammer candlestick is a very good example here too. The stock has pulled back significantly into support and had a reversal signal in the form of a hammer candlestick .The entry is above the high of the hammer candle and the stop is placed below it. **Generally, the entry signal is given, once the price moves above the high of a previous day after a significant pullback.** I like charts that form a doji candle even more since they usually have a more narrow range and therefore give me a smaller stop. The most important aspect for me in swing trades is the stop. It can often be rather large and I am very selective in only choosing the ones with extremely small stops. Instead of placing my stop below the previous days low, I will often use the current intraday low for my stop and I will combine the swing trading setup with day trading criteria.

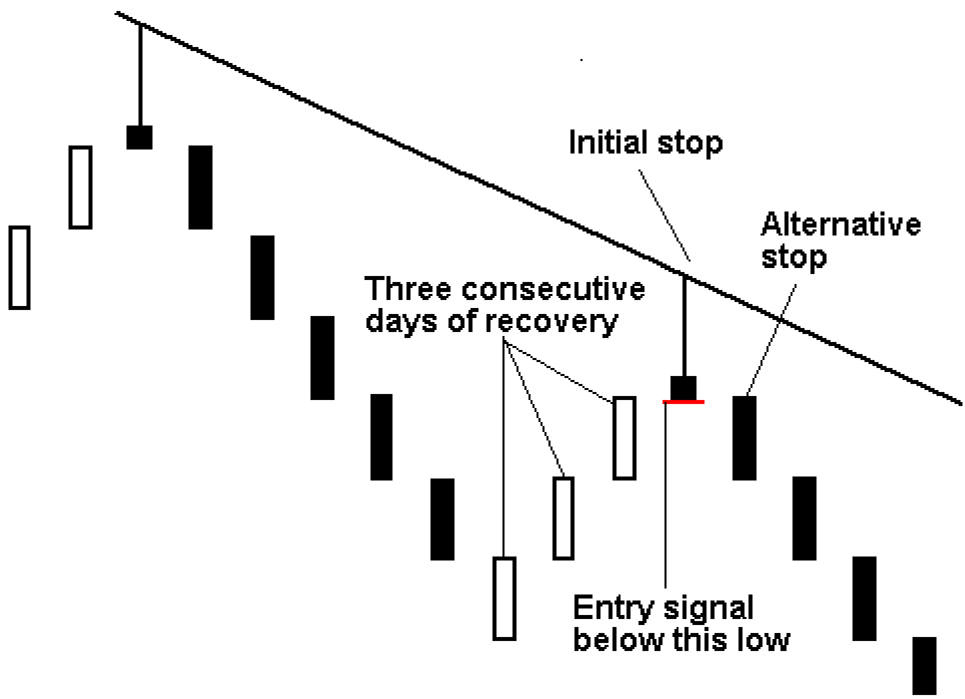
Please see the next page for examples.

The basic buy setup:




Short Setup:

**The short setup is the exact opposite. We are looking for a recovery into resistance within a downtrend.**



***Flags and pennants:***

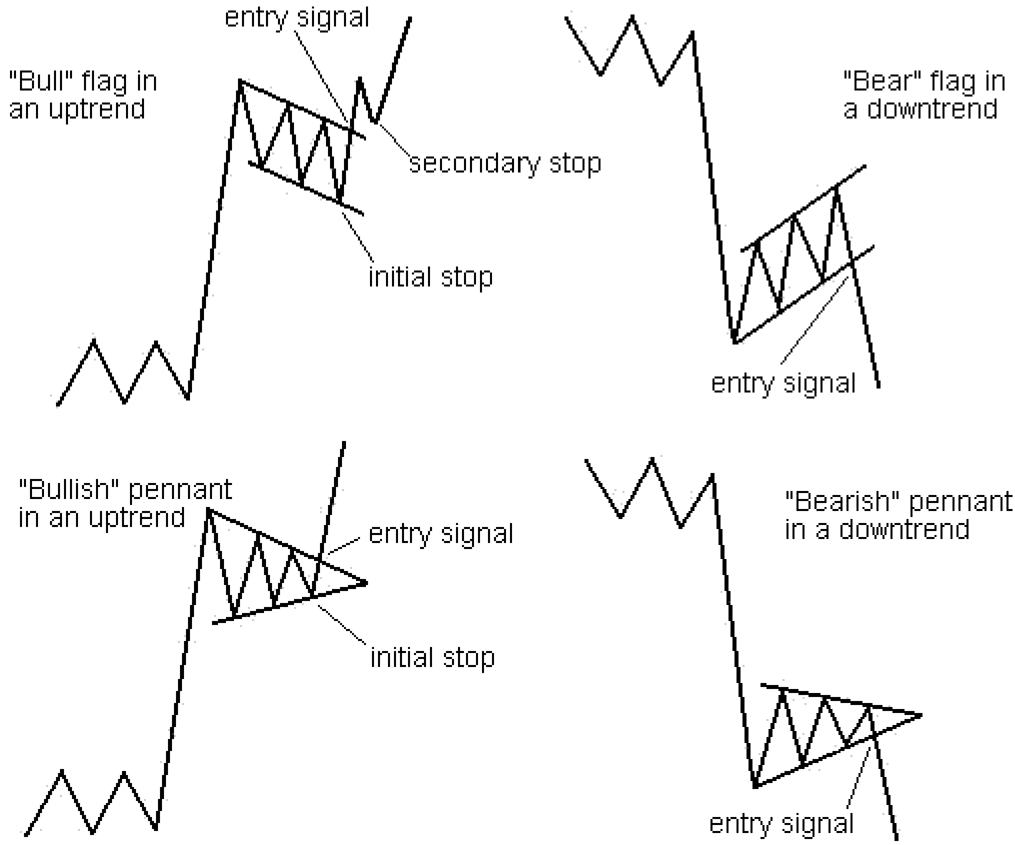
**Flags and pennants are continuation patterns. They usually represent only brief pauses in a dynamic market. They are typically seen right after a big, quick move. The market then often takes off again in the same direction.** (Volume usually drops off during the pause with an increase on the breakout.)

Lower tops and lower bottoms characterize bullish flags, with the pattern slanting against the trend. However, unlike wedges, their trend lines run parallel. **Once the high of the upper trend line gets broken, I will enter a long position. My initial stop is at the lower trend line. I quickly raise my stop to the last low once it is established after the breakout.**

Bearish flags make higher highs and higher lows. “Bear” flags also have a tendency to slope against the trend. Their trend lines run parallel as well.

Note: Pennants look very much like symmetrical triangles. But pennants are typically smaller in size (volatility), duration, and their trend lines don’t run parallel.. Since they are so similar, I will not describe them separately.

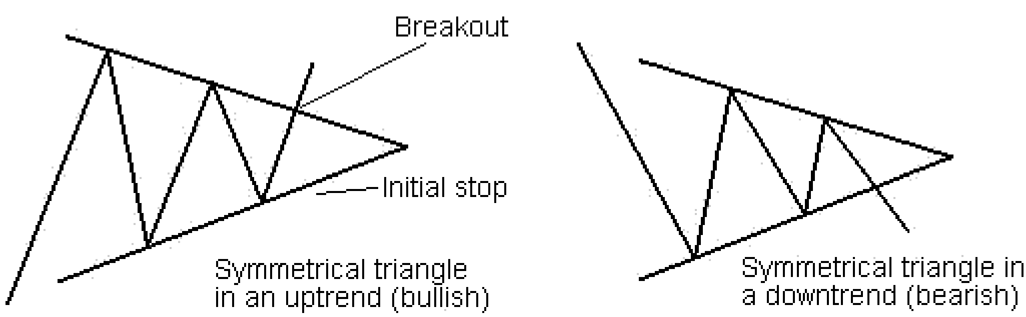
Please see the next page for an example.


"Bull" flag in an uptrend
entry signal
secondary stop
initial stop
"Bear" flag in a downtrend
entry signal
"Bullish" pennant in an uptrend
entry signal
initial stop
"Bearish" pennant in a downtrend
entry signal

### *Triangles:*

**Symmetrical triangles**

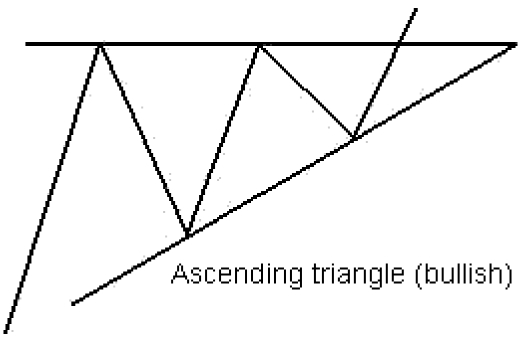
Symmetrical triangles mark a period of indecision - a period where supply and demand are equal and the future price movement is unclear. Sellers stop breakout attempts and breakdown attempts are stopped by buyers. **To get a triangle every high and low has to be closer together than the previous one – the range gets more and more narrow. In order to see the triangle you have to draw a line above the highs and below the lows of the triangle.** During the development of a triangle, the volume usually drops off. Eventually, this indecision is met with a resolve in the prior direction and usually explodes out of this formation (often on heavy volume.) Research has shown that symmetrical triangles overwhelmingly resolve themselves in the direction of the trend.



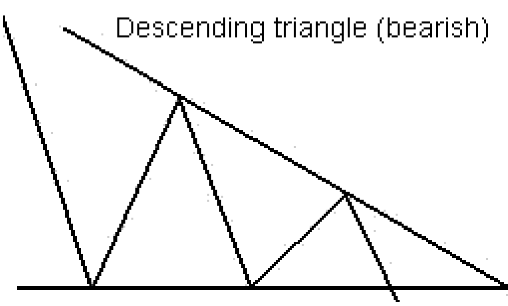

Note: Another formation you might have heard about is a wedge. They are very similar to the triangles; this is why I won't explain them in detail.

**Ascending and descending triangles**

**The ascending triangle is a variation of the symmetrical triangle. Ascending triangles are generally considered “bullish” and are most reliable when found in an uptrend.** The top part of the triangle appears flat, while the bottom part of the triangle has an upward slant. In ascending triangles, the market becomes overbought and prices are turned back. Buying then re-enters the market and prices soon reach their old highs, where they are once again turned back. Buying then resurfaces, although at a higher level than before. Prices eventually break through the old highs and are propelled even higher as new buying comes in. (As in the case of the symmetrical triangle, the breakout is generally accompanied by an increase in volume.)




**The descending triangle, also a variation of the symmetrical triangle, is generally considered “bearish” and is usually found in downtrends.** Unlike the ascending triangle, this time the bottom part of the triangle appears flat. The top part of the triangle has a downward slant. Prices drop to a point where they are oversold. Tentative buying comes in at the lows, and prices perk up. The higher price however attracts more sellers and prices re-test the old lows. Buyers then once again tentatively re-enter the market. The better prices though, once again attract even more selling. Sellers are now in control and push through the old lows of this pattern, while the previous buyers rush to sell their positions. (And like the symmetrical triangle and the ascending triangle, volume tends to dry up during the formation of the pattern with an increase in volume on its resolve.)



*The cup and handle:*

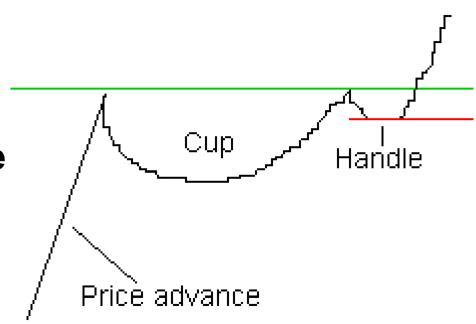
**The cup with handle is a bullish continuation pattern that marks a consolidation period followed by a breakout.**

**As its name implies, there are two parts to the pattern: the cup and the handle. The cup forms after an advance and looks like a bowl or rounding bottom. After the cup is completed, a trading range develops and the handle is formed. A subsequent breakout from the handles trading range signals a continuation of the prior advance.**

The cup should be “U” shaped and resemble a rounding bottom. A “V” shaped bottom would be considered too sharp of a reversal to qualify. The softer “U” shape ensures that the cup is a consolidation pattern with valid support at the bottom of the “U”. **The perfect pattern would have equal highs on both sides of the cup, but this is not always the case.**

**After the high forms on the right side of the cup, a pullback forms the handle.** Sometimes this handle resembles a flag or pennant that slopes downward, other times just a short pullback. The handle represents the final consolidation/pullback before the breakout. I should retrace 1/3 or less of the cup’s range. The smaller the retracement, the more bullish the formation.  **Once the high of the right side of the cup is taken out , the entry is met. The stop is placed under the low of the handle.**

**I like to trade the cup and handle after the first half an hour of trading based on a 3- or 1 minute chart.**



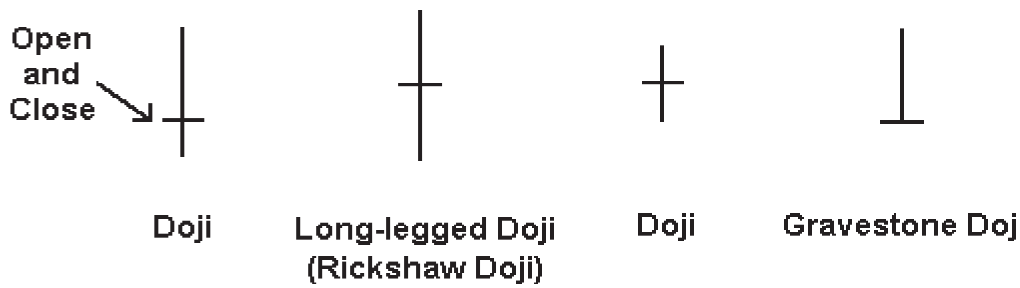

Here is an example for the perfect cup and handle:

*Candlestick indicators:*

**Candlesticks themselves can be used as indicators. There are three main candlestick indicators that can be quickly identified by the way they look. Those are doji -, hammer - and shooting star candlestick.** They are used frequently and are fairly significant indicators. Besides these, there are numerous other candlestick indicators with far less significance to them.

### Doji candlestick

**A doji candlestick occurs when the open and close for a specific time period are the same, or very close to the same price. The doji has almost no body and can be quickly identified.** There are variations of the doji, as you can see in the next example. I am always referring to the classic doji where the body is in the middle between the high and the low.




**The importance of the doji candlestick lies in it being a significant reversal indicator.** However it can also be used as a continuation indicator like I described in the continuation pattern. The key to the doji candlestick which makes it such a powerful reversal indicator is the uncertainty inherent in the candlestick pattern. The doji candlestick represents a period in which trading opened at a certain price, moved in one direction and then back to the opening price and often past that price, only to return once again to the opening price. **It is very important to only use dojis after strong moves into support or resistance.** In sideways markets their informative value is far less.

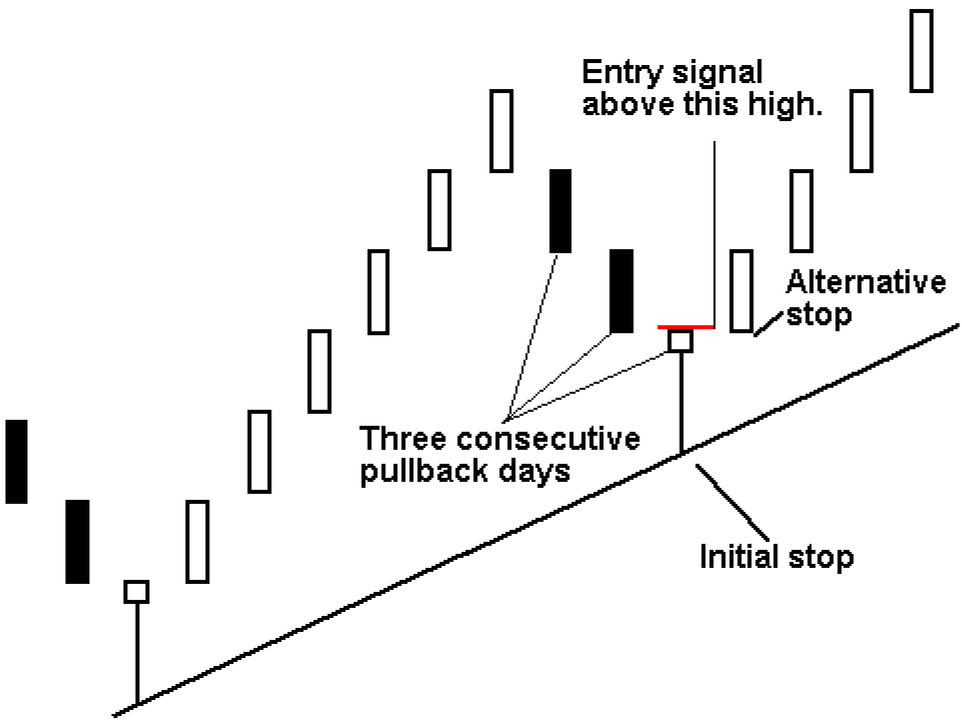
## The hammer candlestick

**The hammer candlestick is another reversal indicator.** The candlestick itself looks like another candlestick pattern known as a hanging man. The difference is where they are found in a trend. Hammers occur at trend bottoms. The body of the hammer candlestick occurs at the top of the day's range (assuming you are looking at a daily chart) and the majority of the day's range is made up of a lower shadow. **The perfect hammer has a shadow, which is twice the length of the body with no upper shadow. The smaller the body and the longer the shadow, the more significant it becomes as a bullish indicator.** The images below are examples of what perfect hammers look like.

Open Hammer Closed Hammer

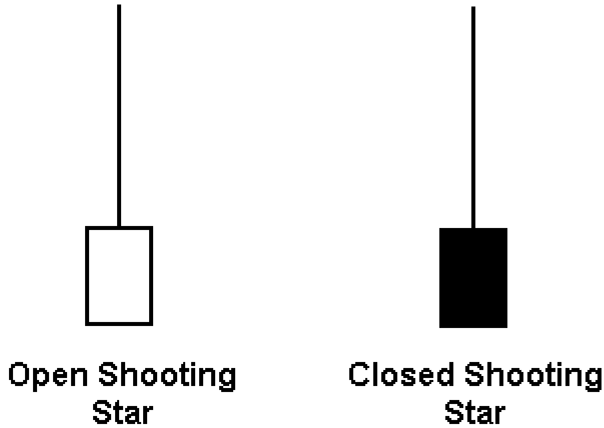
It does not matter what color the candlestick is. It can be either an open or closed candlestick. The open candlesticks are slightly more bullish**. In forming this candlestick, it means that the stock sold off sharply early in the day yet managed to rally back and close above the high of the open.** After an open hammer occurs, often there will be a gap up the next day. **I am using hammers for stocks that are in a solid uptrend but make a pullback into support. The pullback often ends with a hammer candlestick and is an excellent reversal indicator.**

**I enter the stock once it trades above the high of the hammer candlestick. My stop is placed below the low of the hammer (for swingtrades) or below the current intraday low. I mostly use hammers on daily charts.**

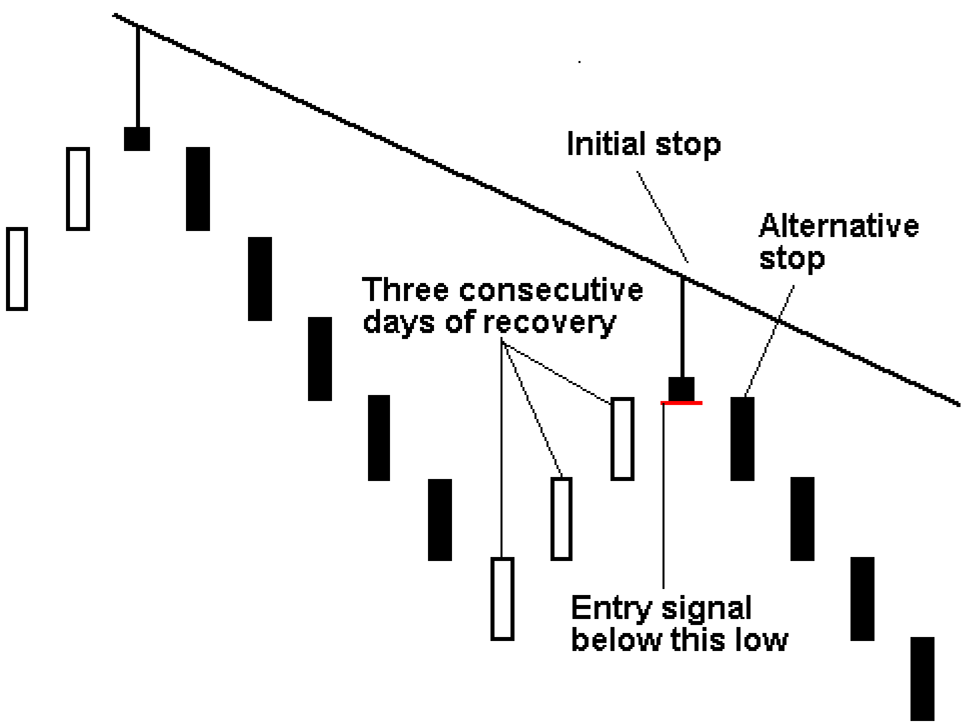



**Shooting star candlesticks**

**The shooting star candlestick is also a reversal signal. Shooting stars occur at trend tops and are therefore used to find short entry points.** In essence, they are hammers turned upside down. The body of the shooting star candlestick occurs at the bottom of the day’s range and the majority of the day’s range is made up of an upper tail. In a perfect shooting star, this tail is twice the length of the body and the candlestick will have no lower shadow. **The smaller the body and the longer the tail, the more significant it becomes as a bearish indicator.**




It does not matter what color the candlestick is. It can either be an open or a closed candlestick. The closed candlesticks are slightly more bearish though. In forming a closed shooting star, it means that the stock rallied early in the day and managed to fall back and close below the low of the open. Again, there will often be a gap down after a shooting star. **The entry on this setup is just under the low of the shooting star in the period following the shooting star. The stop is placed just above the high of the shooting star or at an intraday high.**

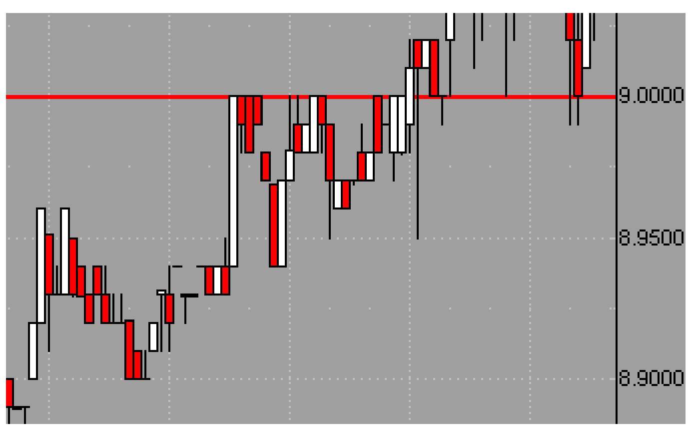


***Price resistance:***

**There are many different forms of support and resistance, i.e. historical highs and lows, price moving averages, Fibonacci retracements etc. Those are all technical forms of support and resistance. There is another very important form of support and resistance - the support/resistance thru whole numbers in the stock price, i.e. $0,5, $1, $5, $10 etc. This form of support/resistance is of psychological nature.** Image you are buying a stock at 55$ and it is going to almost 100$; wouldn't you be very inclined to take some of your profits there?

**I am using whole numbers as areas where I take profits and areas where I place my stop. Sometimes I even consider them more relevant than technical stops**, i.e. I buy a stock above $50,75 and my technical stop is at $50,25; in this case I would rather set the stop to just below $50, because chances of getting stopped out are much smaller than with the technical stop. A good example is a trade I did recently, I bought AMZN at $8,5 and took partial gains at just under $9. It had a hard time breaking $9 and even came back almost to my entry price. Make sure to also consider $0,5 steps especially in stocks priced under $20.

Here is another example of AMZN's resistance at $9. This is not the trade I did, but you can see that AMZN had difficulties breaking $9. It took a few attempts to break that number. The fact that AMZM did not pull back significantly and held just below $9 pointed towards a break though.



### *What makes stock prices move?*

This is a general understanding that is needed for a trader. He can't plan his actions without it. Let's try to analyze what force moves the stock price and then further our understanding of how to apply it to real trading.

We usually say that the buyers move the price up and the sellers move it down. It seems obvious but many still ask the following question:

**Since every trade is a buy and sell at the same time, why does it affect the price?**
**The difference is, which market participant was actively trading. Only active market participants can really move the stock price.**

**If the buyers are active, they are hitting the ask, bidding a stock up and chasing it higher.** In this case, we would expect the stock to move higher. **If the buyers are passive, they are sitting on the bid, willing to buy only if the selling is not too active and ready to drop the bid lower if selling increases. This type of buying won't cause the stock to move higher.**

**The same applies for the converse case of selling. If active selling came about where sellers were hitting the bid sizes while lowering their ask price, the stock would most likely move lower.** Therefore, price movement is a matter of confidence and beliefs in different market participants that determines the supply and demand ratio.

Obviously, stocks do not go straight up or straight down. Therefore a trader needs to learn how to determine the points, when the stock will reverse in direction in order to capitalize on such an event either with an entry or an exit.

Suppose a stock price started to rise because the buyers strongly believe it represented good value at the current level and should trade higher. Sellers consequently are willing to lift their offers because they are convinced by increase in buying pace that the current price level is too low and the stock can be sold higher.

At some point, we can see how this set of beliefs changes. The buyers start to doubt that a stock still has a significant upside and want to take their profits. The sellers doubt they can sell a stock higher and start to increase selling pressure. As a result, the stock is showing a possible turn.

**Price/Volume studies:**

There is a close connection between price and volume. It is important for every trader to understand at least the basics. **Generally speaking, increasing volume indicates a trend continuation and decreasing volume indicates the end of a trend or a reversal.** Lets have a look at some more detailed scenarios:

1. **A price advance with steady increasing volume indicates continuing upward momentum.** As the price is climbing, more and more buyers are getting attracted until the stock gets into a stage of euphoria that usually indicates the end of the price advance.

2. **A slowing pace of buying with decreasing volume indicates that the top is near.** This is also referred to as buying, that is drying up. It has two possible outcomes:

a) Sellers realize that the top might be near and start selling, causing the stock to reverse lower.

b) The stocks starts consolidating and gets supported by strong bids, which indicates that a move higher is likely later.

3. **A relatively big volume increase during the price advance with lower volume on the pullback indicates a continuing uptrend.** The lower volume during the pullback indicates that there are not enough sellers in the market to drive the stock down.
4. **Big buying volume without the price going higher indicates distribution, which means resistance.** A big seller is likely in the market. There is no way to tell yet if the buyers will win this battle and are able to drive the price higher, or if they will give up and the stock eventually reverses.
5. **A slow and steady movement upward with consistent volume indicates continuing upward momentum.** There might be a buyer in the market, who is steadily buying shares, trying not to get too much attention.
6. **An extreme acceleration in the price advancing (an almost vertical movement) is usually not sustained and indicates the end of this stage of the move (euphoric stage).** This is a very common scenario. The best example is the Nasdaq market itself in the beginning of 2000; you all know what happened. Those stages of euphoria are very important exit signals for me. They can also present very interesting entry points especially after a stock had a panic sell off.

***Momentum trading:***

**The market often overreacts to news. There is either panic selling, or panic buying. These overreactions lead to dynamic price movements with predictable patterns.** News usually come out prior to the market open, which gives me time to sort thru my momentum stocks and select the ones that look the most promising.

The classic momentum example is a stock that has lost almost 50% of its value in premarket trading on heavy volume. After the open, it gets some more selling from people that weren't able to sell their shares in premarket trading. Only about one minute after the opening it starts stabilizing and climbing, never seeing that first low again. It was down to almost 20$ after closing at 40$ the day before and is now making it's way back to almost 30$ climbing slowly all day long.

That is certainly an ideal example, but believe me, I have seen many of those. However, times have changed and momentum trading certainly has gotten more difficult and good chances less frequent. It is still an amazing strategy to watch though.

**I don't use charts for momentum trading, the trades are solely based on price action. The momentum trades are mostly entered in the first half hour of the trading day, because the momentum is clearly the strongest.**

**There are two main categories of momentum gappers:**

**Gainer: a stock that is opening with a strong gap up after receiving good news.**

**Dumper: a stock that is opening with a strong gap down after receiving bad news.**

**Gainers and dumpers can both be traded long as well as short. Depending on how strong their overall categories are.** That's why it is very important to follow them each day to get an idea of what to expect. **The basic idea is to see if gainers and dumpers (tracked separately) are either making higher highs (following a stair stepping up pattern), or if they are making lower lows (following a stair stepping down pattern) and to trade the categories according to the patterns you see.** You wont be able to always find strong and clear patterns, but other times you will notice very clear patterns, and that's the best time to play momentum trades. Sometimes a pattern can be consistent for several months, especially the dumper pattern.

**Gainers and dumpers**

**Gainers are stocks that react positive to good news. Ideally, the stock is gapping up 10% or more with strong volume in premarket trading**. You can trade gainers either long or short. It all depends on how strong the individual gainer is and even more important, how strong the whole gainer category is. I will stay with an example for longs here assuming that gainers are strong and make higher highs after the opening.

**There are two entry approaches:**

1. **Entry after the first uptick.**
2. **Entry after break of first range.**

1. **An entry after the first uptick means to enter a long position once the stock made its very first uptick of the day.** Meaning both bid and ask are higher than the previous ones (stock is climbing).

**I am assuming, that after a strong gap up the stock will first receive some profit taking before getting even more buying (assuming the pattern is strong), and therefore making a long trade interesting.** You have to watch your gainer very careful right after the open in order to identify the first uptick and enter your buy order right after you see the uptick. I use level 2 only to find my entry since it shows much more detail than a chart.

2. **An entry after the break of the first range is a more conservative approach than the entry on the first uptick**. **It has the advantage that the stock is confirming its trend.** By breaking to a new high there should be additional momentum coming into the stock. The downside is that you could have gotten in earlier on the first uptick and that your stop is larger. I place my stop below the low of the day. The first range is often established very, very fast, i.e. a stock opens at 48$ and then falls back to 47.85$ and recovers from there; this is already the first established range. This can happen within only a few seconds. My entry would be above 48$ and my stop below 48.85$. **It is very important for this setup, that the first range is extremely narrow; otherwise, the stop is too big.** Often I will watch three or four stocks for opening range breakouts, and in the end only one will qualify for a trade by giving me a tight enough range at the open. If the stock upticks right after the open I will wait until a high is established, let the price come back and consider an entry above the high.

The same strategies applied to the gainers can also be applied to stocks with ongoing momentum, i.e. stocks that run over an extended period of time.

As you have noticed, the examples above were for long setups and assume that the gainer category is strong. **Should the category be weak and gainers are rather closing their gaps instead of adding to their gains, you can apply the opposite and short the stock on its first downtick or go short after the first range breaks to the downside.**

The ideal situation to go long is a market where there is a lot of runners and ongoing momentum in strong stocks.

Tracking the categories and identifying trading opportunities is not as difficult as it might seem. Simply watch gainers and dumpers for a while and write down what they are doing in the first half an hour to an hour of trading. If you notice similarities and consistent patterns, try to trade them on paper.

**Dumpers**

**Dumpers can be traded just as gainers. I am looking for stocks that are gapping down at least 10% on strong volume. Overall, the category proves to be more stable and changes its pattern less frequently, which makes it easier to trade it.** From winter 1999 to late spring 2000 for example the category was strong and you could have traded the first bottom long very successfully. Since the summer of 2000, the category has been very weak and overall you were much better off shorting dumpers. There were and still are very few bottom fishers in the market. **Always make sure, that you don't get involved in a stock that has extremely bad news and might get halted!**

*Liquidity:*

**Liquidity is a very important aspect when it comes to order execution and safety.**

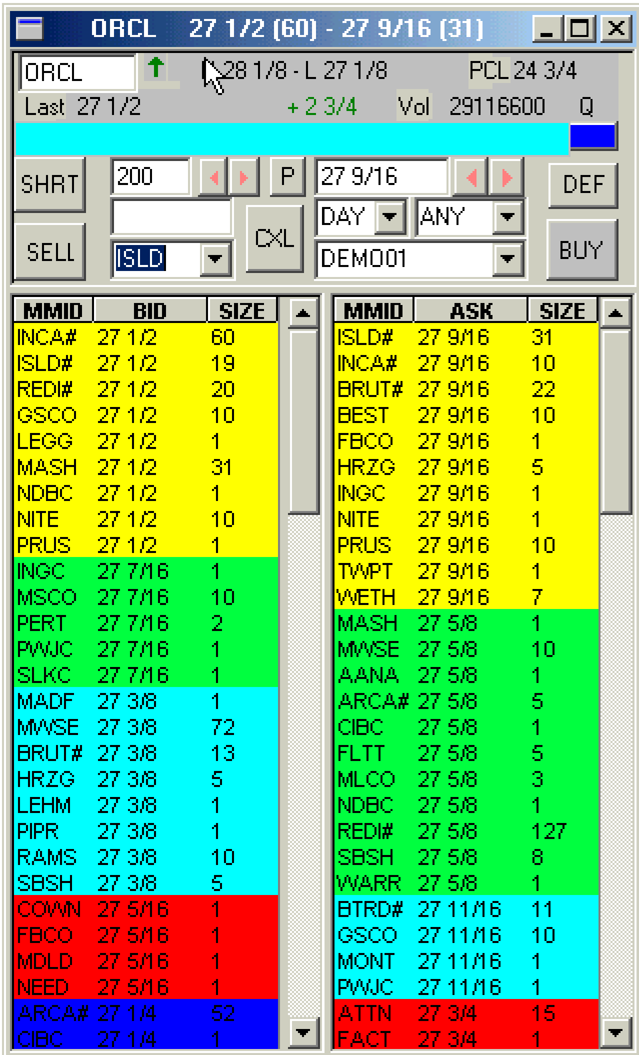
Lets have a look at two examples:

| MMID | BID | SIZE |
|---|---|---|
| BTRD# | 108 9/16 | 10 |
| REDI# | 108 9/16 | 1 |
| INCA# | 108 3/8 | 10 |
| SLKC | 108 3/8 | 1 |
| MWSE | 108 1/16 | 1 |
| CIBC | 107 | 1 |
| HRZG | 107 | 1 |
| MASH | 107 | 1 |
| SBSH | 106 5/8 | 1 |
| NEED | 106 1/4 | 1 |
| NDBC | 106 1/8 | 1 |
| MONT | 105 1/4 | 1 |
| NITE | 105 | 3 |
| BRUT# | 102 1/4 | 1 |
| SUSQ | 100 | 1 |
| TUCK | 98 | 1 |

| MMID | ASK | SIZE |
|---|---|---|
| INCA# | 109 3/8 | 1 |
| REDI# | 109 11/16 | 2 |
| SLKC | 109 11/16 | 1 |
| SBSH | 109 3/4 | 1 |
| ARCA# | 110 1/4 | 1 |
| MONT | 110 1/4 | 1 |
| MASH | 110 7/8 | 1 |
| NEED | 111 1/4 | 1 |
| MWSE | 111 3/8 | 1 |
| HRZG | 112 | 5 |
| BRUT# | 113 | 1 |
| NDBC | 113 1/8 | 1 |
| CIBC | 114 3/4 | 1 |
| NITE | 115 | 6 |
| SUSQ | 115 | 3 |
| FLTT | 118 | 1 |

On the left side, you see a rather illiquid stock (ANEN). **There are very few market participants on every price level; these are called “thin levels”. In addition, these levels are very jumpy themselves.** If you look at the ask side you will see, that after INCA’s bid at 109 3/8$ the next market participant is more than 0,25$ away at 109 11/16$. Therefore, the stock would jump over 25 cents once INCA decides to cancel its order or somebody buys those shares. This is not even an extreme example. In addition, please notice, that the intraday volume is low; there have only been 95.700 shares been traded. The difference between bid and ask itself (called spread) is over 0,8$, making it even more dangerous. You will find situations like this in lower volume stocks. On a stock like ANEN it can be rather difficult to get execution at a fair price, especially if the stock is moving. **The price can rise or fall rather fast because there are only few market participants supporting each price level.** Also keep in mind, that if you trade a stock like this, your stop can sometimes become larger, even if you don’t want to; just because you are not able to get out at the price you want. **I strongly advice beginners not to trade stocks like this.**

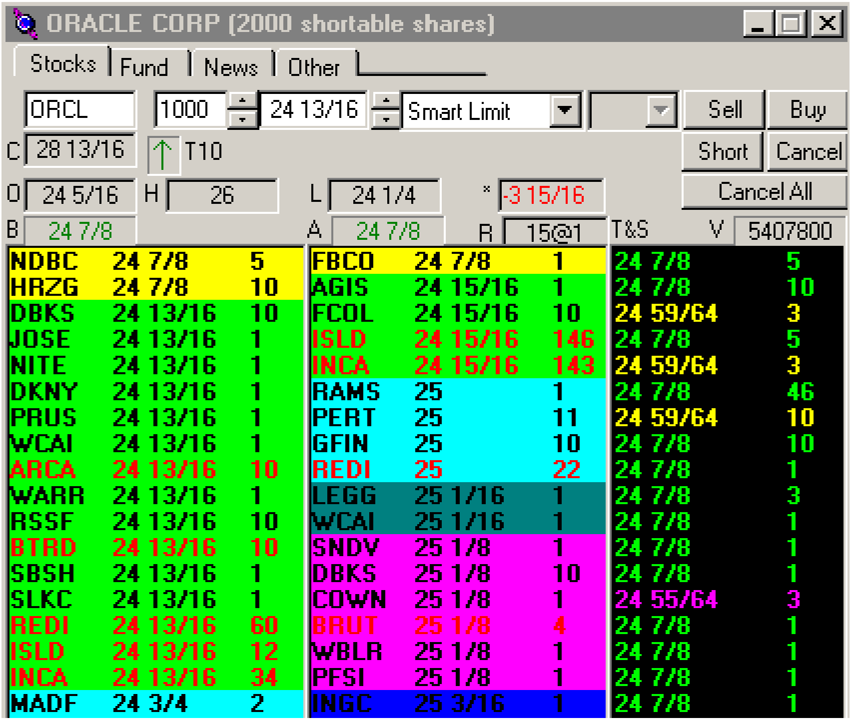
The next picture shows ORCL. ORCL is a widely held stock that usually always has good volume. There are many market participants on every side of the market making entry and exit easy.



***Spotting the "ax" on level 2:***

**The "ax" describes a market participant (most likely a market maker) who reoccurs on the bid or ask side buying/ selling large amount of shares and therefore is blocking the market.** Other definitions simply describe the "ax" as the market participant who has the most influence on the stock price. I would like to stick with the extreme example where the "ax" is literally blocking the market. You can find the "ax" by simply watching the stock you are looking to trade. Imagine you are looking to trade a stock long, but every time it gets close to your setup price MLCO (a market maker) gets on the best ask and keeps selling shares. Even though there are many trades going off on the ask, meaning that there are a lot of buyers, the stock isn't moving higher. He is clearly blocking the market and can therefore be called the "ax". The reason why he is doing this might be a huge customer sell order that he has to execute. Note: he might only be displaying 100 shares for sale, even though he has a lot more to sell. He can do this by auto refreshing his quote once his 100 shares are sold. It is never a good idea to trade against the "ax"; you should wait for him to disappear, before making a long commitment. Most of the times when you see an "ax", it will be from one of the big and influential market maker firms, i.e. MLCO (Merill Lynch), MSCO (), SBSH, and GSCO.

In the following example you see FBCO still selling shares at 24 7/8$ when there is no one else left selling at that price. At the same time, there are many people buying from him (look at all the "green" trades for 24 7/8$ on the T&S). It seems like he is selling a lot of shares, and therefore he is the "ax".




***Gaps and premarket trading:***

Note: I used different level 2 color settings in the examples below in order to make them easier to read.

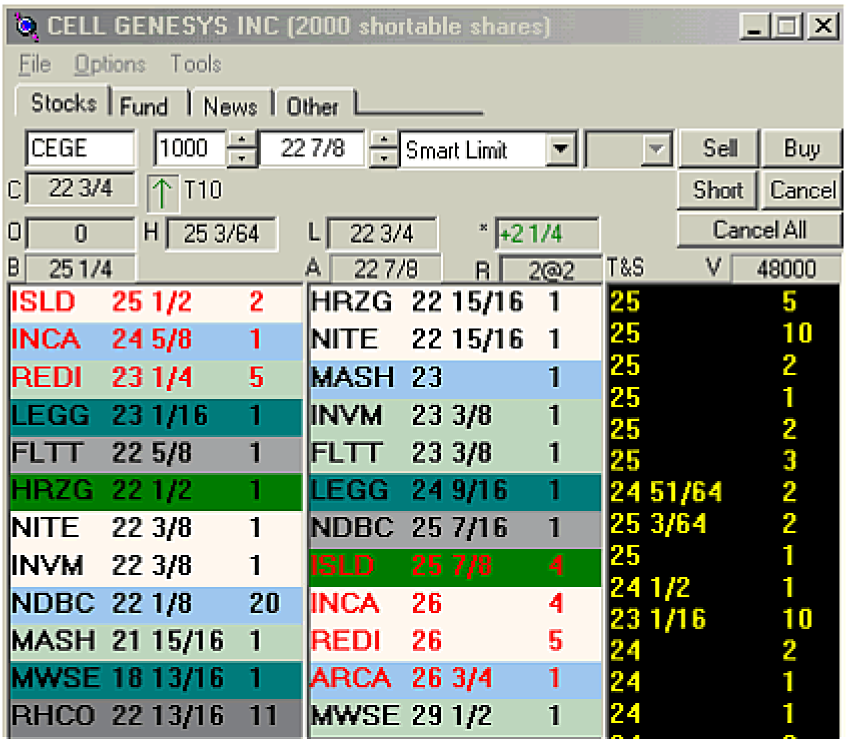
A price gap is a situation where a stock is opening higher or lower than the previous days closing price.

**Stocks listed on the Nasdaq can actually be traded before and after the regular trading hours that are 9:30AM to 4PM EST.** Trading outside of these hours is called pre market and after hours trading. **Stocks are traded on ECN's only.** Some of them offer up to 12 hours of trading from 8AM to 8PM EST. Island is by far the most active ECN and my first choice. What many people don't know is that even NYSE and AMEX stocks are traded outside of the regular trading hours. They are traded only after hours on the Instinet (INCA) network.

Note: Please be careful when trading outside of the regular market sessions since there is often not much liquidity and stock prices can rise and fall rather fast.

Let's have a look at some pre market level 2 screenshots:

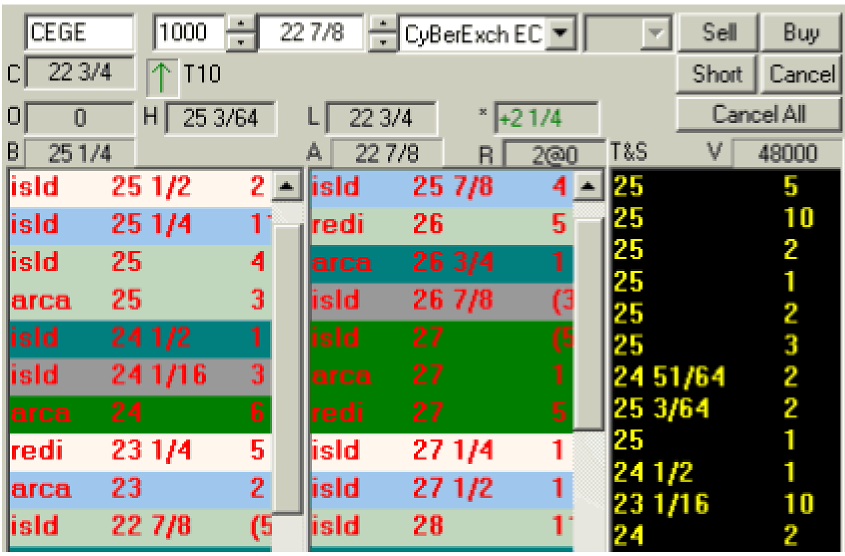
The following picture shows a stock that is gapping about 2.25$ higher than the previous day's close:



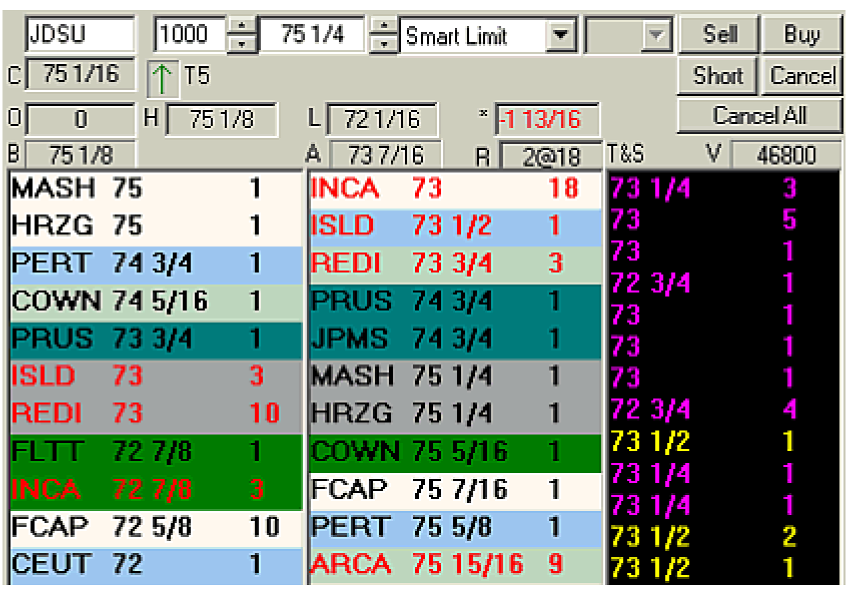

You will notice that bid and ask quotes are crossed. Usually that is not possible, because if buyers are willing to pay more than sellers, there should be trades made. You could assume from this picture that it should be possible to buy shares from HRZG for 22 15/16$ and sell them to ISLD for 25 ½$. This is not the case however.

**Market makers are not required to honor their displayed quotes outside of the regular market hours**. They are only required to start refreshing their quotes 10 minutes before the market open.

**The quotes displayed thru ECN's are "real" though and you can trade with every one of them (assuming you can access all).** If you want to know the exact price the stock is currently trading for please look at your time and sales information (T&S), which is usually displayed on the right side of the level 2 box. In premarket trading, I set my software to only display the ECN's in the level 2 box, which gives me a much clearer picture:

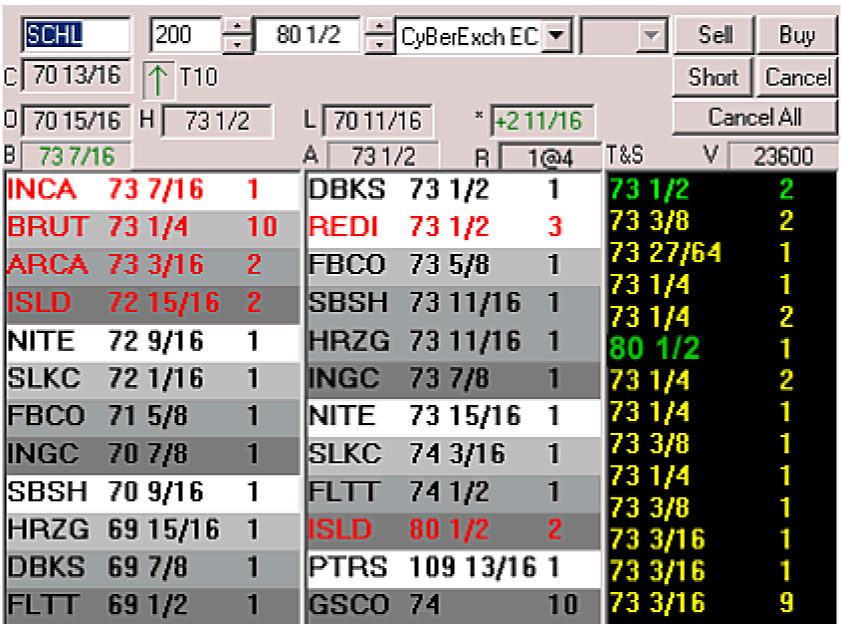



And another example for a stock that is gapping down:



### *Unusual prices:*

Sometimes you will notice trades in your T&S window that are way outside of the current inside market. If you look at the level 2 window below, you will notice a recent trade being made at 80 ½$. That is 7$ away from the current inside market. This could have happened for two reasons.




If you take a closer look at the level 2 screen you will notice an ISLD offer at 80 ½$. If you would enter a buy order thru ISLD, with a limit of 80 ½ or higher, you would actually get executed at that price and your trade would appear in the T&S information, just like the one we are looking at here. Remember: ISLD and other execution systems look for the best available (the cheapest) market participant and seek execution. They can only seek execution from market participants they can actually “communicate with”. In this example, the best available ISLD offer was at 80 ½$. ISLD is only capable of executing to ISLD, 80 1/2 $ was the best price available thru ISLD.

If you ever get into a situation like this and you obviously entered an order “by mistake”, try calling your broker immediately and report your mistake. Your broker might be able to “reverse” that trade for you.

Another reason for this price could have been a late report. The exchanges have a certain time limit to report trades. Therefore, this trade could have been made earlier and is reported now. Usually trades are reported immediately though.

Trades way out of the current market can be a pretty big problem in charts. Imagine our example above – the high of the stock would suddenly be 80 ½$, even though this might have been the only trade in this area. On the chart, you would see a big and sudden spike. If you haven’t followed the stock and watched the T&S it is difficult and time consuming to find out, if it was just a single trade causing this high or if bid and ask actually where that high. What I usually do is to look at the 1 min chart; if the spike happened within a 1 min timeframe, I can be very sure that it was just a single trade, since the stock would have never moved that much within just one minute. Some chart platforms actually filter those trades, which is very helpful since trades outside of the market occur all the time.

***Nasdaq order routing systems:***

Notes on order routing:

Order entry rules change quite frequently. The exact order handling routes are also more complex than described in this book. The descriptions in here are just meant to give you an overview of the most important aspects. Please study the your broker's manual very carefully before making any trades.

**ECN's**

ECN's are relatively new. Changes in the late 90's made it possible for the average investor to get access to level 2 data and compete with market makers thru the use of ECN's. In order to use ECN's you need a broker that gives you direct access to them. Most "traditional" online brokerages won't offer that, only direct access brokers will. Make sure your broker at least offers you access to Island (ISLD) and ARCA.

**ECN's are little exchanges itself. There are many competing bids and offers from every single stock each ECN.** Of course this depends a lot on the interest in the stock you are watching…you might only find very little interest from ECNs in particular stocks, sometimes none. **By default, you will only find the best bid and ask from every ECN displayed in your level 2 window.** Most software systems allow you to display at least the ISLD order book in full depth. Try it, and then you see what I am talking about.

**Generally each ECN is only able communicate with the same ECN, i.e. if you are trying to buy via ISLD you can only buy from another ISLD offer. There are "intelligent" ECN's though, that are looking for execution taking all other ECN's into account.**

**You are able to display your own bids and offers thru ECN's.**

**The major advantage of ECN's is that your orders are send directly to the market, with no middlemen involved. They are kept in an electronic environment.** Let's assume you are trying to buy 500 shares of Microsoft on ISLD and someone is willing to sell 500 shares or more for 24$. By entering an order for 24$ your order gets executed immediately since there is a matching sell order. If the seller would only be willing to sell 200 shares, you would only get executed on 200 shares.

**Since ECN orders are kept in an electronic environment. They can be immediately changed or canceled at any time.**

I think you will be amazed by the speed and ease of execution offered by direct access systems. Imaging hitting the button on your computer and split seconds later, the whole world is able to see your order.

Next, I want to go a little about the details regarding ECN's. Please always also refer to your brokers order entry guide.

**The Island ECN (ISLD)**

The electronic Island network is the most popular order route among daytraders. It is very inexpensive (small to none ECN fees) amazingly fast and offers tremendous liquidity.

- You can place your own bids and offers.
- There is no limit to the amount of shares you can trade.
- You can only place limit orders.
- Island allows you to enter price limits with less than one cent increments. This can be a great advantage if a stock only has a one cent spread and you want to bid or offer a better price than the other market participants.
- Some of the big NYSE stocks can also be traded via Island.

Some direct access brokers will allow you to enter Island subscriber orders. Those orders are only displayed on the Island order book. This can be an advantage in the following situation: Let's assume the best offer in XYZ is 26 ¼$ and there are only market makers on the best offer. If you are now trying to enter a buy order on ISLD with a limit of 26 ¼$, the order would be rejected because it would lock the market. By using the subscriber option, the order would not lock the market cause it is not displayed in the level 2 window. In addition, when you are trying to trade larger amount of shares it is not seen by every trader and therefore is less likely to move the market.

Island accounts for a large percentage of the total trades made on Nasdaq.

**Archipelago (ARCA)**

**ARCA is an intelligent order routing system. It has its own order book but is also able to communicate with other market participants**. ARCA is a very useful system for day traders. The only disadvantage is that if ARCA sends your order to the selectnet system, it can be “stuck” there for 10 seconds without you being able to cancel the order, which can be a problem in fast moving markets. Whenever there are ECN’s inside of your price limit ARCA is generally a very good choice. The following examples are all for active order routing where you are trying to buy from the ask or sell to the bid.

**Limit orders**

- It first searches for ARCA inside of your specified price limit, i.e. if the offer is at 28$ and you are entering a buy order with a limit at 28.5$ it will search for ARCA at a price of 28.5$ or lower.
- If ARCA is not available, it will target other ECN’s to seek execution. It will first target the ECN with the best available price. If there is more than one ECN available at the best price then it will target the most liquid one for that particular stock.
- If there are no ECN’s available it will start targeting market makers thru selecnet preference orders

**Market orders**

- The order will be sent to a market participant at the inside price versus limit orders that are sent to ECN’s first. In many cases, it may be better to just pay a “penny” more and to get immediate execution thru an ECN (assuming there are only market makers at the inside price). If there are ECN’s available at the inside price, the same logic than the one for limit orders is applied.

## General rules

- If there is a better price coming into the market, ARCA tries to target that price.
- ARCA can only accept round lots for smart order routing. Odd share numbers can only be executed against ARCA itself.
- If you get a partial fill ARCA will keep resending your order until it is completely filled or you become bid or ask yourself.
- You can place your own bids and offers via ARCA.

## Small order execution system (SOES)

SOES was developed in the middle of the 80's and was made mandatory after the 1987 stock market crash. During the crash market makers were ignoring their posted prices and therefore clients weren't able to execute their orders. **SOES made it mandatory for market makers to execute orders at the market makers displayed price.** SOES is for trading with market makers only. It cannot execute to ECN's

SOES used to have many limitations to it, such as a maximum number of shares that one could execute, as well as a time restriction for executing orders on the same stock. The biggest problem with it was, that a market maker was only required to execute one SOES order every 15 seconds.

With the introduction of the new super SOES system these rules have changed significantly. **Market makers are now required to execute every order they receive up to the size they are displaying, unless they decide to change their offer. You can now execute up to 999.999 shares via super SOES.**

**Since market makers now have to execute every SOES order they receive it has made SOES executions much faster and it has become a very interesting route for daytraders again.** But it has also changed the market; market makers are now much more inclined to change their existing offers since they don’t want to risk getting too many SOES executions at a point where they don’t want to. This has made the stocks more jumpy in general adding more risky situations for daytraders.

**You cannot display your own bids and offers thru SOES. The old SOES system still exists for small cap stocks.**

**Selectnet (SNET)**

Selectnet was developed by market makers in order to execute their trades electronically and to avoid the verbal communication process via telephone. Nowadays Selectnet is available to direct access traders as well. Thru SNET preference you can send your order to every market participant available on the Nasdaq.

**There are 2 types of SNET orders**

1. Selectnet preference sends your order to one particular market maker or ECN only. If you preference a market maker he has time to decide whether to execute your order or not.
2. A Selectnet broadcast order (with no preference to a particular market participant) gets send out to every market maker available. The market maker who accepts your order first has to do the trade with you.

If you are trying to execute thru an ECN via Selectnet you can only do so by sending a preference order to that particular ECN, not by broadcasting your order.

When using SNET you have the option to send your order as an “all or nothing” (AON) order, meaning that you are not willing to except partial fills.

Especially important are the following points:

- When you are placing an order thru SNET you can NOT cancel it for 10 seconds!
- If you are preferencing a market maker, he has 30 seconds to decide whether to execute your order or not! There is no requirement for him to execute your order.

The fact that you can’t cancel your order for 10 seconds is the reason why Selecnet is not very popular amongst day traders. Imagine being in a stock that is falling fast and trying to sell it thru SNET; you might not get executed and have to reenter your sell order at an even lower price.

**Instinet (INCA)**

Market makers frequently use the Instinet order route. INCA will often be the “Ax”. It was implemented in 1969 as an alternative exchange for banks and institutional traders. Since the ECN’s are implemented into level 2, INCA is providing very good liquidity to the market.

***Trade Management:***

For most traders entering a position is no problem, the exit however is by far more difficult. I use four different types of exit strategies for my trading:

1. **The initial stop: The initial stop is your insurance against big losses** and by far the most important aspect in trading overall. You should never enter a trade without knowing exactly where your initial stop is. **Not keeping stops is the biggest reason for potential failure.**

2. **Partial gains: Taking partial gains means to sell part of your position after the first "reasonable" move in your favor.** A reasonable move would be a move into a resistance area (for longs). This resistance can be of technical nature or of psychological (whole number resistance). Partial gains play an important role in my trading. I have seen many of the most successful traders using this concept. Taking partial gains is especially powerful in conjunction with setting the stop for the remaining shares to breakeven. Many traders have trouble with letting profits run. **Taking partial gains can be a tremendous help because of it's very positive psychological influence**…imagine being in a position where you already took partial gains and the stop for the rest of your position is set to breakeven…**you can let profits run without having to be afraid of potential losses.**

3. **The breakeven stop:** This stop is getting interesting once your trade is inside positive territory enough so that you won't end up loosing on it, but there is still more room for potential gain. **Breakeven means to set the stop just below the price where you initially bought the stock or where your entry price was set at.**

I start using breakeven stops once the stock has successfully held above my stop area (for longs) or it has risen a significant amount.

**4.Trailing stops: Trailing stops come into play after I took my first gains and the stock has successfully taken the first area of resistance.** The stop is set just under the area of the last resistance. Moving averages are also an excellent area where to place trailing stops.

***Learning plan:***

Before you start trading you should develop a learning plan. Here are some suggestions that have helped me and many other traders:

1. **Familiarize yourself with your trading platform and the different tools included. Simply watch stock movements and charts and try to identify the patterns they move in.** Experiment with different strategies and try to find a strategy that you would feel comfortable trading live. Trying to identify patterns and applying technical analysis is certainly very difficult for beginners if they try it on their own. That's why I strongly recommend that you have a professional trader helping you. The best thing would be a personal trainer or a very good chat room that is focused on education. **After having a strategy that you are following, you should start doing some trades on paper only.** There are many mistakes you will be making and it is much better to do so on paper than with real money. **Trade on paper for a while (I would recommend at least four weeks) until at least 75% of your trades are positive.** This percentage will drop significantly once you trade live.

2. **Start trading with a small amount of shares. I would recommend starting with no more than 100 shares at a time. Now emotions will come into play because you are trading live and you will most likely be making a lot more mistakes than on paper and probably even break some stops**. The most important lessons you will learn are the ones thru losses. But you can keep those losses small by trading small amounts of shares only. **You should trade small for at least one month.**

3. **If you are experiencing problems trading live and your success ratio drops, you should go back to paper trading. Most likely you lost your objectivity due to emotions that come into play when you are trading live.** Paper trading should get you back on track and make you see things clear again. If there weren't any emotions involved, trading would be much easier. **You can go back to paper trading as often as you want; even I do it occasionally to evaluate new strategies.**

4. **After trading a small amount of shares, you can gradually start trading more shares**. Only increase to an amount that you feel comfortable with and that goes along with your general risk management (see risk management).

Of course, this is a simplified plan and there are many obstacles to face. The point is that you take it slow. You will also find yourself experimenting with different strategies since there is no strategy that works all the time. It is also very helpful to learn from a variety of traders and to read more than one book. Every different angle will help you understand the markets more and lead you to the ultimate goal of seeing everything as a whole picture.

*Paper trading:*

Paper trading means to actually write down trades on paper instead of buying actual shares and risking money. Paper trading can be very effective when done correctly. You have to be very honest with every trade you write down and complete it as if it was real with the same rules applied. It is important to make sure that you would have actually been able to execute the paper trade in reality. Trading on paper is much easier than real trading, since there are very few emotions involved.  It will be much easier for you, to just execute according to your plan, whereas in real trading you would have probably thought twice about your decision or you would not have reacted at all. If you take paper trading seriously enough you should feel some level of excitement, almost nervousness. This is the state of mind you should be in. Tell yourself that paper trading is real; it will determine how much money you are able to make later on. You want good results in order to be successful.

**For "realistic" entry and exit points I apply the following rules:**

**The (paper) order can only be executed thru ECN's since this is the only way I can be sure to get an execution with, if there are offers available and no one steps in front of me. I can only buy and sell actively (buy from ask, sell to bid).** I wait a few seconds after my entry point is hit until I look at ECN's that could have executed my order. Here is an example: I am getting a long signal in XYZ. Now I look at the level 2 offer side and try too find ECN's I can buy shares from. Obviously, they have to be somewhere near my setup price because I don't want to chase the stock. If there are ECN's available, I will wait a few more seconds to make sure no one would have stepped in front of me. If the ECN'(s) are still there I will write down the price that I would have gotten. I do the exact opposite for the exit.

### *Choosing brokers:*

Choosing the right broker may seem like a difficult task to beginners. There are numerous brokers out there all offering different deals and different trading platforms; at least that's what it seems like on first sight.

Make sure you open an account with a direct access broker; that is the most important aspect of all. Your broker will offer you software that has features like realtime charts, level 2 and order entry implemented into one platform. In some cases the charting and realtime quote software might be purchased separately from the order entry, I will go over that later.

There are only three major trading platforms available, which are available thru numerous licensed brokers. Some of those brokers might be very small. They operate on a "franchise" basis with big clearing firms, software providers and banks. Make sure that the bank you are sending your money to is SIPC insured. Some of the biggest clearing firms are pension financial service, computer clearing service and southwest securities. Most likely your money will go to one of their accounts.

Realtick is probably the most widely used platform of all. It has very reliable quotes, solid charting and very advanced order features like conditional orders and trailing stops. The second most widely platform used is a software called Cybertrader, which is now also available thru Charles Schwab. Cybertrader is a very nice platform; although it has had some problems though with the reliability of quotes and charts, especially when you are using a slower Internet connection. Cybertrader offers excellent order features though, such as their own intelligent order routing system. The other platform is called ESPTrader. It is used by many small brokers under various names since it is extremely easy to franchise. It is a very stable platform with the only downside being poor charting features.

## Stand-alone platforms

Various providers offer charts or order entry only. The biggest chart providers are Qcharts, Esignal and DTNIQ. I like Qcharts a lot, it has outstanding charting features that are especially easy to scale and work with. Some people were complaining about the reliability of Qcharts (lagging quotes). However I cannot agree with that, I had very few problems. There are some brokers that offer you order entry only and (usually very limited) quote/chart features. They offer very competitive commissions (see commissions) but are not as easy and fast to operate, i.e. the order can not be entered via point and click on your level 2 screen; the stock symbols have to be typed in manually. Even though these are disadvantages, these brokers might still be interesting for people who are interested in doing slower trades with a small amount of shares.

## Commissions

The standard commission rate is 14.95$ per trade, meaning that you have to pay 14.95$ for every buy and sell. Partial executions should not cost you extra commissions. On top of the base commission there are additional fees, called ECN fees that are charged by the various order routing systems to your broker and are passed on to you. They can be as high as 0.01$ per share. If you are trading larger amount of shares this is certainly a factor to consider. Usually brokers offer you discounts if you do many trades every month. Commissions can get to as low as 7.95$ per trade. There are brokers that charge you on a per share basis only; these brokers will most likely offer order entry only. The commissions are usually 1 cent per share or even 0.5 cent if you are trading larger amounts of shares.

### Service

A very important aspect when choosing a broker is the quality of service it is offering. Imagine you are in a trade, your Internet connection fails, and you have to close your position over the phone. Someone should pick up the phone immediately; otherwise this could be a costly experience. I had very good experiences with all the Realtick brokers. Usually someone picks up the phone immediately and is able to help you. Be careful with the “order entry only” brokers; don’t expect anyone to be available immediately. That is another reason why I don’t recommend them to serious traders.

### Opening the account

Most brokers let you open an account partly over the Internet; you only have to send or fax copies of some documents.  It usually takes less than a week to get your account number so you can fund your account. You will only be able to transfer assets back to your own account, not someone else’s.

### Minimum requirements

Most direct access brokers require you to fund the account with at least $25.000. This is important, because new SEC regulations require daytraders to have at least 25K in their account in order to daytrade. There is still much controversy around this rule. Some brokers still allow you to trade with less than 10K on cash only, not on margin. If you are not a daytrader those rules don’t apply to you. Additionally there are minimum “net worth” and income requirements. Please check with your broker for the exact details.

For a list of brokers please refer to my website at www.daytradingcoach.com.

***Technical requirements/computer setup:***

A reliable computer system as well as a good display(s) is very important, especially for traders who are planning to trade full time. Here are some tips:

**Computer**

In order to run a direct access trading platforms efficiently I would recommend a computer with at least 500MHZ processing power and 256MB of RAM as well as a quality graphics card. Your trading platform actually needs very little resources; I remember running my trading platform on a 233Mhz 16MB machine without any problems. However, I strongly recommend the settings described above in order to run multiple applications without trouble.

Many times you will find yourself using multiple applications such as your trading platform, your Internet browser, chat rooms, stock scanners, virus protections etc. Every application will take up system resources, so you rather have more resources available, which also makes your system more stable. The trading platform itself usually takes up few resources, however some scanning applications you might want to use can take up significant resources. The fewer applications you have running on your computer, the more stable your system will generally be. Please make sure to only have programs installed that you really need and to erase ones that become useless for you.

**Operating systems**

Windows is a must, I never saw trading platforms running on a Mac. Use windows 98 or higher to support multiple graphic cards.

## Graphics and multi monitor setup

Screen size is very critical for traders. The more you have, the better. You want to be able to display multiple charts, level 2 windows, and order entry etc. on your computer screen. It is very important to have all the information right in front of you when you need it. Minimized windows often just cause confusion and take critical time away. That's why many traders work with multiple computer screens on one or more computers. You will be able to extend your desktop over to the other monitors and move your mouse from screen to screen. It is very easy to attach multiple monitors to your computer. There are two ways of doing so. The easiest option is to just add additional graphic cards to your computer. Windows (win 98 or higher) will recognize the card(s) and enable you (after installing all the drivers for the card) to extend your desktop automatically. The other option is to use one card that supports multiple monitors itself. There are cards available that allow you to attach up to four monitors to them. This is supposed to be a safer option since you are less likely to run into hardware interference; however I have never had a problem with multiple cards. Another reason for a card that supports multiple monitors can be that you have no free slots available for additional cards. I would suggest using multiple cards rather than buying one of the more expensive multi monitor cards and rather invest the money saved into a good computer monitor. I would advice every trader to work with at least 2 monitors and a screen resolution of at least 1024 by 768 pixels.
Make sure you buy the right graphic card that fits into your computer. There are 2 types of slots used, either AGP or PCI. Most systems need a PCI graphic card in order to enable multiple monitors. Please consult your computer specialist for details.

## Monitors

The quality of the monitors you are using is very critical especially when you want to work with higher resolutions that the standard 1024 by 768 pixel resolution. The higher the resolution you use, the more you will be able to display on your screen, since objects get smaller. You will have exactly four times the screen space by setting your 800 by 600 pixel resolution to a resolution of 1600 by 1200 pixel. Most modern graphic cards can handle screen resolutions of 1600 pixels or higher. The problem is with the monitor though. Many of the lower quality screens are capable of handling high resolutions technically, but the quality of the picture gets very bad, causing your eyes to tear after only a little awhile. If your monitor is capable of handling a 1600 pixel resolution you can usually expect the picture to turn more and more unclear once you cross the 1280 pixel mark. Make sure to get a high quality screen that offers more resolution than you actually need and that has a high refresh rate. Please try different models in the store on higher resolutions; you will be amazed about the differences. Flat panel monitors are usually very good for the eyes but it is harder to get them with high resolutions.

## Internet connection

In the world of high-speed DSL and cable connections this subject certainly has become less and less of an issue. When you are using one of the high-speed connections you usually don’t have to worry about a slow connection on your side. Lost connections and outgages still occur though, that’s why I would strongly advice you to have a backup ISP (a regular dial up is fine). In case there are any problems you can still connect through the regular dial up line and close out positions etc. Especially for faster paced trades I would strongly advice you though, to call your broker immediately and have him close all your open positions if there is a connection problem.

Remember, without a connection you are blind; you don't know what is happening and are at risk of not being able to keep your stops! For people who do not have access to high speed Internet, a regular 56K dial up line is usually fine. Depending on how far away you live from the next "telecom switch" your connection speed might be much lower that 56K though, and it might be impossible for you to trade. In case your dial up connection is too slow and prices are not updating fluently and get stuck, please try different ISPs. I would stay away from Internet services that require you to have access software such as AOL. Access should be available thru a regular dial up network connection.

**Laptops**

If you whish to trade from a Laptop, you usually run into two problems. 1. Screen resolution and 2. Adding additional monitors. Many laptop models allow you connect a separate monitor to your screen. Please make sure you can also expand your desktop to that screen. Tip: right click on the desktop and go to settings. There should be two monitors displayed and an option asking you to extend your desktop. If there is only one monitor then you can't extend the desktop and you will only be able to display the same information on both screens. You probably won't have a hard time finding a Laptop allowing the 2-monitor option, high screen resolution however is hard to find. Most Laptops will only offer the standard 1024 by 768 pixel resolution. I only found high resolutions (up to 1600 pixel) with the high-end models of Hewlet Packard as well as Sony and Dell. As of last year (2001) Dell was clearly providing the most powerful graphic options for good prices. Laptop screens should be used with their native resolution settings (the max. resolution) for best quality, unlike regular screens that usually suffer significantly in display quality when used at maximum resolution.

***A typical trading day and pre market preparation:***

Even though every trader has a different daily routine I would like to share mine with you. I usually start my day at 8:30AM EST. The first thing I do after starting my computer is to tune on to financial news as well as world news. I try to get a general overview over the news that are moving the market and if there might be more news to be released (i.e. Fed announcements, economic news). I read most of the news wrap-ups over the Internet, but also listen to financial TV. However, I do take the information I get there very cautiously. Just recently for example they announced a new bull market on TV and the market saw a few very strong days of sell-off after that.

A very important part of my preparation is the technical analysis of the market itself, especially the NASDAQ. I will use indicators such as retracements, moving averages and trend lines for my analysis. Most importantly though, I want to look at recent lows and highs. If someone would wake me up 2 minutes before the market were to open and ask me to make a quick analysis of the market I would only look at the prior days high for upside resistance and the prior days low for downside support. I would most likely do very well just by doing that. All market analysis is based on the daily charts.

In the beginning of the day I already have a list of stocks (a watch list) that I want to watch and potentially trade. This list is usually created after the market close. Please see “how to find trade candidates” for more details more on how to find potential candidates. My original watch list mostly has stocks in it, that I am interested in based on technical analysis. I will add additional stocks to the list that are gapping in the morning for potential momentum trades as well as stocks that are mentioned by other traders in newsletters I receive every day. I will only consider stocks that fit my style of trading and my risk tolerance.

After all that is done I sometimes have a big list of stocks that needs to shrink before the market opens. I try to sort out as many stocks as I can and only focus on three to four stocks that I actually put into level 2 screens and add charts to them. There might be more stocks in my watch list, but rarely more than 10, simply because I would loose my focus by having too many stocks to watch.

At the market open I already have my first orders ready to submit, assuming that there are stocks that might setup right after the open.

Most of my trades are entered in the first half hour of the day. Movements are the strongest during this period of the day. Momentum trades can almost only be done in this time. I make sure to watch what happens in the market during the reversal zones, especially the one at 10:15 and choose my entries accordingly (meaning I wont enter another long if the market is already going up and a reversal zone approaching.

Most of the stocks from my initial list will either setup in the first half hour or become invalid.  Only a few stocks are sometimes left that I will continue watching for potential setups.
If there is not much interesting left on my initial watch list I will start scanning for intraday trades, i.e. I will scan for strong stocks that are consolidating near their highs for potential breakout trades. I will create another watch list based on those scans. Again, I put the most interesting stocks into level 2 and charts.

Ideally, the stocks I find thru intra day scanning will setup after the first 45 minutes of trading and after a reasonable consolidation (depending on the setup). Many of them setup right before the lunch hours (11:30AM- 1:30PM). These hours are usually the slowest of the day, with the overall volume being very low.

A general rule is not to trade during these hours, since moves are more random and less predictable. I do however find many interesting and often very strong moves during this period and therefore don't agree anymore with this "old" trader wisdom. This is especially true, if there wasn't much movement in the first trading hours. If the first hours were slow, then you will often see strong moves over noon. If the first hours were very volatile, then lunch-hours are most likely very slow.

After placing my morning trades and potentially some intraday trades, I will take a break of about 30 minutes, then return to intraday scanning and continue following the stocks that are still on my morning list.

If the market didn't break out over noon I will be looking to enter more trades once the market gets busier, which is typically after 2PM. I enter my last trades before 3PM. For some reason I was never overly successful with trading after 3PM. There is no real explanation for that. Every trader has different times when he or she is the most successful.

I will be mostly just watching the market from about 3PM to the close and exit some of my trades or take partial gains if I have any open positions. In this time I will also start working on my watch list for the next morning. The close will be very interesting for me to watch, especially if I have positions that I might be willing to hold overnight. A general rule is, that the stronger the stock is at the close, the more likely it is going to continue higher the following day, and the more likely I am to hold it overnight. I like my long positions to finish at least in the upper half of the trading day in order for them to be interesting as an overnight hold (vice versa for shorts).

Note: this is pretty much how my trading day looks if I trade trend-following patterns as well as some swing trades. If I would only do very short-term scalps, my day would certainly look different because I would be less affected by the overall market. If I am in a position I will always keep an eye on it. For longer term trades I strongly advice using automated stops for your protection. They have two advantages: 1.You don’t have to watch the stock all the time and 2.They automate your exit decision, which leaves less room for failure. Please be careful though with stop orders and study your brokers order guide carefully. Some stop orders are only saved on your computer; if you lose your Internet connection or your computer crashes your order wont be send out anymore and you are not protected.

***Keys to success - psychological aspects:***

I believe that the right state of mind is by far the single most important key to successful trading. Yes, a solid strategy is an absolute necessity too; but without being in the right state of mind it won't make you successful either. I state in the "philosophy" section of my website that I don't think trading needs to be complicated and that keeping it simple is the way to success. The most successful traders I know only use a few basic strategies. What made them so successful was their confidence in their strategy, their ability to stay neutral and to execute according to what they see. Other people I met had very sophisticated and complex approaches using several indicators. And guess what, a lot of them were successful too. I doubt that the indicators themselves made them successful though; more important was their confidence in their strategy. Some people can only work with very sophisticated approaches just because they don't believe that simple things work. They say: "it can't be that easy". My point is that there are many approaches. I don't want to judge whether one is better than the other. As long as they work for you the goal is achieved. No one holds the Holy Grail to success. Personally I don't like advanced technical indicators too much. The reason is that there are too many variables that can be adjusted. I like to get clear entry signals based on absolute prices (i.e. highs and lows), which I am not able to alter. This gives me less room for personal interpretation and more clear signals.

Going back to the mental aspects, I would like to point out some of the key traits of successful traders:

**1.They stay neutral:**
Staying neutral means to be emotionally detached from your trading decisions. You probably know guys for whom the world sucks if they take a loss of $100 and if they make $1000 they are on top of the world. They are definitely not neutral.

If you are like that, then your trading will definitely be driven by fear and greed; if you are down $100 you probably don't want to take a loss, just because you know that you will be emotionally suffering. If you are up $1000 you might want more, even though you should take profits. Or you might end up taking profits way too early because you are afraid that the position might turn against you. The professionals don't let the day-to-day oscillations in their account faze them. The results of one week don't matter much, not even the monthly results. It's just a small blip of time in their career, so the day-to-day oscillations don't really matter. Emotional ups and downs are pretty normal for beginners. If they influence your trading decisions too much, then I would strongly advise you to go back to paper trading in order to gain the confidence you need to not let those oscillations affect you too much.

Staying neutral also means to see the price movements like they really are, not how you want them to be. You might all know the situation where a trade is going against you, and you start looking for other reasons why it is still a good trade and you should hold it. This is very dangerous since it leads people to breaking their stops and to lose big. Your entry and exit criteria has to be absolutely clear before you make a trade. Switching strategies while you are in a trade is one of the worst things you can do. You can always find a reason for your position to go up or down, but you don't see the actual price movement anymore.  You are shifting from reaction to prediction! A day trader should under no circumstance try to predict future price movements. As traders we have to play the actual price movement, not what we think the movement should be! Please leave prediction to investors. A lot of times I see traders taking positions in stocks they know very well fundamentally. They mix trading with investing. This is very dangerous too. While there might be reasons to enter a position for a short-term trade they often end up holding it as an investment if it goes against them. Just think about Enron.

Yes, there were points during the Enron sell off where a trade would have been justified. Even I held Enron for a short recovery from about $8.5 to $10. The problem is, that if you base your entry on the belief that the company is cheap and it has to recover, you will be more and more inclined to hold your position or even add to it once it goes lower. The stronger your opinion on a stock, the harder it is to make decisions based on the actual price movement. I would strongly advise you to have a separate account for fundamentally based trades. A day trading account gives you too much leverage, making it very tempting to take risks that are way too high!! I am not saying that it is not good to have expectations; everyone should know what his potential trades are most likely going to do. Should those expectations be wrong though, then we have to accept that and react according to what is really happening.

**2. Successful traders have confidence in their trading decisions:**

Confidence in your trading decisions is the key to everything. A lack of confidence can lead to fear. Fear or a lack of confidence in your trading decisions makes it hard to enter trades in the first place. You will often find yourself letting good opportunities pass by, or you are waiting for additional confirmation that the stock is going your way, which makes you enter trades too late and you end up chasing the stocks; often getting in at the end of the movement. Fear of losing money makes it harder to take losses. To much fear will either make you not take losses at all and cause significant draw downs, or it will make you take losses to soon, before the actual stop price was hit. Confidence in your ability to make good trading decisions will help you to be patient since you know that eventually there will be good opportunities. Traders with a lack of confidence tend to look for different trading strategies every time something goes wrong for them. They are therefore never able to focus on one strategy and master it. Even if you are a experienced trader you might lose some confidence once in a while.

Go back to paper trading or to trading small shares in order to get yourself back on track.

**3. They only use risk capital for trading:**
If you are trading with all the money you have without having another income you will be way too scared in order to make any neutral decisions. There is a saying that scared money never wins. I have yet to see a trader who was able to live off a 5K trading account without any additional income.

**4. They focus on a few strategies that suit them well:**
Many traders try to implement too many strategies at once. They think they have to make money every day. The most successful traders I know only have a few strategies that they are highly successful with, sometimes only one. The goal is to find a strategy that YOU are comfortable with and to master it. This won't come overnight. Of course you need to have a look (and try) different strategies until you find something that you are comfortable with. Keep in mind that no strategy works in every market. Therefore it is normal to sit on the sidelines every once in a while. You don't have to make money every day. The key is to only trade when the odds are in your favor and to stay in the game. Once you have established a "bottom line" strategy you should slowly move on and implement other strategies.

**5. They are patient:**
This starts with patience in your learning process. Take time to trade on paper for a while. You will make mistakes and it will take time to get comfortable with your trading decisions. Please make your mistakes on paper; this will keep you in the game. If you absolutely want to trade live right away please do so with a very small amount of shares. You can make a lot of mistakes if you are trading a small amount of shares. If you use your full buying power though one blown stop can wipe you out. I have yet to see a trader (including myself) who didn't blow a stop at least once!!

Patience to wait for trading opportunities is very important too. As stated above, not every strategy works every day. You might have to wait a while to find a good trade. It can also happen that you have a loosing streak. A good trader will not worry too much about that and will do something else. Sitting in front of your computer trying to make back losses is the worst thing you can do. I would strongly advice you to set maximum losses per day, week and overall. Stop trading immediately if your maximum losses are hit. Remember, as long as you stay in the game there will always be another day with new opportunities.

**6. They are great money managers:**
A good trader will never risk more than 2% of his trading capital on a single trade. This means that if he has to take a stop, the amount of money he is wiling to lose will be no more than 2% of his capital. 2% is the absolute maximum. You should attempt to risk less than that. The reason why this is so important is that even if you are right 99% of the time you can still lose 10 times in a row. Every once in a while this might happen to you. Only if you risk little money you will be able to survive such a draw down.

***Disclaimer:***

**THE RISKS OF DAY TRADING**

This book is dedicated to providing sound and proven trading techniques and support for those who wish to enter the business of day trading. Most of those who attempt to day trade are thwarted by their own lack of understanding and discipline. They have no rules and lose money trying many unproven strategies.

**None of the techniques discussed in this book should be undertaken without extensive study, back testing and paper trading analysis. The author makes** no warranties or guarantees to the content or accuracy of any information.

**Please be aware that the risk of loss in electronic trading can be substantial. You should therefore consider, whether such trading is suitable for you in light of your circumstances and financial resources.**

**Potential Daytraders should be aware…**

**That day trading can be extremely risky.** Customers should be prepared to lose all of the funds that they use for day trading. They should not fund their day trading activities with retirement savings, student loans, second mortgages, emergency funds, funds set aside for purposes such as education or home ownership or funds required for current income.

**That customers should be cautious of claims of large profits from daytrading.** Customers need to be wary of advertisements or other statements that emphasize the potential for large profits in day trading. Day trading can also lead to large and immediate financial losses.

**That day trading requires knowledge of securities markets.** Day trading requires in-depth knowledge of the securities markets and trading techniques and strategies. In attempting to profit through daytrading, an investor must compete with professional, licensed traders employed by securities firms. An investor should have appropriate experience before engaging in day trading.

**That day trading requires knowledge of a firm's operations.** An investor should be familiar with a securities firm's business practices, including the operation of the firm's order execution systems, procedures, and should confirm that a firm has adequate systems capacity to permit customers to engage in day trading activities.

**That day trading may result in large commissions.** Day trading may require an investor to trade his or her account aggressively, and pay commissions on each trade. The total daily commissions that they pay on trades may add to losses or significantly reduce earnings.

**That day trading on margin or short selling may result in losses beyond the initial investment.** When customers day trade with funds borrowed from the firm or someone else, they can lose more than the funds originally placed at risk. A decline in the value of the securities that are purchased may require additional funds to be paid.