

DEFINITIVE GUIDE TO SWING TRADING STOCKS

PROPRIETARY METHODS REVEALED



INSTANT DOWNLOAD!

WWW.SWINGTRADERGUIDE.COM

The Definitive Guide to Swing Trading Stocks

Edition 5.0

Disclaimer

The information provided is not to be considered as a recommendation to buy certain stocks and is provided solely as an information resource to help traders make their own decisions. Past performance is no guarantee of future success. It is important to note that no system or methodology has ever been developed that can guarantee profits or ensure freedom from losses. No representation or implication is being made that using The Definitive Guide to Swing Trading Stocks will provide information that guarantees profits or ensures freedom from losses.

Disclaimer: Futures, FOREX, stock, and option trading is not appropriate for everyone. There is a substantial risk of loss associated with trading these markets. Losses can and will occur. No system or methodology has ever been developed that can guarantee profits or ensure freedom from losses.

SwingTraderGuide.com makes no representation or implication that using the Definitive Swing Trading Guide's methods will generate profits or ensure freedom from losses.

U.S. Government Required Disclaimer – Commodity Futures Trading Commission Futures and Options trading has large potential rewards, but also large potential risk. You must be aware of the risks and be willing to accept them to invest in the futures and options markets. Don't trade with money you can't afford to lose. This is neither a solicitation nor an offer to Buy/Sell futures or options. No representation is being made that any account will or is likely to achieve profits or losses similar to those discussed on this web site. The past performance of any trading system or methodology is not necessarily indicative of future results.

CFTC RULE 4.41 – HYPOTHETICAL OR SIMULATED PERFORMANCE RESULTS HAVE CERTAIN LIMITATIONS. UNLIKE AN ACTUAL PERFORMANCE RECORD, SIMULATED RESULTS DO NOT REPRESENT ACTUAL TRADING. ALSO, SINCE THE TRADES HAVE NOT BEEN EXECUTED, THE RESULTS MAY HAVE UNDER- OR-OVER COMPENSATED FOR THE IMPACT, IF ANY, OF CERTAIN MARKET FACTORS, SUCH AS LACK OF LIQUIDITY. SIMULATED TRADING PROGRAMS IN GENERAL ARE ALSO SUBJECT TO THE FACT THAT THEY ARE DESIGNED WITH THE BENEFIT OF HINDSIGHT. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFIT OR LOSSES SIMILAR TO THOSE SHOWN.

Copyright © All rights reserved. No part of this eBook may be reproduced or transmitted in any form or by any means, electronic or mechanical, without written prior permission from the author.

This is NOT a free eBook. You are not permitted to give this eBook away or resell it or any part of its contents without written permission from its author. You should have purchased this eBook from www.swingtraderguide.com. If you did not please inform the author at inquiries@swingtraderguide.com

Contents

Introduction	6
Who Should Read This Trading Guide?.....	8
The Ground Rules	9
Rule #1: NO “secret” methods will work	9
Rule #2: Price is the ONLY reality.....	10
Rule #3: A high percentage of winning trades is NOT the answer.....	11
Rule #4: Risk is ALWAYS present	12
Rule #5: Trading is not an Ego Play.....	13
What Is Swing Trading?	14
Day trading (Ultra short term)	14
Swing trading (Short-term).....	14
Position trading (Long-term).....	15
The Basics of Trading	16
Trading Jargon.....	16
Stock-Price Charts	17
Comparing Candlestick Charts to Bar Charts.....	18
Order Entry: Best Practices	19
Market Orders.....	19
Limit Orders	19
Stop Orders	20
One Caveat (Warning!).....	20
Other Order Types	20
All-or-None (AON) Orders	20
Good-till-Cancelled (GTC) Orders.....	21
Day Orders	21
An Overview of Trading Systems.....	22
Trading System Components	22
Trading Statistics	23
Trading System Quadrant™.....	25
Some Common Trading Methods	27
WD Gann.....	27
Fibonacci	28
Elliott Waves	28
Chart Patterns.....	29
Candlestick Patterns	30
Overbought/Oversold Indicators.....	30
Trading Only Long or Short.....	31
Trading on News or on Fundamentals.....	31
Why Technical Analysis?	32
Using Multiple Time Frames.....	33

How to Choose Stocks for a Watch List	35
Trading Volume.....	35
Stock Share Price	36
Identifying Trends Using Price Charts	38
Identifying Pivot Points Using Price Charts.....	38
Trend Lines	42
Moving Averages	44
Trade Entry Setups	49
Pivot-Point Breakouts	49
Stochastic Oscillator	53
Rate of Change (ROC).....	58
Profit-Taking Methods	62
Calculating Profit Objectives with Swing Trade Levels TM	62
Stop-Loss Methods	68
Conserving Account Equity	68
Initial Stop-Loss.....	68
Trailing Stop-Losses	69
Managing Portfolios	71
Trade Management.....	71
Balancing Short and Long Trades	73
Number of Stocks in Portfolio	73
Pyramiding Your Position.....	74
Putting It All Together.....	75
Trading Campaign Checklist	75
Business Operations.....	75
Frequently Asked Questions.....	77
Brokers.....	79
Other resources.....	80

Introduction

I have been involved in the investment markets for more than 20 years. I remember when I first learned about stock trading: I thought it was truly amazing to be able to make money from anywhere in the world and all I needed was a computer, Internet access or a telephone.

Trading, in many ways, is the perfect business opportunity.

It offers a multitude of unique benefits:

- ☑ no employees
- ☑ low overhead
- ☑ no physical inventory
- ☑ instant liquidity
- ☑ multiple ways to leverage capital
- ☑ independent of economy
- ☑ independent of climate
- ☑ easy to scale
- ☑ easy to automate
- ☑ favorable tax considerations
- ☑ the ability to take time off at any time



I have been involved in the investment markets for more than 20 years. I remember when I first learned about stock trading: I thought it was truly amazing to be able to make money from anywhere in the world and all I needed was a computer, Internet access or a telephone.

Trading, in many ways, is the perfect business opportunity.

People are drawn to stock trading for many reasons. Yours might include:

- ☑ Making additional spending income
- ☑ Producing capital for other investments, such as real estate
- ☑ Saving for your children's education
- ☑ Becoming self-employed
- ☑ Building your nest egg for retirement

In my library of stock trading books and courses, I have found that 90% of the information is the same, just rehashed in some way. However, if I learned just one new thing, I considered each purchase worth my while. In this trading guide, I believe you will find not just one, but

many things that will elevate your trading to new levels. In the chapters that follow, you will learn some of the best techniques I have found for extracting profits from the stock market on a regular basis.

I have written this trading guide in a very concise manner. You won't find a lot of anecdotal stories or hypothetical filler. I tell you what you need to know, why you need to know it and how I use it. I also include plenty of examples of what I am teaching along the way. I find this to be the easiest way to learn my methods.

REALIZE THIS: *If an idea in this course can make you an extra \$100 on your next trade, this course will have paid for itself! With that in mind, prepare your brain to soak up everything like a sponge.*

Here's to your success in the markets!

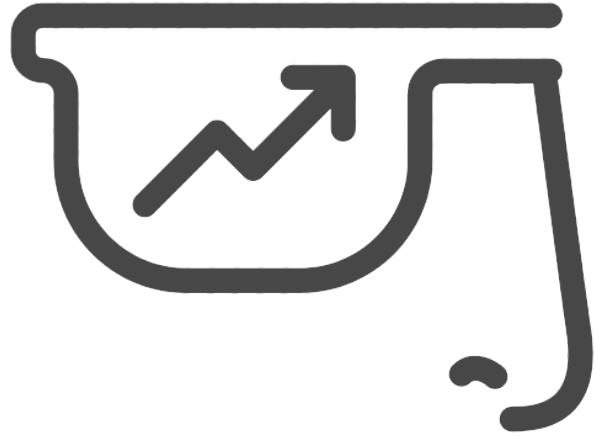


Kevin Brown,
Author/Trader
www.SwingTraderGuide.com

Who Should Read This Trading Guide?

The Definitive Guide to Swing Trading Stocks was written for anyone who wants to learn easy and time-tested stock trading methods that are successful in **all stock sectors, all time frames, and all economies**.

Regardless of your motivation, at some point in time you need someone to teach you the ropes of stock trading, whether it is by seminar, videos, or a written guide such as this one. There are lots of ways to make money in the stock markets, but my experience has taught me that the *simplest* methods work best.



The methods I use are driven by two easy to follow principles:

Principle # 1: ONLY trade by the rules
(You will read more about them in the next section)

Principle # 2: Keep the trading SIMPLE

In general, I always try to keep things simple. Making stock trading more complicated than it really needs to be is the tendency for many “intellectual” traders, who eventually burn out. After all, it can’t be as simple as just picking up the phone or logging on to a website, placing an order, and making money—can it? No, it’s not quite that simple. But you certainly don’t need to stare at a screen all day, spend thousands of dollars for trading software, set up multiple computer monitors, purchase real-time data feeds, and subscribe to several advisory services.

Throughout this guide, I will provide you with a double look at things. First, I will show you what are conventionally considered to be “best practices,” so that you’ll be aware of them, Then I will give you my take on the same thing and why I have taken that position. I think this is a more balanced approach, and it’s fairer to you as a reader.

The Ground Rules

If you're like me, you may have been "taken" a time or two by overzealous or unscrupulous vendors offering stock trading information that may have seemed a bit too good to be true—but you just had to find out for yourself.

That need to "find out" was driven by some internal beliefs. Some of those are good; some are not. Over the years, I have come to understand a few things about the markets, and I'd like to debunk a few of the most prevalent beliefs that are unfounded.

My hope is that I can pull you alongside me, and we both can look out of the same window. To do this, you will need to relinquish (or at least adjust) some beliefs you may have regarding trading and the stock markets.

This trading guide contains many trading methods and their related "rules." Below are the basic ground rules that you must use to guide all your decisions as a trader, regardless of whether you use my trading methods or not.

Rule #1: NO "secret" methods will work

**TOP
SECRET**

So many trader educational offers out there supposedly reveal "little-known" or "secret" formulas for finding profitable stock trades. But here's the most important secret you need to know: *NO* trading method that is truly secret or little known will work. You must understand that the very first requirement for making a profit is to make trades (long or short) involving stocks that everyone else is trading.

Now think about this: If a method is secret, then very few traders are using it. But it takes more than a few traders to move a stock price. The preponderance of buyers or sellers is what causes a stock to rally or decline in the first place.

**KNOW THE
RULES!**



Thus, many traders are suckered into thinking that there is some new method, system, technique, or indicator that no one else knows about, that will give them the winning edge. You don't want to be a lone wolf with a winning edge in trading; you want to be part of the pack that's *on the right side of the price moves*.

It is, always has been, and always will be, that plain and simple.

Rule #2: Price is the **ONLY** reality

I mostly use price charts for determining when to enter and exit trades. This is otherwise known as "technical analysis". Price charts are more than just current and historical references for a stock's price; they are also visual representations of the opinions of all active participants for that stock.

This is an important concept to grasp. If something important (positive or negative) is going on in a company, someone knows about it. If they know about it, they are going to act on it, and if they act on it—that is, place trading orders for that company's stock—it will be reflected in price.



"We know stocks will go up but we don't know which ones or when."

Since price is the indicator everyone uses to keep score in the market, this is what I mostly pay attention to when it comes to money management, entries, and exits. I allow the price-sensitive rules of my methods to dictate all actions.

I'm still waiting for someone to disprove this fact. Nobody has yet been able to show me that orders being placed for a stock DO NOT affect its price. Understand that this is not a single instance; it is a cumulative effect. But it is always present.

Now, as it pertains to price movement, did you know that there are only four market-price occurrences possible? Although a plethora of technical indicators have been isolated to measure these few possibilities, the only possible states of a stock's price are **trend continuations, trend corrections, consolidations, and breakouts**. That's it!

Now, all technical indicators/methods attempt to measure or capitalize on one of these four stock-price states. If you assume the possibility of at least 10 different indicators/methods to measure each one of the price states, you would have a minimum of 40 different measurements, with more than **3,628,800 possible combinations!**

3.6 Million possible combinations are a vast number!

Now you know why so many trading books, courses, videos, and websites are out there offering to teach you esoteric trading methods and secret information. They are merely measuring the same handful of things in millions of possible ways and calling it **NEW** and **REVOLUTIONARY!** This is also how some traders fool themselves. They create their own indicators or find a consistent price pattern, and believe they have found something that nobody else knows about. But in fact, they're measuring the same price occurrence that others are measuring, only in a different way.

Rule #3: A high percentage of winning trades is NOT the answer

This is truly the hardest lesson to teach ANY trader. It certainly was the toughest one I personally had to learn.

So many trading gurus out there are pitching their amazing winning streaks. Who wouldn't be mesmerized by a track record with "90% winning trades" or "more than 150 winning trades in a row"? What they don't tell you is that the winning trade's profits are so small that the few but much larger losing trades and commissions tend to completely swallow the profits.

I 
**WINNING
TRADES**

In addition, there are many times when the more detailed statistics seem to be curiously absent. As a trader, you must learn to concentrate on what is important: the "size" of your average loser versus your average winner.

Here's an example to illustrate. I put ten bills on a table. Each is just a \$1 bill. When we hear "go," we both try to grab as many bills as possible and the person with the highest dollar amount wins. Of course, in this scenario the **ONLY** way you can beat me is to grab more bills.

Now, suppose I lay out ten bills again, but this time three of them are \$20 bills. Ahhh... now you've got it! You can still win, even if you grab fewer bills. That is the essence of making money in stock trading.

What if you could duplicate this over and over? Most trading-course offers are touted as set-it-and-forget-it trading “systems.” A trading system is a mechanical way of trading stocks, a hard and fast set of rules that must be followed each and every time. No opinions or subjectivity are involved. Though I am not this rigid in my own methods, I do believe trading systems can be good for some traders. This trading guide includes a section to help you evaluate and construct trading systems. It also will show you how to calculate a positive, mathematical expectation for profit, using trading statistics.



Rule #4: Risk is ALWAYS present

You must understand the fundamental fact that risk, as it pertains to trading or to anything else, can *never* be eliminated; the best you can do is **manage** it. Even so-called risk-free investments, such as savings accounts, run a risk—that the cost of living will grow faster than the account balance. Good stock-trading strategies should always address the management of risk.

There are only five ways to manage risk. Risk can be:

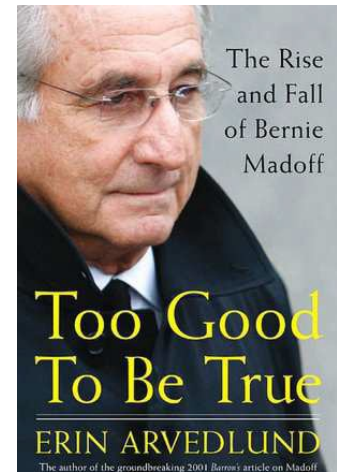
- **Avoided** – A trader avoids risk by not entering the market at inopportune times.
- **Transferred** – A trader transfers the risk to others by exiting positions.
- **Reduced** – A trader uses stop-loss orders to reduce risk.
- **Distributed** – A trader distributes risk by trading a number of individual issues, rather than just one.
- **Assumed** – A trader assumes risk by entering a position or by not entering a position. In the second scenario, the trader assumes the risk of lost profit opportunity.

Rule #5: Trading is not an Ego Play

This last rule will be something that almost any trader can relate to. We all love to make a prediction about a stock move and watch it come true. We typically boast about these trades with all of our friends and family and can't wait to "call" another market move. (The losing trades curiously have lackluster airtime)

Though this act of predicting strokes the ego it has absolutely nothing to do with the business of trading. Read the statement

Trading is a business decision, predicting is an ego play.



below slowly and even several times to let it sink in.

What does that mean exactly? It means that you should enter trades only if there is a sound business reason to do so. Those reasons are discussed at length in this course. However, you should never trade or hold on to a position because you want the market to prove your prediction right. As a matter of fact, you shouldn't have an opinion or prediction for any trade but rather have a plan for whatever the markets happen to do. In my experience this is the only way to become a profitable trader in the long-term.

What Is Swing Trading?

There are three primary styles for trading stocks. Below I compare swing trading to other trading styles.

Day trading (Ultra short term)

Day traders buy and sell stocks in the hope that the price of the stocks will fluctuate in value during a single the day, allowing them to earn quick profits. A day trader will hold a stock anywhere from a few seconds to a few hours, but will always sell all of those stocks before the close of each day.

The day trader will therefore not own any positions at the close of the day, and there is overnight risk. The objective of day trading is to quickly get in and out of any particular stock for a profit as small as a few cents to as much as several points per share.

Day trading can be further divided into several sub-styles, including:

- **Scalping:** This style of day trading involves the repeated buying and selling of a large volume of stocks within seconds or minutes. The objective is to earn a small per-share profit on each transaction, while minimizing the risk.
- **Momentum trading:** This style of day trading involves identifying and trading stocks that are in a moving pattern throughout the day, to buy such stocks at bottom prices and sell at top price.

Swing trading (Short-term)

The principal difference between day trading and swing trading is that swing traders will normally have a slightly longer time frame for holding a position in a stock. As is the case with day traders, swing traders also attempt to predict the short-term fluctuation in a stock's price.

However, swing traders are willing to hold stocks for more than one day, if necessary, to give the stock price some time to move or to capture additional momentum in the stock's price. Swing traders will generally hold on to their stock positions anywhere from one to 15 days.



Swing trading has the potential to provide higher returns than day trading offers. However, unlike day traders, who liquidate their positions at the end of each day, swing traders also assume overnight risk.

The risks involved in carrying positions overnight can be significant. For example, news events and earnings warnings announced after the closing bell can result in large, unexpected—and possibly adverse—changes in a stock's price.

Position trading (Long-term)

Position trading is like swing trading, but with a longer timeframe. Position traders hold stocks for a time period lasting anywhere from one day to several weeks or months. These traders seek to identify stocks for which the technical trends suggest a possible large movement in price is likely to occur, but which may not be fully played out for several weeks or months.

The Basics of Trading

NOTE: Traders experienced with terminology, price charts, and order entry can skip this section. I summarize at the end of this section the order types I use, if you would like to review.

Trading Jargon

A great deal of esoteric lingo has arisen from the trading of stocks. To ease the way for those who are unfamiliar with the terminology (and for those who are just a little rusty), here are a few of the terms that you'll encounter most frequently.



Ask: Also known as the "offer", the price that the seller is willing to accept for a stock. A buy order placed at the market will usually be filled at the current asking price. The ask price is usually greater than the bid price.

Bear, bearish: A person who believes that prices will decline. Bear markets occur when roughly 80% of all stocks decline for an extended period of time.

Bull, bullish: A person who believes prices will advance. Bull markets occur when roughly 80% of all stocks advance over an extended period of time.

Bid: The price that the buyer is willing to pay for a stock. A sell order placed at the market will usually be filled at the current bid price. The bid price is usually less than the ask price.

Breakout: Price of a stock emerging from a previous trading pattern. If you were to draw lines to enclose all other prices for a stock during a given period, the new price "breaks out" above the high—or below the low—pattern lines. Breakouts are used by technical analysts to predict significant upside or downside movement.

Gap: Gaps form when opening price movements create a blank spot on the chart. This occurs when the high of the day is below the low of the previous day or when the low of the day is above the high of the previous day. Gaps are especially significant when they are accompanied by an increase in volume.

Liquidity: The ease with which a stock may be bought or sold in volume without causing a radical fluctuation in its price. A highly liquid stock is characterized by a large volume of trading and a large pool of interested buyers and sellers.

Long position: Buying a stock with the expectation that it will increase in value.

Setup: The price condition predetermined as the potential point of entry into a specific stock. Once the setup entry price is triggered, the trader will enter a position determined by the setup. This could mean shorting the stock because the price is expected to drop or going long because the price is expected to move up. The setup price can be determined on the basis of technical or fundamental factors.

Short position or short selling: The sale of a borrowed stock with the expectation that its value will fall. A trader who borrows shares of stock from a broker and sells them on the open market (thus using margin to finance the borrowing) is said to have a short position in the stock. The trader must eventually return the borrowed stock by buying it back from the open market; if the stock falls in price, the trader buys it back at a profit. For example, you borrow a stock that's selling for \$10 and sell it for that price. Over time, the price of the stock falls to \$5, and you buy it back. You've just made \$5.

However, if the price of the stock advances too far, the short seller will receive a margin call and be required to put up more money. When the price advances so fast that short sellers are forced to cover their positions, and buy the stock back, it tends to drive prices even higher; this is called a short squeeze.

Spread: The difference between the bid and the asking price. Generally speaking, more liquid stocks (those with high volume) usually have smaller bid/ask spreads. Less-liquid stocks (those of low volume) usually have larger spreads.

Volume: The number of shares traded (of a single stock or in an entire market) during a given period of time. Any fluctuation in price, up or down, is more significant when it involves a greater number of shares—that is, it represents a higher volume of trades.

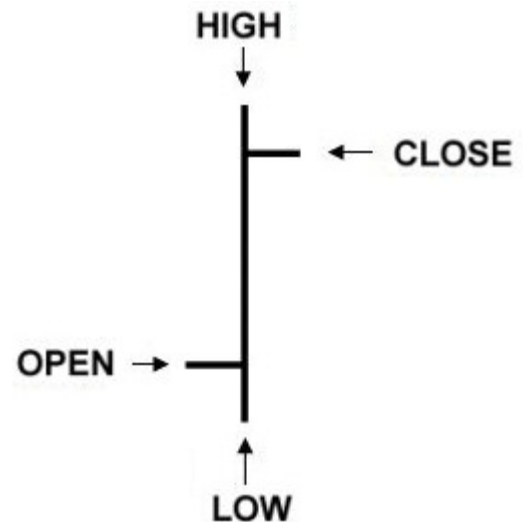
Stock-Price Charts

There are two primary ways to construct price charts:

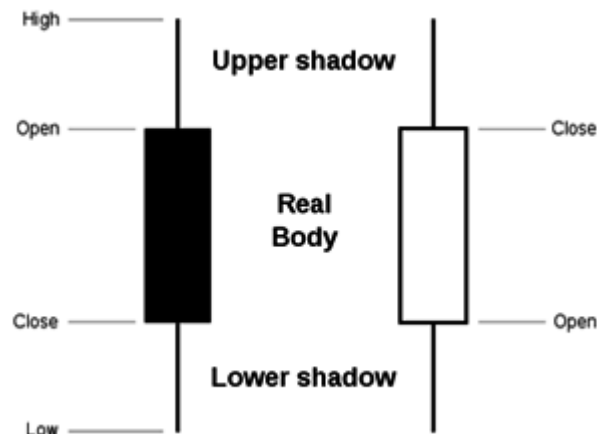
- Bar charts
- Candlestick charts

Bar charts are common in western traders; candlestick charts (also known as Japanese candlesticks) were originally more common with eastern traders but recently have gained extreme popularity with western traders as well.

On a **bar chart**, the top of the vertical line indicates the highest price a security traded at during the day, and the bottom represents the lowest price. The closing price is displayed as a horizontal line on the right side of the bar, and the opening price is shown as a horizontal line on the left side of the bar. A single bar like the one below represents one trading period. A trading period can be defined by any length of time—5 minutes, 1 hour, 1 day, 1 week, 1 month and so on.



When first looking at a **candlestick chart**, the student of the more common bar charts may be confused; just like a bar chart, the daily candlestick bar displays the market's opening, high, low, and closing prices for a specific day. But it takes on a whole new look with the addition of a wide center part, which is called the "real body." This real body represents the range between the open and close of that day's trading.



When the real body is filled in, or solid black, it means the closing price was lower than the opening price. If the real body is empty, it means the opposite: the close was higher than the open.

Just above and below the real body are the opening and closing points and the highest and lowest prices for the day. Chartists have always thought of these as the "wicks" of the candle, and it is the tip of the wick that shows the high or low price of that day's trading. If the upper wick on a filled-in body is short, it

indicates that the opening price was closer to the high of the day than the closing price was. A short upper wick on a white (or unfilled) body shows that the close was nearer to the high point. The relationship between the day's open, high, low, and close determine the look of the daily candlestick. Real bodies can be long or short and black or white. Wicks also can be either long or short.

Comparing Candlestick Charts to Bar Charts

A big difference between the bar charts common in North America and the Japanese candlestick line is the relationship they illustrate between opening and closing prices. Bar-

chart analysis places more emphasis on the fluctuation of today's closing price from yesterday's close. In Japan, chartists are more interested in the relationship between the closing price and the opening price on the same trading day.

Japanese candlesticks offer an entire methodology for analyzing price patterns. However, I don't use these analysis methods. Because the chart types represent exactly the same price action, there is no strategic advantage to either one; but I do find that candlestick charts are much easier to read at a glance than bar charts. I can just look at a price chart and, if I see more black than white, I know there is downward pressure on the price of the stock. I use candlestick charts for all of the chart examples in this guide.

Order Entry: Best Practices

With the growing importance of digital technology and the Internet, many investors are opting to buy and sell stocks for themselves, rather than pay large commissions to advisors for research and advice. However, before you can start buying and selling stocks, you must know the different types of orders and when they are appropriate. The three basic types of orders that every investor should be aware of are the market order, the limit order, and the stop order.

Market Orders

A market order is an order to buy or sell immediately at the best available price. These orders do not guarantee a price, but they do guarantee the order's immediate execution.

Typically, when you buy a stock, you pay an amount near the posted asking price. When you sell a stock, you receive a price near the posted bid. One important thing to remember, however, is that the most recently traded price is not necessarily the price at which the market order will be executed.

In fast-moving and volatile markets, the price at which you actually execute (or fill) the trade can deviate from the last trade price. The price will remain the same only when the bid and ask prices exactly match the price of the last trade.

Market orders are popular with investors who want to buy or sell a stock without delay. Although the investor doesn't know the exact price at which the stock will be bought or sold, market orders for stocks that trade more than tens of thousands of shares per day will likely be executed at a price that is close to the bid and ask prices.

Limit Orders

A limit order sets the maximum or minimum price at which you are willing to buy or sell. For example, if you wanted to buy a stock at \$10, you could enter a limit order for this amount. This means that you would not pay a penny over \$10 for that particular stock. You would still be able, however, to buy it for less than \$10.

Stop Orders

Also referred to as a stop loss, stopped market, on-stop buy, or on-stop sell, this is one of the most useful orders. This order is different because—unlike the limit order and market order, which are active as soon as they are entered—this order remains dormant until a certain price is passed, at which time it is activated as a market order.

For instance, if a stop-loss sell order were placed on the shares of XYZ Corporation at \$45 per share, the order would be inactive until the price reached \$45 or lower. The order would then be transformed into a market order, and the shares would be sold at the best available price.

You should consider using this type of order if you don't have time to watch the market continually, but you need protection from a large downside move. A good time to use a stop order is before you leave on vacation.

One Caveat (Warning!)

When deciding between a market order, limit order, or stop order for entry, traders should be aware of the related costs and risk. Typically, the commissions are cheaper for market orders than for limit orders. The difference in commission can be anywhere from a couple of dollars to more than \$10.

For example, a \$10 commission on a market order can be boosted to \$15 when you place a limit restriction on it. When you place a limit order, make sure it's worthwhile.

Let's say your brokerage charges \$10 for a market order and \$15 for a limit order. Stock XYZ is presently trading at \$50 per share, and you want to buy it at \$49.90.

By placing a market order to buy 10 shares, you will pay \$500 (10 shares x \$50 per share) + \$10 commission, a total of \$510. But if you place a limit order for 10 shares at \$49.90, you will pay \$499 + \$15 commission, for a total of \$514.

Even though you save a little from buying the stock at a lower price (10 shares x \$0.10 = \$1), you will lose it in the added cost for the order (\$5), a difference of \$4. Furthermore, in the case of the limit order, it is possible that the stock won't fall to \$49.90. If it continues to rise, instead, you may lose the opportunity to buy.

Other Order Types

Now that we've explained the three main types of order, here's a list of extra restrictions and special instructions that many different brokerages allow on their orders.

All-or-None (AON) Orders

An all-or-none order ensures that you get either the entire quantity of stock you requested or none at all. Getting this type of order executed can be problematic if the stock is very illiquid or if a limit is placed on the order.

For example, if you put in an order to buy 2,000 shares of XYZ but only 1,000 are being sold, an all-or-none restriction means your order will not be filled until there are at least 2,000 shares available at the price you specify. If you don't place an all-or-none restriction, your 2,000-share order would be partially filled for 1,000 shares.

Good-till-Cancelled (GTC) Orders

This is a time restriction that you can place on different orders. A good-till- cancelled order will remain active until you decide to cancel it. Brokerages typically will limit the time you can keep an order open (active) to 90 days.

Day Orders

If, through the GTC instruction, you don't specify a time of expiry, then the order will usually be set as a day order. This means that the order will expire at the end of the trading day. If it isn't transacted (filled) by then, you will have to re-enter it the following trading day.

How I use it: I use the following types of orders for my trading.

1. **Entry orders:** I use stop-limit orders to enter positions. This prevents me from getting filled on huge price-gap openings. These are usually day-only orders.

Example: Buy 100 shares of DELL @ \$33.00 stop \$33.02 limit. This means to get my order filled, price must hit at least \$33.00 but now higher than \$33.02.

2. **Stop-loss orders:** I use a regular stop order to limit my losses. These are usually GTC, to ensure that I am never unprotected.

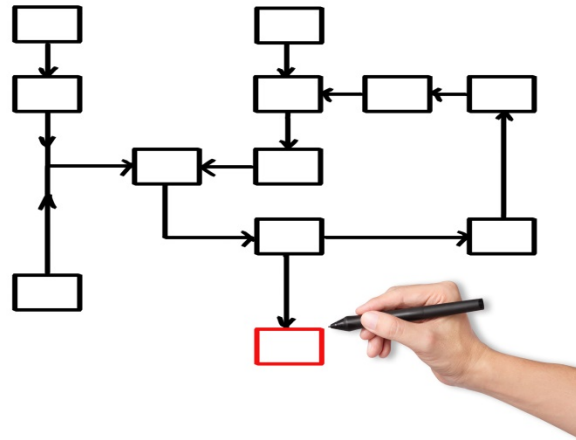
Example: Sell 100 shares of DELL @ \$32.00 stop. This means that if prices move against my Long position down to \$32.00 my position will be exited.

3. **Profit objectives:** I use limit orders for my profit objectives. These are usually GTC orders, as well.

Example: Sell 100 shares of DELL @ \$35.00 limit. This means that if my long position goes up to \$35.00 I will be existed at that price.

An Overview of Trading Systems

Systems provide a way of making objective and mechanical decisions for implementing a trading method. Typically, a computer is used to program the rules and generate entry and exit signals automatically. Though I use my methods in a systematic manner, I do not act mechanically on the signals that have been generated this way. I use them as a guide, I personally evaluate them, and then I act on them subjectively. This is my preference but you can choose to be completely mechanical.



Systems provide a way of making objective and mechanical decisions for implementing a trading method. Typically, a computer is used to program the rules and generate entry and exit signals automatically. Though I use my methods in a systematic manner, I do not act mechanically on the signals that have been generated this way. I use them as a guide, I personally evaluate them, and then I act on them subjectively. This is my preference but you can

I have included this section for those traders that either believe in, or like to implement, mechanical trading systems. It is important to note that the decision to trade a method mechanically is not a question of being right or wrong; it's a personal preference. I would imagine that, if I were managing other people's money, or if my portfolio comprised hundreds of millions of dollars, I would be more apt to use a mechanical system.

Trading System Components

This section will focus on the best practices for trading stocks with a system, whether it is your own system or a purchased one.

First of all, let me define the term system and its importance in trading. A system is an organized set of interrelated ideas or principles. Systems exhibit repetitive patterns and produce predictable outcomes. Examples of natural systems include our solar system, global weather systems, and your body's circulatory system. Man-made examples include play-calling systems for football and franchise systems for business. All have a blueprint for producing expected outcomes.

The exact same principles apply to a stock-trading system. By following the proven steps each and every time, you have a reasonable expectation of results over time.

A trading system provides many advantages:

- Faster analysis of stocks
- Objective decision making
- Reasonable expectation of reproducing results

A high-quality stock-trading system should fulfill several key functions:

- Generate profits in both up and down markets.
- Trade a multitude of market sectors.
- Minimize the risk of losing capital.
- Demonstrate, based on the system's performance statistics, a positive mathematical expectation for profit.

A basic trading system should include rules for:

- Entering a position
- Taking a loss
- Protecting existing profits
- Taking a profit

An advanced trading system could also include rules to determine:

- When to increase or reduce the number of shares for a position
- When to reverse a position
- When to exit (based on the length of time allowed to achieve a profit target)
- When to stop trading (based on total losses)

How I use it: I execute a trading position only when I have defined all of the basic rules and, if applicable, the advanced system components identified above.

Trading Statistics

Many unsuspecting traders are fooled by a trading system's statistics, or they pursue unrealistic statistics themselves. A trading system's statistics should produce a positive mathematical expectation for making a profit. This can be defined as:

Avg. Dollar Amount of Win Trades X Percentage of Winners

is MORE THAN the

Avg. Dollar Amount of Loss Trades X Percentage of Losers

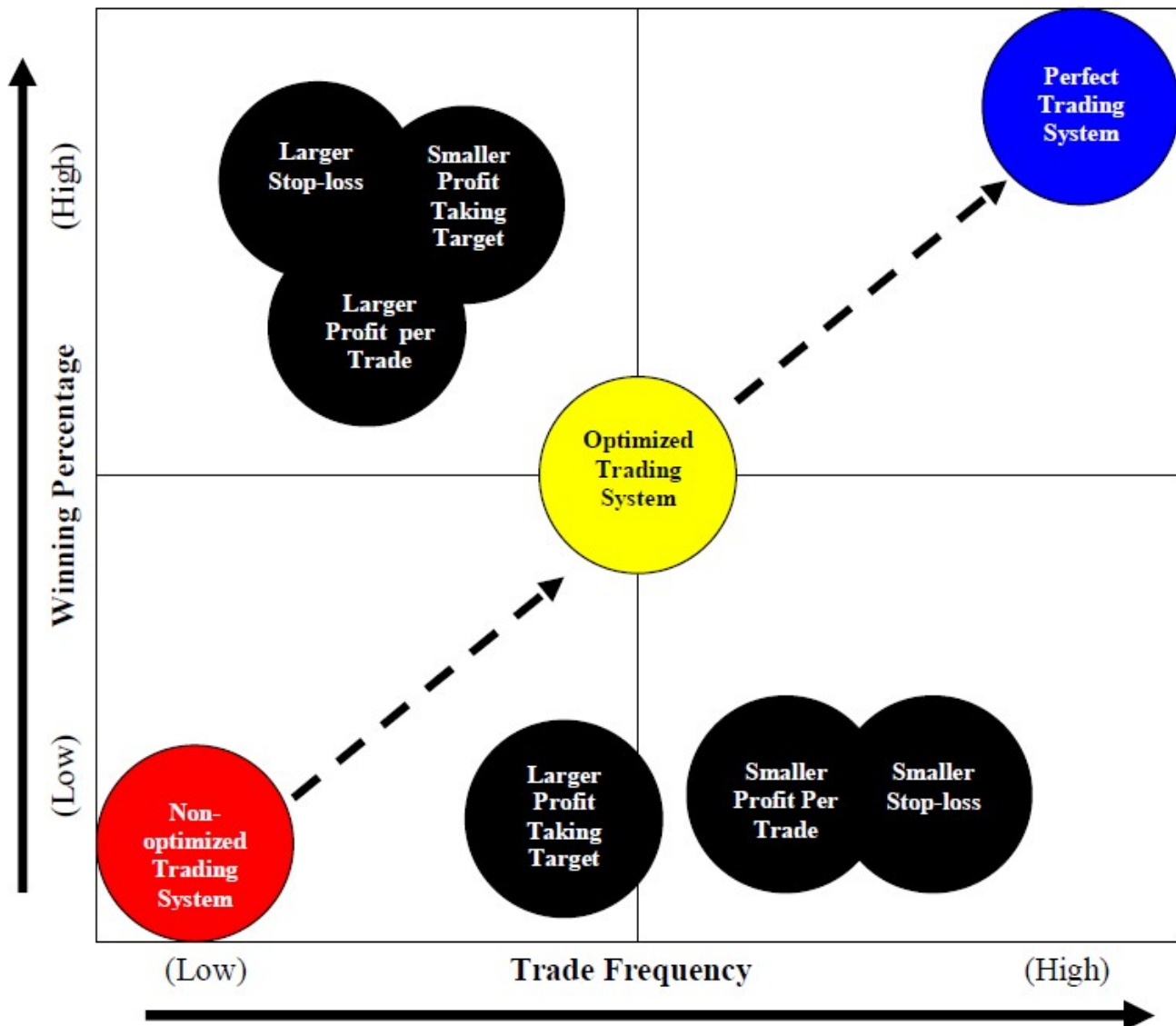
There is always some trade-off when it comes to system performance. For example, if a system has a very high win percentage (70%- 90%), then you can bet that the system either trades very infrequently or makes a very small profit per winning trade.

Ideally, you want a trading system that demonstrates an average ratio of wins to losses (40%-55%) and an average win of at least twice the amount of the average loss.

In addition, you want a system that trades both long and short, to maximize the potential for profit in all market conditions. The win/loss and average- win/average-loss ratios should be similar for both long and short trades.

Take a look at the Trading System Quadrant™ on the next page. Study it very carefully. Keep it handy when you evaluate your own trading strategy or the strategies of others. Its principal is both practical and flawless; all trading systems evolve along the four quadrants.

Trading System Quadrant™



Monitoring Fear and Greed

Fear and greed are, by far, the worst enemies of every trader. They're virtually inescapable, because they are the primary human emotions involved in trading. By following a trading system judiciously, traders attempt to circumvent these emotions and make the correct decisions when appropriate.

If you don't mechanically follow a trading system, you must be aware of how these emotions can (and will) affect your decision-making process. The tables below list factors that can trigger fear and greed and describe the consequences you can expect when they are not held in check.

Factors That Trigger GREED	Emotional Consequences of GREED
<ul style="list-style-type: none"> • Positive pattern of returns • Large potential payoff • High probability of payoff • Possibility of quick payoff • Liking a company or its products • Desire to offset an earlier loss • Disregard for risk of trading • Extra money for trading 	<ul style="list-style-type: none"> • Overconfidence in knowledge and skills • Reckless disregard for information about a trade's risk • Compulsive trading • Failure to plan • Chasing performance • Excessive disappointment when things go wrong

Factors That Trigger FEAR	Emotional Consequences of FEAR
<ul style="list-style-type: none"> • Losing trade or trades • Repeated media exposure for the company that is contrary to your trade position • Anticipating a losing trade • Desire to avoid loss instead of following trading rules 	<ul style="list-style-type: none"> • Compulsive liquidation of trades • Loss of confidence in your own judgment • Fixation on company news • Avoidance of trading altogether

Match the System to Your Needs

You should ensure that the trading system you choose can accommodate your personality and goals. Here are some questions you need to answer.

Do you want to trade full time or part time?

The answer to this question will help you determine how much time and capital to commit. You probably will not be able to meet your goals if your living expenses are \$5,000 a month and you have only \$10,000 in the bank.

Can you monitor the trades in real time?

If you answer no to this question, you can pretty much exclude any type of day-trading system.

What is your tolerance for risk?

If it's high, you can afford to incorporate margins, options, or even futures in your trading system.

Some Common Trading Methods



Stock markets and the desire to profit from trading them have been around—and evolving—for centuries. The latest activity of the stock market is reported as a matter of routine in the daily news. The size of the world stock market is estimated in tens of trillions of dollars. Can you think of any other human activity (other than basic biological necessities, of course) that plays a more

pervasive role in your life? Virtually every human endeavor is, in some way, affected by the movements of the market.

As the Internet has grown increasingly accessible, opportunities to invest and trade in the stock market have become available to virtually anybody with a computer or a mobile phone. So, too, has the opportunity to claim expertise and to sell the next sure-fire, guaranteed, whiz-bang, knock-your-socks-off (see disclaimer) get-rich method. When tens of trillions of dollars are in play, would you expect anything less?

But as dozens of newcomers each claim to have discovered the newest most- reliable method or for cleaning up in the market, you have to wonder what took them so long. The market is, as we noted before, several hundreds of years old. People have been studying it—and hoping to profit from it—for a very long time.

Indeed, a number of methods have been in use for a long time. They're well known and well-studied, and you should be aware of them and decide whether you should—or shouldn't—pay attention to them.

WD Gann

William Delbert Gann (1878 – 1955) was a market trader who based his forecasting methods on geometry, astrology, and ancient mathematics. He developed a technical-analysis tool, known as Gann angles that he explained in *The Basis of My Forecasting Method*, published in 1935.

Gann angles predict price movements by charting the geometric relation-ship between time and price. Ideally, the movement of these two values will match: one unit of price for one unit of time. This can be represented by a 45- degree angle, or what Gann called the 1x1 angle, and it's the most important of the nine that he identified. If you divide a square from corner to corner, you have Gann's 1x1 angles; the line represents the movement of one point per day.

My Viewpoint: This is a very esoteric, almost mystical approach to trading. Most people (including myself) find themselves lost in the geometry and, for that alone, it violates one of my basic principles of trading which is keep it simple.

Fibonacci

Leonardo Pisano (circa 1170–1250), an Italian mathematician, has been called the most talented mathematician of his time. His book *Liber Abaci* (Book of Calculation), published in 1202, and effectively introduced the Arabic numeral system to the West. It also described a number sequence in which each number is the sum of the two previous numbers: $0+1=1$, $1+1=2$, $1+2=3$, and so on, producing the sequence 0, 1, 1, 2, 3, 5, 8, 13, 21, 34, 55, 89, 144, to infinity. This sequence of numbers is also known as “The Golden Ratio”. This sequence eventually became known as Fibonacci numbers, after Leonardo, son of Bonaccio (“Fibonacci”).

Some traders use ratios created using the Fibonacci sequence to establish support and resistance levels for market waves, projecting price corrections or “retracement” levels. The idea is that prices retrace (reverse) an original move, as far as the point where they encounter support or resistance at a key Fibonacci level, and then they resume their original direction. The key levels are determined by drawing a trend line between two extremes and dividing the vertical distance by the Fibonacci ratios: 23.6%, 38.2%, 50%, 61.8%, and 100%.

My Viewpoint: I fully believe that the markets are built on replicating patterns such as Fibonacci’s golden ratio. However, working with Fibonacci sequences is a labor-intensive and time-consuming process that requires a multitude of measurements; on that basis alone, it violates my simplicity principle. Even though you can find software packages that support it, the method fails so frequently that it’s not worth the time required to use it as a primary indicator.

Elliott Waves

Ralph Nelson Elliott (1871–1948) was an accountant who proposed that market prices unfold in specific, repetitive patterns. Elliott believed that trends in any collective human activity can be predicted because humans are rhythmical, and the pattern of their behavior is rhythmic, recurring in waves that seem to correlate with Fibonacci numbers. These recurring patterns are called Elliott waves.

Basically, the Elliott wave principle quantifies investor behavior, identifies patterns in that behavior, and anticipates the market’s most likely next move from a given point in the pattern.

My Viewpoint: As with Fibonacci, working with Elliott waves is both labor intensive and time consuming; and it's a manual process, since the ability to plot Elliott waves usually is not included in software packages. It's also highly subjective; practically everyone that uses the method seems to interpret and use it in a different way. Beware of any indicator that is so susceptible to personal interpretation.

Chart Patterns

Remember that the first requirement for making a profit is to trade stocks that *everyone else is trading*. The pressure of many buyers or sellers is what causes a stock to rally or decline in the first place.

Many traders and investors spend a great deal of time charting data and studying patterns, trying to get a complete picture of all market trading. The idea is that, by analyzing past trading behavior, they will be able to predict what the market will do in the future.

When data is represented graphically, on a chart, patterns emerge that may repeat or indicate trends in performance. Classic chart patterns typically represent a time frame longer than 12 days, and they appear in a handful of basic shapes:

- symmetrical triangles
- ascending and descending triangles
- wedges
- flags and pennants
- rectangles
- head and shoulders

However, there are dozens of named patterns, categorized by the reversal trend they represent—bullish or bearish. This should give you an idea of the vast array of designs in the technical analyst's repository:

Bullish: Ascending Continuation Triangle, Bottom Triangle, Continuation Diamond, Continuation Wedge, Cup with Handle Diamond Bottom, Double Bottom, Flag, Head and Shoulders Bottom, Megaphone Bottom, Pennant, Rounded Bottom, Symmetrical Continuation Triangle, Triple Bottom, Upside Breakout...

Bearish: Continuation Diamond, Continuation Wedge, Descending Continuation Triangle, Diamond Top, Double Top, Downside Breakout, Flag, Head and Shoulders Top, Megaphone Top, Pennant, Rounded Top, Symmetrical Continuation Triangle, Top Triangle, Triple Top...

Of course, candlestick charts, moving-average charts, oscillators...all create patterns. You can find Double Moving-Average Crossovers, Price- Crosses Moving Averages, Triple Moving-Average Crossovers; Bollinger Bands; Commodity Channel Indices; fast stochastic chart patterns, slow stochastic chart patterns; short-term, intermediate-term, and long-term chart

patterns; Moving-Average Convergence/Divergence (MACD) patterns; momentum patterns; Relative-Strength Indices (RSI); Williams' %R patterns...

My Viewpoint: The point is, you can bury yourself in an ever-deepening landfill of charts, graphs, comparisons, patterns and analyses, and you may never again see the light of day. You may never make a buck in the market, either.

Learn which indicators will give you enough information on which to base quick, sound decisions and learn how to interpret them. That's what this guide will teach you.

Candlestick Patterns

We've already discussed the basics of candlestick charts. Like any other type of chart, candlesticks create dozens of different patterns, both bullish (Engulfing, Hammer, Harami, Piercing) and bearish (Shooting Star, Dark Cloud Cover). Then there's the Doji—possibly the most popular candlestick pattern—that looks like this: +. As you can see, it represents no movement: the stock opens up, goes nowhere, and closes at, or near, the opening price.

My Viewpoint: Candlestick charts are very popular, because they make it so easy to observe the ups and downs at a glance. The aforementioned patterns created by candlestick charts may be slightly less subjective than other methods, however it's still mostly a manual process to analyze. The charts are commonly included in trading software, but it's very difficult to program the identification of candlestick chart patterns.

Overbought/Oversold Indicators

Generally, overbought refers to a stock or an overall market when prices have risen too high, too fast, and are likely to turn down. Oversold is exactly the opposite: prices have fallen to the point that selling has stalled, and investors will probably jump in and push the price up again.

Overbought and undersold indicators describe the momentum of the market, by measuring a moving average of the difference between declining and advancing stocks. If more stocks are decreasing in price (more stocks are declining than are advancing), a value less than zero is generated. If more stocks are increasing in price (more stocks are advancing than are declining) a value greater than zero is generated.

Overbought/oversold indicators work best in sideways markets, not so well in trending markets.

My Viewpoint: The truth is that you can never know if a stock has truly topped or bottomed out so the terms "overbought or oversold" are fallacies. Overbought and oversold indicators have their place in trading but you simply have to understand their strengths and weaknesses as indicators.

Trading Only Long or Short

Every trader has a strategic comfort zone. You may find that you prefer to trade almost exclusively within a certain time frame. Long-term trading requires, above all, patience and perseverance. Short-term trading, on the other hand, requires intense focus and discipline.

Depending on your temperament, you may thrive on action, and you may be seduced by the thrill of the chase. No trade is too short for you; you're after the win-win-win. On the other hand, you may feel most confident taking the long view, carefully positioning yourself in a major move and waiting for it to develop over weeks, months, or even years. You want to wait for the big win.

When you trade short, you're betting the stock price will go down. Every hiccup in the market could be a trading opportunity. So you borrow stock (usually from the broker) to sell, and you use margin to finance the borrowing. But if the price of that stock goes up too much, you'll get a margin call and have to put up more money. When the price advances so fast that short sellers are forced to buy the stock back to cover their positions, it drives the price even higher. More trades equal more transaction costs, as well as more risk.

Long traders are betting that the price of stock will go up, and they're willing to wait for it. Fewer trades over time can result in fewer mistakes; long, gradual trends may offer lower-risk buying or selling opportunities, fewer transaction costs, and potentially bigger—though fewer—wins.

My Viewpoint: Most traders trade long, for one of two reasons. Many simply don't understand short trading. But others believe that trading short is actually unhealthy for the market and for the economy in general; they avoid it on principle. In reality, it's not hard to see that a balance between long and short trades would create the optimum potential for profit in all market conditions.

Trading on News or on Fundamentals

Some traders base their decisions to buy or sell a stock on media reports, world news, and the overall state of the economy. According to this line of thought, social conditions and investor emotions ultimately drive the market. Perhaps the greatest weaknesses of this practice are the inevitable time lag involved in the delivery of such reports and the fact that media sources are almost always biased.

Fundamental analysis also considers qualitative factors, such as a company's management, product, market strategy, competitive advantages, and industry conditions, as well as its financial statements, to determine a stock's "intrinsic" or "true" value and predict its future performance. The idea is that, if the market has priced a stock below its intrinsic value, you should buy. If the stock is overpriced, you should sell or go short. If all is equal—just hold on.

My Viewpoint: It's literally impossible to know every variable that affects the value of a stock. Moreover, depending on the news for crucial information will often get you into the market late; those that are closest to the company's action will certainly have acted on it already. Fundamentals do, in the end, drive the market. But it's a crapshoot whether or not you'll find out in time.

Why Technical Analysis?

Technical analysis assumes that the historical performance of stocks and markets generate patterns that can predict the movement of prices in the future. It's essentially the opposite of fundamental analysis; in that it ignores the company, market, or product—or the intrinsic value of the stock—in favor of charts and measurements of the stock's price and volume fluctuations.

Technical analysts believe that prices already represent the effect of all the economic and social influences considered in fundamental analysis, before investors are aware of them. So, the study of price action alone is sufficient to predict movement.

Some traders use technical or fundamental analysis exclusively, while others use both types to make trading decisions.

My Viewpoint: I advocate this method over any other. Remember the old cartoons of the tuxedoed tycoon—cigar clenched between his teeth, stock ticker by his side, piles of ticker tape on the floor, and the tape held before him like the Holy Grail — shouting BUY! SELL!

That ticker tape was telling Mr. Magnate what stock prices were doing, as they did it. He was a technical analyst, without benefit of computer and Internet. Technical analysis is the most objective and immediate way to get information on which to base your trading decisions. If something is happening with price, the market will let you know instantly. Like the old-fashioned ticker tape, the prices on your chart are telling you a story.

Using Multiple Time Frames

You know the story about the blind men and the elephant? You remember: Six blind men encounter an elephant and try to figure out what it is. They all reach out, feel around, and get a really good, hands-on reading of the critter.

"Obviously, it's a tree," said the one that wrapped his arms around one leg.

"No way. It's nothing more than a pile of rope," said the one that was swinging from the elephant's tail.

"Are you guys nuts? Back away slowly, right now! It's a snake!" said the one, shuddering, that had accidentally grabbed the writhing trunk.

"You're either drunk or hallucinating. How do you get all that nonsense from a flag flapping in the breeze?" scoffed the one batting at the long-suffering animal's ear, which was ruffling the hair on top of his head.

"You're almost right," the fifth one said, smiling indulgently and running his hand along the tusk, *"Except that it's laundry. This is nothing but a clothesline pole."*

"You're all blind!" The last of the six leaned against the elephant's broad side and barely kept from laughing. *"You all must have knocked yourselves silly when you walked into this wall!"*

Reading stock charts can be a lot like that, if you try to base your decisions on the performance of an indicator using only one measurement, you simply don't get the whole picture. Worse, many trading indicators and methods have inherent weaknesses that can be amplified by certain market conditions.

You need a strategy to correct for false readings. By observing an indicator within several overlapping time frames for example, you can significantly increase the validity of the signals it gives. So, for example, if you compare the movement of a stock over the past month, the past week, and today, you can see clearly where signals align and which ones are less reliable.



You can use as many measurements or time frames, as you like. Generally, two to five will give you optimal results. The more measurements you use, the greater the accuracy of your signals will be—because fewer signals will align through all time frames. Dr. Alexander Elder is usually credited with popularizing a similar approach he named the “triple-screen” method, first in Futures Magazine in 1986 and later in his book Trading for a Living, published in 1993.

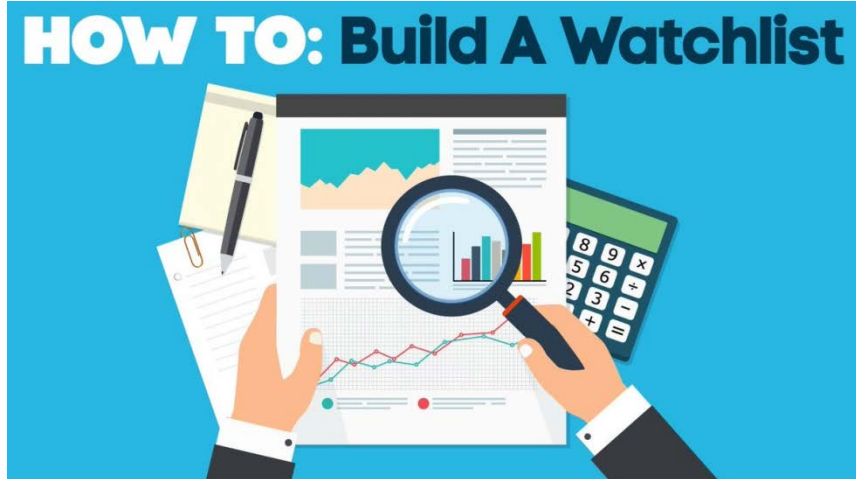
Multiple measurements can be applied to natural systems, as well as to artificial ones like the stock market. For example, you could predict the hottest hour of the year within a reasonable degree of accuracy by aligning charts of temperatures measured during the season (3-month time frame), the month (4-week time frame), and the day. (24-hour time frame).

Or take surfing. Surfers wait for an incoming tide; think of that as an overall uptrend. They catch outgoing wave energy, the backwash, to ride out into the surf, where the outgoing wave collides with a bigger one coming in. The advancing swell breaks over the outgoing wave, creating that beautiful barrel wave you see in all those spectacular photos. If the surfer is good (or lucky), he catches the sweet spot just in front of the wave (the point where the tidal forces converge) and rides it in. Then he starts all over, catching the outgoing wave (like a Fibonacci retracement!) to catch the next big one just before it breaks.

How I use it: In any situation for which you want to evaluate movement based on past behavior, using multiple measurements of the same indicator is the most reliable way to confirm a trend or an entry point. I apply this approach in various ways throughout this course.

How to Choose Stocks for a Watch List

When you're evaluating stocks to swing trade, you need to build a "watch list" of some type. A watch list is just a short-list of stocks that meet some basic criteria for trading, but have not yet reached the trigger point established for entering a trade. Keeping a watch list is important, because it prevents you from



becoming overwhelmed, trying to analyze thousands of stocks at once. Many software programs and online services now offer a watch-list feature.

In the sections that follow, I'll discuss each of the criteria I use for building my watch lists. These include:

- Volume
- Share price
- Float

Trading Volume

Many traders are duped into thinking that you should look for little-known stocks that are undervalued. But think about that: If a stock is not being traded actively, it's for a good reason. The best approach for choosing stocks to trade is one that identifies stocks that lots of other traders are also buying and selling.

Understand one thing, high trading volume for a stock does not necessarily mean that it's of high quality; it only means that people are watching it and transacting heavily in that particular issue. (This applies for both rallying and declining stocks.)

Volume is important because that is what starts and sustains large price moves. Think of trading volume as the catalyst—or "oxygen"—that breathes life into the stock-market fire.

Fuel	+	Oxygen	+	Heat	=	Fire
Stock	+	Trading Volume	+	Fundamentals	=	Price Volatility

The signals derived from trading higher-volume stocks have the benefit of being more accurate, and fills for orders of these stocks are much better because of their increased liquidity.

Of all the factors to consider for an individual stock, volume has, by far, the most influence on movement. In the table below, volume's influence on trend is ranked, along with other criteria, on the basis of my own research and experience.

Notice that the top two criteria are the same, except in the case of a bear market, when lower priced stocks tend to fall faster. The rationale is that, during a market decline, people seek "quality," which is often thought to be represented by higher-priced stocks.

BULLISH MARKET		BEARISH MARKET	
Criteria for best performance	Rank	Criteria for best performance	Rank
High Volatility	1	Low avg. price per share	1
Volume	2	High Volatility	2
Capitalization	3	Volume	3
Percent held by institutions	4	Percent held by institutions	4
High avg. price per share >\$17	5	Capitalization	5
Low avg. price per share <\$17	6	Optionable	6
Dividend Yield	7	P/E Ratio Top 50% of all stocks	7
Optionable	8	High avg. price per share	8
P/E Ratio Top 50% of all stocks	9	Dividend Yield	9
P/E Ratio Bottom 50% of all stocks	10	P/E Ratio Bottom 50% of all stocks	10

How I use it: In order participate in stocks with the potential to move rapidly, I only trade stocks whose volume is ranked in the top 50% of the overall market. Many software programs support screening for this scenario. A free resource is Google stock screen which is pictured below. <http://www.google.com/finance/stockscreeener> (Please review the video included with this course on how to use this tool)

Stock Share Price

There are a lot of ways to leverage your money in the stock market, such as margin accounts, options, pyramiding, and futures contracts. But the best way to do so without increasing risk is to buy lower-priced stocks.

You are always better off if you can own more shares for the same price movement. Think of each share of a stock as a mini franchise. The more franchises you have making money, the better, right? This may seem like an overly simple concept, but you would be surprised by the number of traders that go fishing for higher-priced stocks.

Better yet—depending on your account size—you also free up more funds to trade other positions which diversifies your trades and your risk.

One thing I try to avoid, however, is stocks lower than \$5. Stocks below the \$5 price point are sometimes prohibited by some brokers from being traded short and mutual funds are also prohibited from trading these stocks. You want to be trading where the “big boys” are so you can benefit from the influence of their trading volume so stocks below this price point should be avoided.

How I use it: To maximize leverage, I trade stocks that are more than \$5 per share, but less than \$25.

Identifying Trends Using Price Charts

Now that you know how to create a manageable watch list of stocks, I will show you how to find which stocks are exhibiting trending behavior.

If you've been trading stocks for any length of time, you've heard the saying, *"the trend is your friend."* The trend is the general direction a market is trading. There are only three possible trends:

- Up trends
- Down trends
- Sideways trends (also known as trading ranges)

Stocks that are trending in a certain direction will usually continue in that direction, within a certain degree of predictability and that is what give you the edge.

Think of Newton's first law of motion: *"Every object in a state of uniform motion tends to remain in that state of motion unless an external force is applied to it."*

Because of the certain degree of predictability, stocks that exhibit trending price patterns represent, by far, the **highest probability** for profitable moves in the market.

How can you identify trends? I use several methods, including:

- Pivot-point breakout
- Trend lines
- Moving averages

Identifying Pivot Points Using Price Charts

Price swings are defined by highs and lows on a price chart, such as the one below. Taking advantage of these swings is the essence of swing trading.

Price pivots mark the turning points for each swing, and a pattern identifies the makeup of each price pivot. The pattern, or setup, works like this: For a pivot top, the HIGH POINT of a period must be preceded and followed by two periods with a LOWER HIGH POINT. For a pivot bottom, the LOW POINT of a period must be preceded and followed by two periods with a HIGHER LOW POINT.

Patterns for Top and Bottom Price Pivots

Top Pivots



Bottom Pivots

How I use it: This is important. ALL price trends must start with the breakout of a pivot turning point. I only trade a stock if a pivot in the opposite direction of the trend has not experienced a breakout.

I don't trade specifically on the basis of pivot-point breakouts, since my methods tend to get into trades earlier (more on the entry rules later); but many traders do, and you need to be aware of that.

Examples of Price Pivot-Point Swings on a Stock Chart



IWA (Iowa Telecommunications Services Inc.) NYSE
13-Nov-2009 11:15am
Open 11.86 High 11.96 Low 11.70 Last 11.83 Volume 142.8K Chg +0.00 (+0.00%)



CFFN (Capitol Federal Financial) Nasdaq GS
13-Nov-2009 11:20am
Open 30.43 High 30.43 Low 30.05 Last 30.24 Volume 17.1K Chg -0.03 (-0.10%)



WST (West Pharmaceutical Services) NYSE
13-Nov-2009 11:26am
Open 38.14 High 38.23 Low 37.56 Last 38.15 Volume 19.1K Chg +0.26 (+0.69%)



Trend Lines

Trend lines use the aforementioned pivot points and provide one of the most used tools for analyzing stock prices. Trend lines are a bit more significant because they take into account both price and time by connecting pivot point with a line.

The method for drawing trend lines is quite simple:

- Connect **HIGHER PIVOT BOTTOMS** for *up trends*
- Connect **LOWER PIVOT TOPS** for *down trends*

As you can see from the charts below, the violation of an up-trend line can signal both a continuation for an existing trend as well as a reversal for an existing trend. Note that when a trend line is broken it often changes from a support line to resistance line. My rule of thumb for drawing trend lines is to connect closing prices only (not low prices or high prices) and to wait at least 10 days before connecting trend-line points.

How I use it: I trade LONG only when an up trend line is established and the stock's price is above that line.

I trade SHORT only when a down trend line has been established and the stock price is below that line.

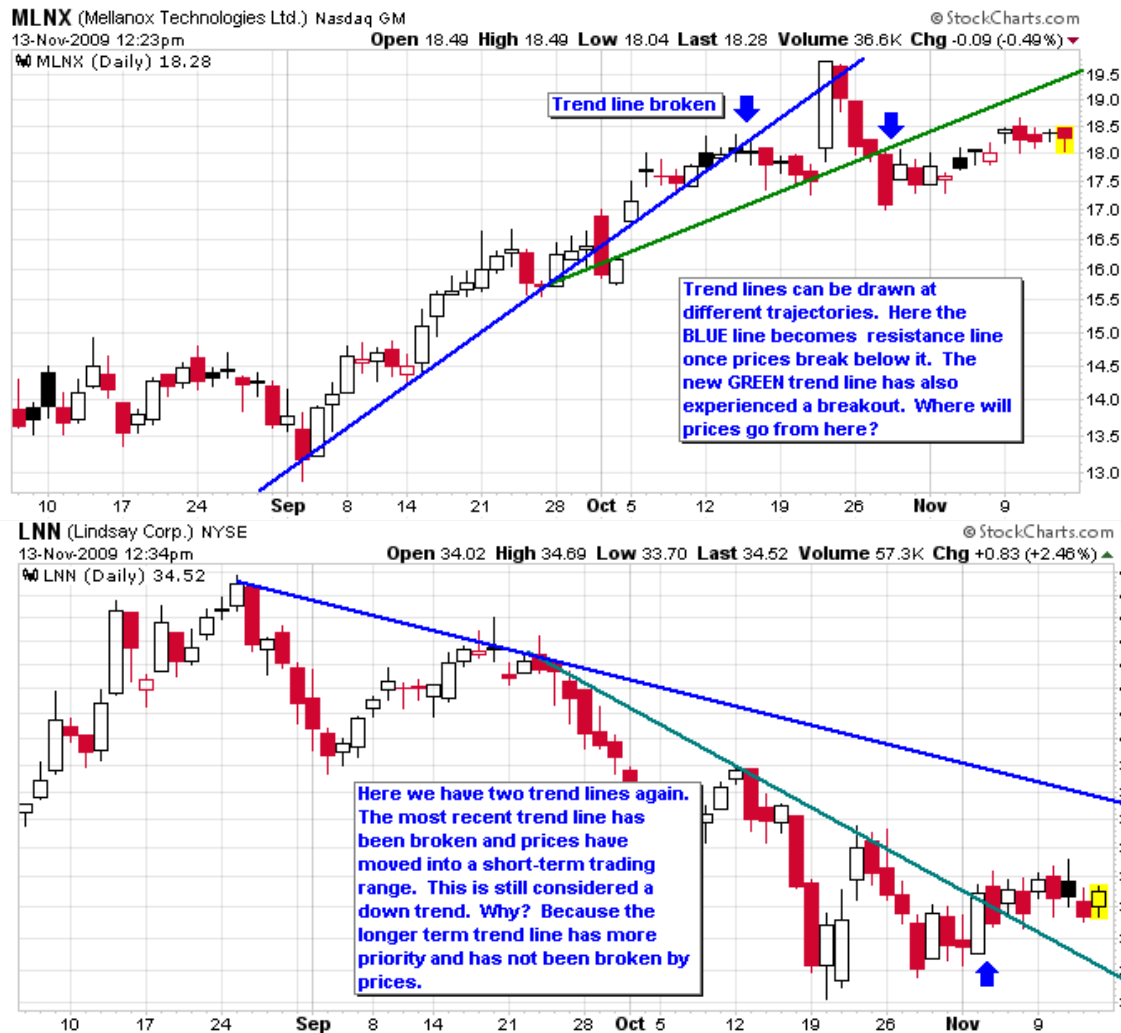
Longer term trend lines take precedence over shorter term trend lines.

Lower sloped trend lines take precedence over trend lines with a steeper slope.

Examples of Trends Lines on a Price Chart







Moving Averages

Moving averages are probably the most popular technical indicator used by traders. The function is available on most stock charting websites and in most software packages.

Averaging stock prices smooths the data series and makes it easier to spot trends. But this method has an inherent weakness: it can “whipsaw” or cause false signals in sideways or trading-range markets.

By using two to three moving averages, however, you can counter the weaknesses of this indicator. Notice, in the chart below, the way prices swing above and below the 10-day moving average. To combat this, you need to use a longer-term moving average. When the short-term moving average is above the longer-term moving average, you have a confirmed upward trend; the reverse is true for a down trend.



The most common simple moving average (SMA) is formed by computing the average (mean) price of a security over a specified number of periods. While it is possible to create moving averages from the opening, high, and low data points, most moving averages are created using the closing price.

For example, a 5-day SMA is calculated by adding the closing prices for the last 5 days and dividing the total by 5.

Example: Closing-price average for a specific 5-day period:

$$10 + 11 + 12 + 13 + 14 = 60$$

This calculation is repeated for each price bar on the chart, and the averages are then joined to form a smooth, curving line—the moving-average line.

Extending the example, the next (sixth) day's closing price—let's say it's 15— can be added and the oldest (first) day's price, which is 10, would then be dropped. The new 5-day SMA would be calculated as follows:

$$10 + 11 + 12 + 13 + 14 = 65$$

$$65 / 5 = 13$$

How I use it: I compare the 10-day, 20-day and 30-day moving averages to determine trend direction. I also use another “circuit breaker” moving average combination of a 5-day and 30-day to cancel out any trends signals. The logic with the circuit breaker is that the 5- day will cross the 30-day faster if the market moves dramatically against the trend.

NOTE: There is nothing magical about using a 10, 20, 30-day moving average combination. You can use other combinations as long as you understand how they behave. i.e. Combinations using shorter periods will follow trends more quickly but get whipsawed more. Combinations using longer periods will exhibit fewer trend alignments.

Uptrend conditions:

1. 10-day is more than 20-day
2. 20-day is more than 30-day
3. The circuit breaker is the 5-day moving average must be more than the 30-day.

Downtrend conditions:

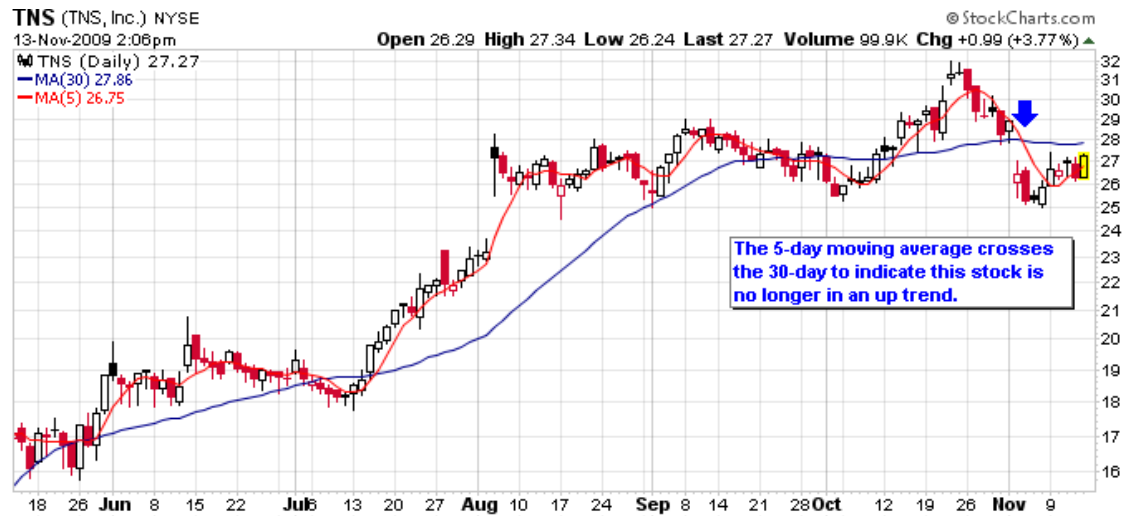
1. 10-day is less than 20-day
2. 20-day is less than 30-day
3. The circuit breaker is the 5-day moving average must be less than the 30-day.

Note: There’s nothing magical about using 10, 20 & 30 day moving averages. You can experiment with different combinations. The thing to remember is the advantage of using multiple measurements. You can even add more moving averages, such as 100 days and 200 days. This can increase your accuracy, but it will substantially reduce the number of trading opportunities.

Examples of Moving Averages on a Price Chart







Trade Entry Setups

Now that we have discussed how to build a watch list of stocks that meet basic trading requirements, and how to determine the trend of a stock, we will move into specific methods for triggering entries for trades. These methods are meant to be stand-alone entry methods but you can combine them when needed for confirmation



purposes. I don't recommend combining **more than two** as this will dramatically reduce your trading opportunities and not significantly increase the accuracy of your trades.

The indicators I use to determine when to get in and out of a trade positions are designed to identify areas where prices have pulled back against the trend and where I can expect them to resume their movement in the direction of that trend. Once again, I only trade LONG in up trends and SHORT in down trends. Many of these methods use the approach of using multiple measurements discussed previously in this course.

The methods I use for entry signals include:

- Pivot-point breakout (multiple measurement)
- Stochastic oscillator (multiple measurement)
- Rate of change (multiple measurement)

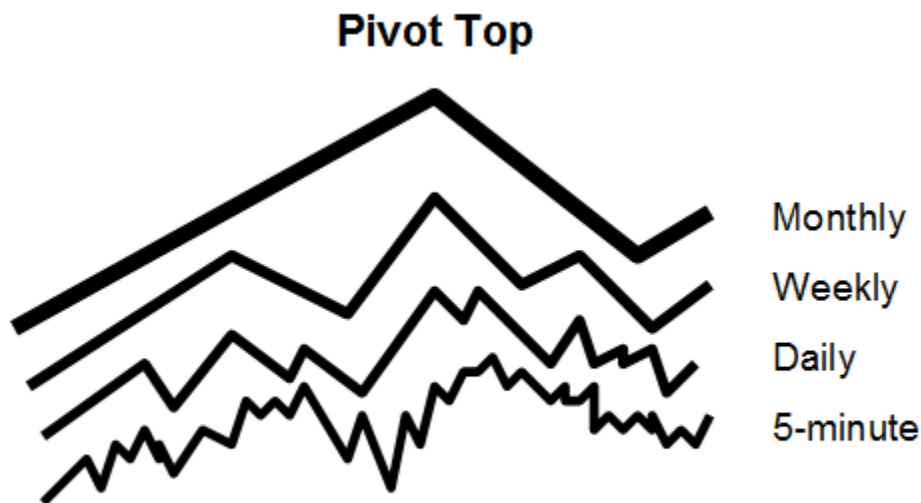
Pivot-Point Breakouts

One of the most powerful and intriguing aspects of the stock market is its *fractal* nature. In other words, the price movements for a stock are comprised of similar movements in both short-term and long-term time frames. (Think of a box with a smaller box inside and an even smaller box inside of that one.) The same pivot point setups on a 5-minute chart can be seen on a daily chart, and the same pivot setup on a daily chart can be seen on a weekly chart, and so on with ever-larger time frames.

The most important thing to understand here is that the biggest price moves always happen when short-term prices are in alignment with long-term prices.

The chart below shows how a TOP pivot would look in multiple time frames. It is exactly the same pattern, building upon itself! How do I take this event into account in my trading? Typically, I enter a trade either **above the HIGH or below the LOW** of the previous day, depending on the trend, because it represents a break of a pivot point on a smaller time frame (review the section on the importance of pivot point breakouts if necessary). Notice in the example below that the HIGH on a daily chart is represented by a TOP pivot on a 5-minute chart! This is why it's better to enter above the HIGH or below the LOW on a daily chart. You are entering at a pivot point alignment, which is a must for the start of any trend.

Example of Multiple Time Frames for a Pivot TOP

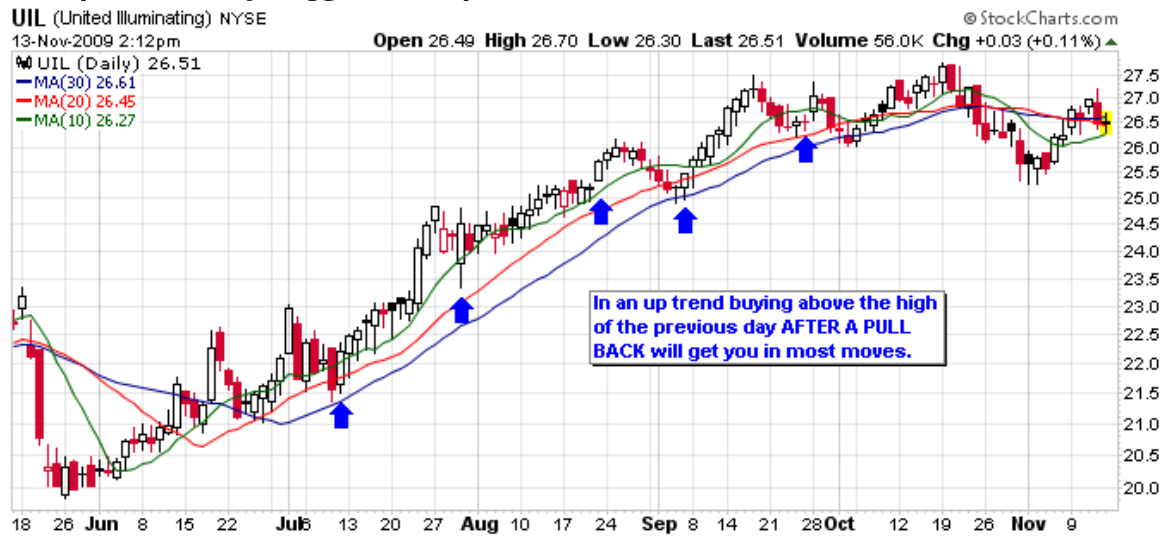


How I use it: AFTER a trade setup is formed, I enter a trade only if prices move (1-2 ticks) above the HIGH or below the LOW price of the previous day. This ensures that prices are once again moving in the direction of the prevailing trend before my order is filled and, at the same time, represents the breakout of a pivot on a smaller time frame (which, as we discussed earlier, is the beginning of any trend).

I have a stop-limit entry order in place each day, as long as the trend and other entry signals are intact. I use this entry technique for all trades. (see the order type section to review the benefits of using stop-limit orders for entries)

NEVER enter trades before prices breakout above or below the previous day's High or Low.

Examples of entry triggers on a price chart





Stochastic Oscillator

The stochastic oscillator was developed by George C. Lane in the late 1950s and is still a very popular technical indicator amongst traders. For the purposes of trading, being widely used is a very desirable trait. The stochastic oscillator compares a security's closing price to its price range over a given time period. This indicator is calculated with the following formula:

%K =	100 × ($\frac{\text{Recent Close} - \text{Lowest Low (n)}}{\text{Highest High(n)} - \text{Lowest Low(n)}}$)
%D =	3-period moving average of %K		
(n)=	Number of periods used in calculation		

For our purposes we are really just concerned with the %K or fast stochastic. The above formula creates an indicator that oscillates between the values of 0 and 100. The classic reading of this indicator suggests that, if the value is more than 80, the market is overbought and should turn down soon; if it's less than 20, the market is oversold and should rally soon.

The stochastic oscillator is part of most trading software packages, and it's a favorite among many traders. (Remember, this is good; the more, the better. You want as many traders following an indicator as possible, as this influences the stock's price in everyone's favor.) It's a great way to translate cyclical patterns in prices, but it also has some weakness. It would work perfectly for calling tops and bottoms, if prices always moved within a trading range. But prices don't remain within trading ranges forever, and, as I pointed out before, trending prices have the highest probability of moving in a particular direction.

The stochastic oscillator does not perform well in trending markets because it attempts to define both oversold and overbought conditions. The problem with this is that extreme overbought/oversold conditions could exist for long periods of time in strongly trending markets.

You can adjust the stochastic oscillator's sensitivity to market movements by changing the time periods in the calculation and as with other indicators I have found that comparing multiple time period measurements will produce more reliable results. As far as I know, this is the only trading course that brings this revelation to light for this particular indicator.

How I use it:

- I use three stochastic time frames (multiple measurements) to eliminate the fallacy of a single time period. Though I believe this is a unique approach to using stochastics it is not a "secret" since you are relying on the fact that there are traders watching this indicator using at least one of the individual time frames. By looking at all three you now know where there is a confluence of opinions.

Rules for entering a long trade:

1. 5-day stochastic below 20
2. 14 day stochastic below 50
3. 40 day stochastic below 80

Rules for entering a short trade:

1. 5-day stochastic above 80
2. 14-day stochastic above 50
3. 40-day stochastic above 20

Once again, the concept of multiple measurements are more important than the actual values so you can experiment at will.

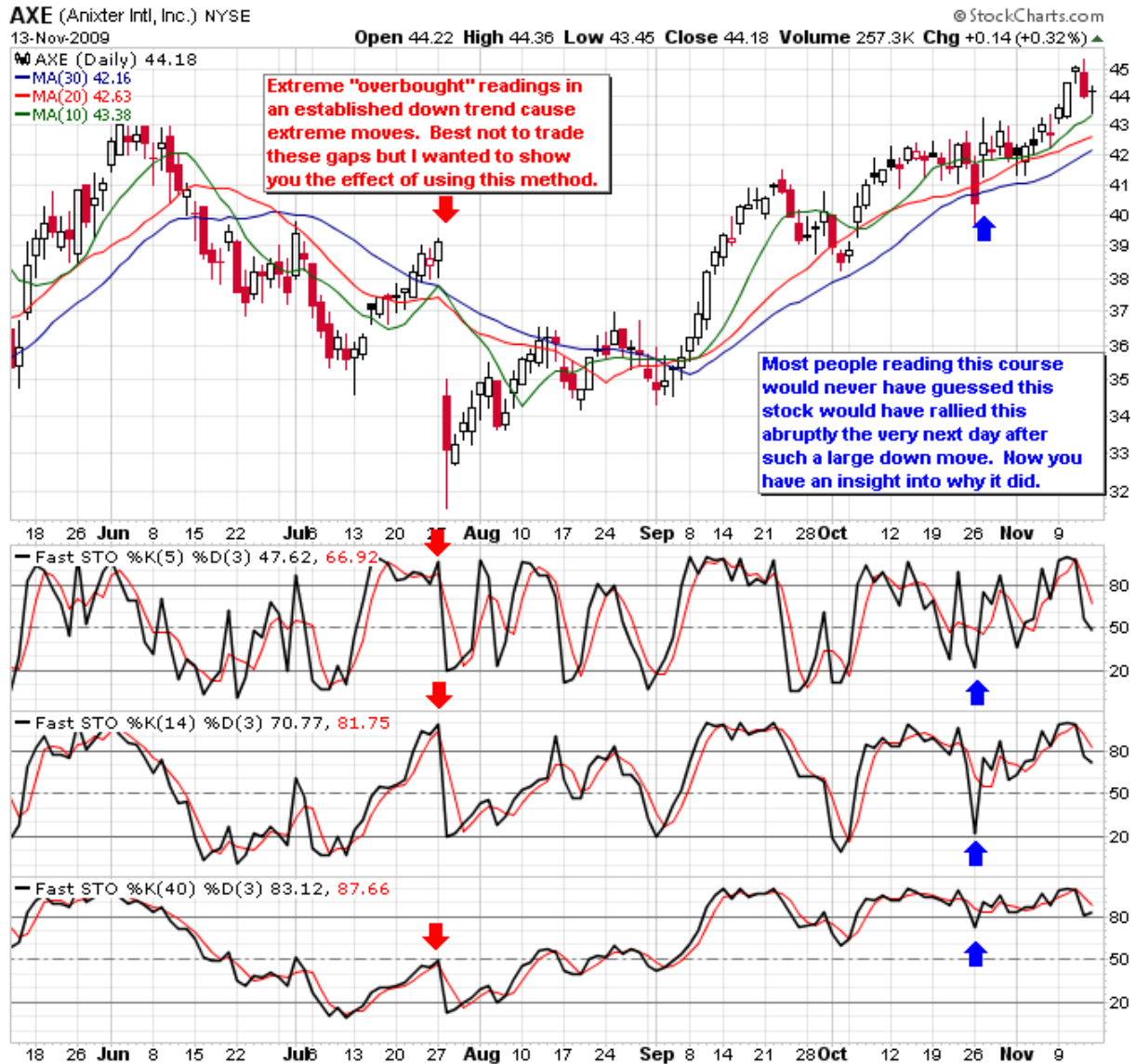
Example of Stochastic Oscillator Indicator Signals











Rate of Change (ROC)

Rate of change (ROC) is a momentum oscillator that measures the amount of change in price (in ticks) from one period to another. It's simply calculated by comparing the current price with the price n periods ago:

$$\text{ROC} = (\text{Close today} - \text{Close } n \text{ periods ago})$$

Charting the result forms an oscillator that fluctuates above and below the zero line as the rate-of-change moves from positive to negative. A positive value suggests that the market has enough momentum to continue driving activity in the direction of the current trend. A negative value would indicate a slowing of momentum, and that prices may stall or reverse. It can also be used to measure divergences like other momentum oscillators, by looking for

higher lows, lower highs, positive and negative divergences, and crosses above and below zero.

Though ROC is a trend indicator, I am including it in this section of the course because I also use it as an entry method by combining both a long and short measurement. Once again, you are seeing the use of multiple measurements.

How I use it:

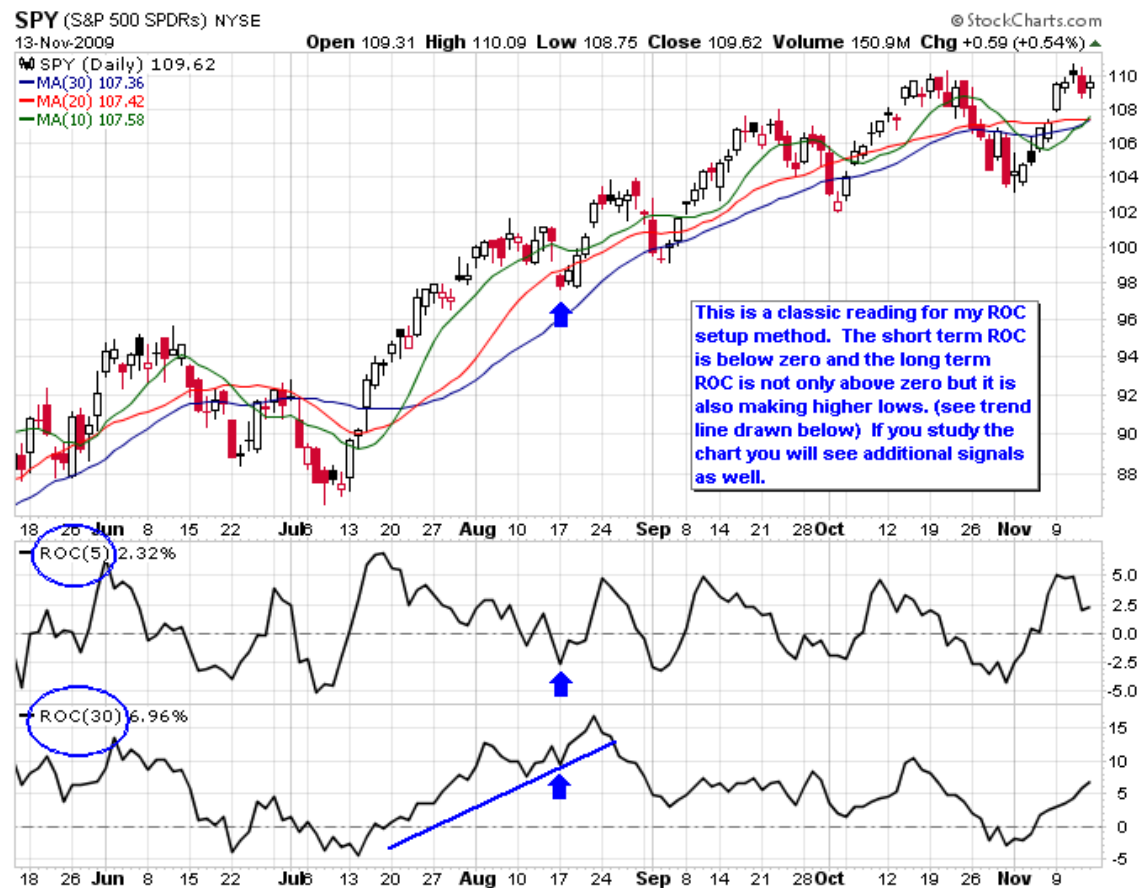
- I use both a 5-day and 30-day ROC (multiple measurements)
- The 5-day ROC is used to confirm entry indicators
- The 30-day ROC is used to confirm trend indicators

Rules for entering a long trade:

1. 30-day ROC is above 0
2. 5-day ROC is below 0

Rules for entering a short trade:

1. 30-day ROC is below 0
2. 5-day ROC is above 0







Profit-Taking Methods

Well we have covered a lot so far. You now know how to do the following:

1. Build a watch list of suitable stocks to trade
2. Identify which stocks are in a trending state
3. Identify entry setups
4. Enter a position at the appropriate target price with the appropriate order type

We will now move into methods for taking profits once you have initiated a trade.



Calculating Profit Objectives with Swing Trade Levels™

Determining when to take profits is a conundrum for most traders, however, I have developed method that is as sure-fire as they come for extracting profits regularly from the markets.

Swing Trade Levels™ is a method I created to help me see the hidden price levels of support and resistance in a stock's price more easily. ***They are very similar to moving average envelopes, but without the lag and constant flux in values.***

The market is really a system of percentages. (not dollars) This method works quite well to exploit that reality. The calculations are simple. First, find the midpoint of the long-term range of prices with the following formula.

(Highest high price for the past 60 days) +

(Lowest low price for the past 60 days) ÷ 2

= Midpoint of past 60 days

Next, calculate value for the following percentages above and below the midpoint of the range:

+20%
+15%
+10%
+ 5%

Midpoint of past 60 days

- 5%
-10%
-15%
-20%

The resulting *Swing Trade Level™* value above and below the midpoint line act as a sort of barometric scale for a stock's price. Prices will often find support or resistance at these levels in the future and can be used for profit- taking opportunities.

This method tends to work extremely well, not only because of the uncanny occurrence of support and resistance at these levels, but because it corroborates some of my personal research into how far prices typically move over time.

In my research, I examined more than 500 hundred stocks between the prices of \$5 and \$20 over a 10-year time span. Below is a summary of the results for the typical variance in price after any given day in the past. When you examine the chart, you'll see two things: First, stocks spend most of their time in narrow trading ranges with minimal movement. Second, the highest probability lies in price movements between **2% and 5%**. If you average much lower than that, say just 1% a day, you will make huge profits in the markets

Once again, to my knowledge, this research is unique to this trading course and this piece of research alone, is worth the entire price of this trading course. You now have empirical data which shows that constantly hoping for "home run" trades of 10% to 30% is a losing business proposition. Looking for "home run" trades goes against my basic rules and is basically an ego play.

	Percent Variant in price	Percent occurrence
After 3 days	1%	11%
	2%	9%
	5%	5%
	10%	1%
After 5 days	1%	12%
	2%	10%
	5%	6%
	10%	2%
After 10 days	1%	12%
	2%	11%
	5%	7%
	10%	4%

How I use it: When placing orders to exit at a profit objective, I combine what I know about Swing Trade Levels and price variances.

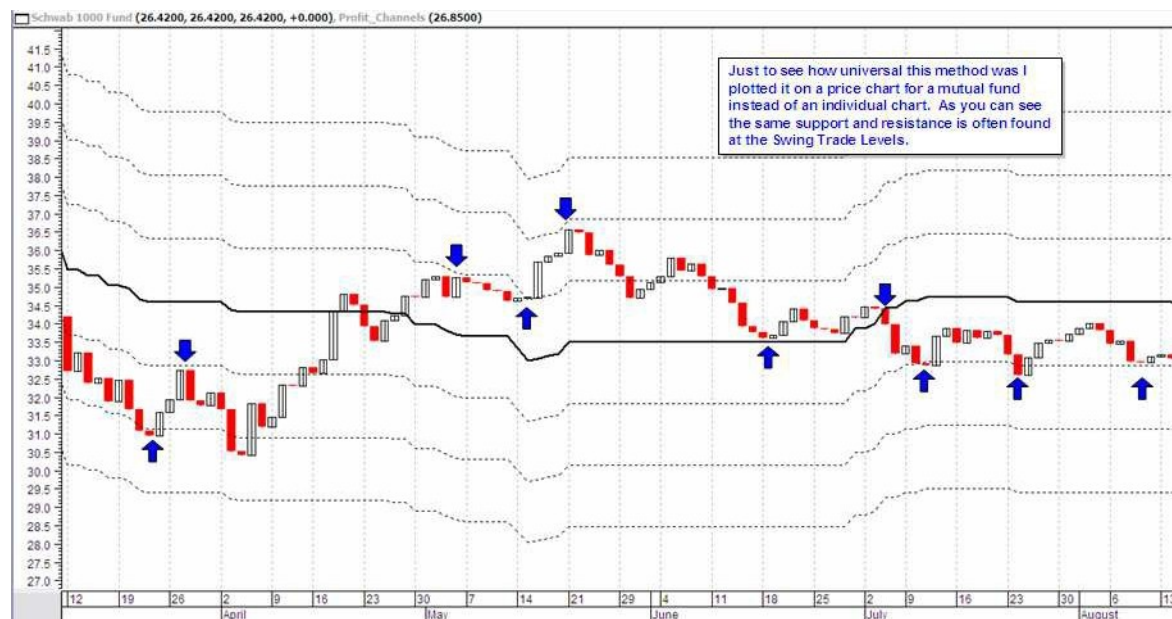
I look for profit objectives that are near one of the Swing Trading Levels and that also equates to a 2% to 5% move in price.

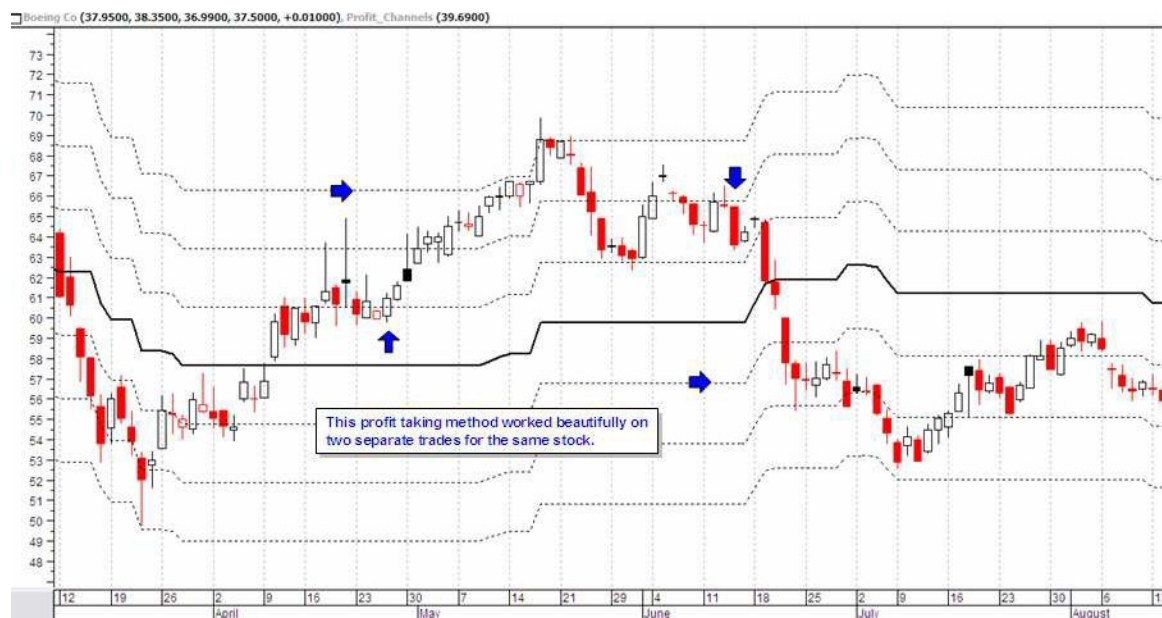
I target a swing trade level that is established at the time of entry and I do NOT the profit target even if the swing levels themselves change over time during the trade.

NOTE: The ability to produce Swing Trade Levels will require a software package that can plot customer indicators on a price chart. If you don't have access to such a software package, then just use the rule of thumb of 2%-5% for profit objectives.

Examples of How Swing-Trade Levels Act as Areas of Support and Resistance



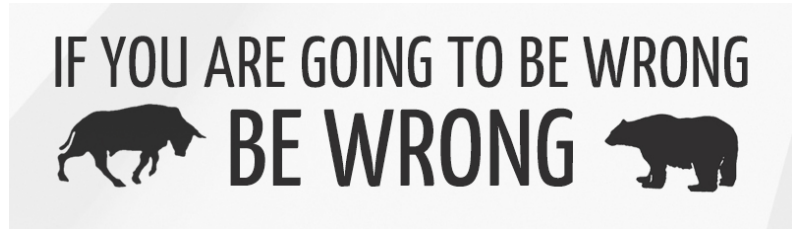




Stop-Loss Methods

Conserving Account Equity

The primary focus in risk management is the preservation of capital in your trading account. There are many schools of thought, but the most universally accepted



method is to risk only a percentage of your account equity with each trade and no more than a certain percentage on all combined trades. This method is preferred because it automatically adjusts to fluctuations in your account balance.

Trailing stop-loss orders will help you lock in profits but your initial stop-loss price is the key to managing your risk. I recommend that you set your initial stop-loss order to risk no more than 2% of your account equity for individual trades and no more than 6% in any given direction (long or short). So, with a \$50,000 account, you would risk only \$1000 per trade, or \$3000 in combined positions, in a single direction. The amounts would then increase or decrease with your account equity.

Account Balance	Maximum 2% risk per trade	Maximum 6% risk (long or short)
\$5,000	\$100	\$300
\$10,000	\$200	\$600
\$15,000	\$300	\$900
\$20,000	\$400	\$1,200
\$25,000	\$500	\$1,500
\$30,000	\$600	\$1,800
\$35,000	\$700	\$2,100
\$40,000	\$800	\$2,400
\$45,000	\$900	\$2,700
\$50,000	\$1,000	\$3,000
\$60,000	\$1,200	\$3,600
\$65,000	\$1,300	\$3,900
\$70,000	\$1,400	\$4,200
\$75,000	\$1,500	\$4,500
\$80,000	\$1,600	\$4,800

Initial Stop-Loss

Placing stop-losses is a necessary business practice when you trade stocks. Think of it as insurance against catastrophic loss. Now understand that stop-loss orders are NOT a guarantee against losses since stocks can always “gap” open against your position and you

will still encounter a large loss. However, in the absence of a nothing at all, stop-loss orders fulfill their purpose, and they're far better than doing nothing at all to protect yourself.

What's the best method for placing initial stops? There are several options:

- Fixed percentage stops use the value of your current account equity and risk a fixed percentage of that amount.
- Fixed-value stops use a fixed dollar amount or number of points for the stop-loss points.
- Percent-based stops use a percentage of the stock price as the stop-loss point.
- Support/resistance-level stops use the latest support or resistance levels.
- Moving-average stops use a moving average to place the stop-loss.
- Volatility stops use Bollinger bands to set stop-loss levels.

I have found that the best approach is to use fixed percentage for your initial stop-loss orders. Why? My research and experience show no significant advantage to using any of the other methods, and the fixed-percentage method is a lot simpler to manage across your entire portfolio.

Here's a typical scenario for determining the initial stop-loss for a trade:

Calculation (Long trade)	Value	How to calculate
Account equity	\$20,000	Value of trading account
Maximum risk (2%)	\$400	A percent of account equity
Share price	\$11	Determined by stock's entry price
Number of shares	500	Determined by trader preference
Initial stop-loss	\$10.20	(Share price - Initial stop loss price) * Number of shares = Maximum risk amount

Trailing Stop-Losses

If a trade is moving in your favor, you should try to lock in your profits by moving your initial stop-loss point closer to the current price action. The most common ways to do this:

- **Moving averages.** You continuously move your stop-loss above or below a moving average value.
- **Time and price.** You continuously move stops above/below the high/low price of every x days.
- **Percent stops.** You continuously move stops a specified percentage below the previous day's closing price.
- **Price stops.** You place your stops at a predetermined price point. Usually near support/resistance levels.

My results show that percent stops are the most reliable. I like to exit if price moves 3% against the previous day's closing price. An even more reliable (but higher-risk) variation of this method is to exit only if price closes below 3%. This prevents you from being stopped out during an intraday price spike.

Note that your risk-to-reward ratio becomes larger as you adjust your stop-loss.

How I use it: I always lock in profits by moving my initial stop-loss to 3% of the previous day's closing price (3% below for long trades and 3% above for short trades).

Examples of a Trailing Stop-Loss



Managing Portfolios

Trade Management

The definition of good trade management is simple: Execute a strategy that produces a positive mathematical expectation of making a profit.

A “**positive mathematical expectation**” is defined as:

$$\text{Avg. Dollar Amount of Win Trades} \times \text{Percentage of Winners} > \text{Avg. Dollar Amount of Loss Trades} \times \text{Percentage of Losers}$$

Take a look at the table below. It shows that if you limit your losses, you simply don't need to be as accurate as most people think you do. Most traders wouldn't even consider purchasing a system that was only 30% accurate, but the data below shows that you would actually break even with such a system if your winners were 2.3 times larger than your losses.

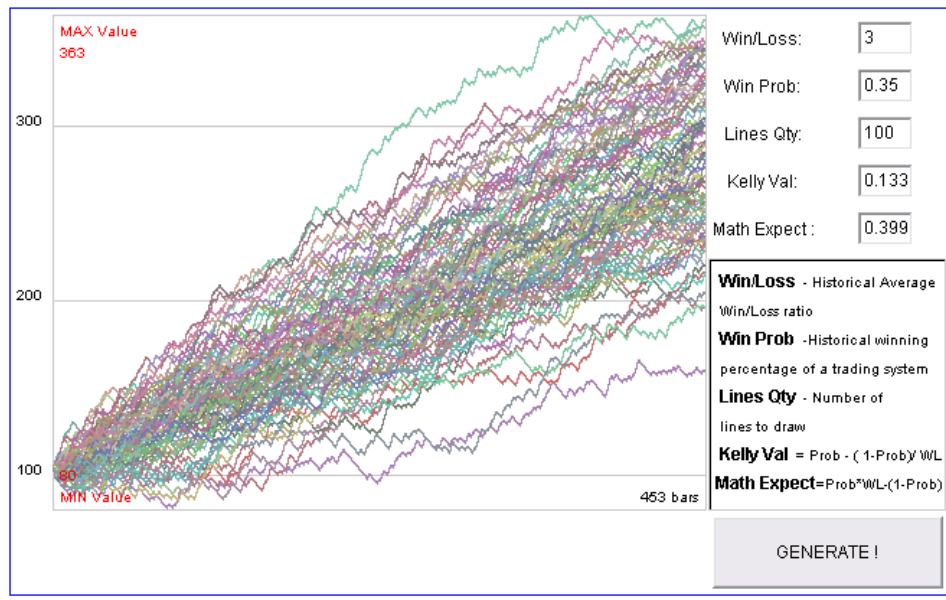
This table clearly shows that a winning percentage should not be the primary focus for trade management. Instead, you should concentrate on the average size of winners versus the average size of losers.

Winning Percentage	Breakeven Win/Loss Ratio		
25%	3.0	:	1
30%	2.3	:	1
35%	1.9	:	1
40%	1.5	:	1
45%	1.2	:	1
50%	1.0	:	1
55%	.8	:	1
60%	.7	:	1
65%	.5	:	1
70%	.4	:	1
75%	.3	:	1
80%	.3	:	1
85%	.2	:	1
90%	.1	:	1
95%	.1	:	1

Here's an even more powerful example of this concept. Below is a screenshot from my *Ultimate Trading Calculator* utility. (You received this software free with this course.) It shows that, if your winning trades outnumber your losing trades by a ratio of 3 to 1, even though your system is only 35% accurate, you will make money in the long run.

The chart shows a simulated equity curve for 100 traders with 453 random trades each. All of them would have made money with a system that was less than 50% accurate!

I encourage all traders to track their percentage of wins over time, as well as average winners versus average losers, and use this calculator to map their probability for long-term success.



How I use it: I concentrate on making trades with profit objectives that are two to three times larger than the amount I am risking, and I track my trading statistics constantly to ensure that my overall trading results have a mathematical expectation of success.

Balancing Short and Long Trades

One of the trading strategies most commonly overlooked is the balancing of both long and short positions. Why? Traders tend to have a “go long” mentality when it comes to stock trading. This mindset can have a disastrous effect on a trader’s portfolio when the overall market (which can be adequately defined as the Standard & Poor’s 500 index) has a big decline. Research shows that over 80% of a stock’s price movement can be attributed to the direction of the overall market. Many traders have seen weeks of equity gains wiped out by a large market decline, because they were holding all long positions.



This can happen to you, even when you’ve judiciously used stop-loss orders. The best approach (especially if the market is not trending strongly in either direction) is to balance your portfolio by trying to hold an equal number of long and short positions.

Here are some recommended ratios, but you should adjust them to your own trading preferences.

S&P 500 Trend	Long Positions	Short Positions
Up Trend*	70%	30%
Trading Range	50%	50%
Down Trend*	30%	70%

**Trends are defined here by the alignment of the short-term, medium-term, and long-term moving averages for a period of 10 days or longer.*

How I use it: I try to maintain a balanced number of both long and short positions in my trading portfolio. In situations where the overall market is trending steeply in a particular direction, I balance my positions in favor of the prevailing market trend.

Number of Stocks in Portfolio

When choosing stocks to trade, you should also consider the number of positions you enter in the same direction at once. Traders sometimes try to diversify their portfolios and spread the risk by holding lots of positions. Remember, as much as 80% of an individual stock’s movement can be attributed to fluctuations of the broad indices, such as the S&P 500.

Below is a listing of how the performance of a randomly selected portfolio of stocks becomes closely correlated to the market.

2 stocks	=	46% correlated to the market
4 stocks	=	72% correlated to the market
8 stocks	=	81% correlated to the market
16 stocks	=	93% correlated to the market
32 stocks	=	96% correlated to the market
64 stocks	=	98% correlated to the market
500 stocks	=	99% correlated to the market

You can see that even small portfolios—as few as four stocks—will soon have the overall market as the primary reason for their gains or losses. Your losses, even with a small portfolio, will ramp up very quickly if the positions are all in the same direction.

This obviously should encourage you to trade fewer stocks, since you will lose more and more diversification with every position you add, but it also points to one of my primary rules for successful trading: keep it simple. A list of 15 or 20 positions can quickly become overwhelming, if not impossible, to monitor and update effectively.

How I use it: I hold only 4 to 8 positions at a time to avoid both limiting my diversification and complicating my trading.

Pyramiding Your Position

Pyramiding is the practice of using open trade profits to add shares to an existing trade even though it has not yet realized those profits. Though this practice does leverage your funds more effectively, I personally don't believe the benefit justifies the added risk and complexity. I mention it only so that you will be aware of it and, if you do choose to try it, you'll know how to execute it appropriately.

If you decide to use it, the correct way to do so is the traditional method. With traditional pyramiding, you add fewer shares than you took with your initial position. So, if your initial position was 1000 shares, you would add, say, 250 more shares as your position moves in your favor.

An inverse variation of this strategy is to liquidate part of your initial position once an initial profit objective is achieved. This actually decreases your risk (and your profits), but—once again—it complicates your trading.

How I use it: Though pyramiding does offer some benefits, I enter or liquidate 100% of my shares at the same time, to avoid complicating my trading.

Putting It All Together

How do all of these methods work together to produce profits in the stock market? The easiest thing to do in the beginning is to confirm each stock trade with a simple checklist like the example below. After a while, you'll be able to perform the checklist in your head.

Trading Campaign Checklist

Category	Method	Comments
Watch List Selection	Volume (Top 50% of all stocks)	
	Share Price >\$5, <\$25	
	Price above/below trend line	
Trend Direction	3 moving averages aligned	
	No pivot point breakouts against trend	
	Rate of Change (3 measurements)	
Entry Point	Stochastic Oscillator (3 measurements)	
	Place entry 1-2 ticks above HIGH or below LOW	
	Swing Trade Levels™	
Profit Objective	Profit objective between 2%- 5%.	
	Long/Short position ratio	
Portfolio & Risk Management	Initial stop-loss <= 2% of account equity	
	Projected Win/Loss ratio >= 2:1	

Business Operations

One thing that I've noticed is missing from most trading publications and courses is an overview of what the day-to-day operations look like for a trader. Here's a checklist of the major tasks that must be completed on a regular basis.

Daily (in order of significance)

- Review any filled orders for the day (entries and exits)
- Review all existing positions & update profit and/or stop-loss targets
- Review watch list scans & enter new entry orders with broker for best trade candidates

Weekly

- Update trade statistics spreadsheet with completed trades



- Review losing trades for learning

Monthly

- Mark important financial dates on calendar so that you are not caught by a surprise in the market (i.e. earnings, triple witching and economic reports)
- Review brokerage statements for accuracy

Annually

- Archive statements and statistics
- File tax return with trading profit/loss details

Frequently Asked Questions

Will these methods work on stocks that are higher in price?

Yes. The price selection is a preference to maximize leverage; however, the methods will work equally well on higher-priced stocks.

Can these methods be used to trade futures or mutual funds?

Absolutely! The methods, if used as described, will work for any freely traded market.

I use software to scan for my trade opportunities. How many trading candidates should I expect to get when I scan for your stock selection criteria?

This is completely dependent on market conditions. In an up-trending market, you usually will see more long candidates on your scans.

If you include the entry criteria in your scans, as well, you will generally see fewer than 50 stock candidates a day.

My charting software does not support the creation of Swing Trade Levels. Can I use moving-average envelopes instead?

This doesn't work as well, since moving-average envelopes fluctuate quite a bit more, but it can be done. Just be aware that the results will be less accurate.

I am not yet comfortable trading stock short. How will trading only long positions affect my long-term trading results?

Many traders prefer to trade only long positions, and this is okay. I recommend that you perhaps use either tighter stops or smaller profit objectives, to counteract the additional risk from trading in a single direction.

Your success is really dependent on market conditions in the future. Obviously, you'll have more success trading only long positions if we have a sustained up-trending market.



What is the minimum or optimal amount of money needed to be successful in trading stocks?

It depends on your goals. How much money do you need to make? Will you be extracting profits along the way, or reinvesting them continuously? Trading stocks is just like any other business: the larger your starting capital (assuming all other things are equal), the higher your chances for success.

Here's an example: A trader who has \$5000 to work with must be very conscious of the number of trades executed, because commissions represent a cost that eats into profits. This is not as significant, proportionately, for a trader with \$500,000. I would suggest that you first identify your trading goals and then work backwards to come up with the amount you need to be successful.

Can your methods be used for stock-options strategies?

Yes, this is very possible. Though it's beyond the scope of this trading guide, I often use stock-options strategies in conjunction with stock trades.

Brokers

I am not affiliated with any of the brokers listed here. They are included only as a helpful reference. Traders should perform their own due diligence before deciding on a broker.

TradeStation Securities

www.tradestation.com

A former technical-analysis software vendor turned discount broker. They now lease their software platform and have a large following of developers and programmers.

Interactive Brokers

www.interactivebrokers.com

A discount broker that has a good overall reputation. Highly automated; good commission prices.

Scottrade Securities www.scottrade.com

A bit overpriced on the commissions, but they do offer the same price for limit and market orders.

Fidelity www.fidelity.com

This is an excellent choice if you want to house your trading account with other traditional investments. Offers lots of ancillary services, such as check writing and debit cards for your trading account. Also, the trading platform features advanced order handling, which makes things a lot easier.

CyberTrader www.cybertrader.com

This is a division of Charles Schwab. Offers online trading for active traders and lots of tools to choose from, but the commissions are still a bit high.

TD Ameritrade www.tdameritrade.com

TD Ameritrade bought one of the best online brokers - ThinkorSwim and it benefits a lot from this acquisition. Because of ThinkorSwim's excellent trading technology, TD Ameritrade now has the best trading platform in the industry.

Etrade www.etrade.com

Etrade is one of the best-known online brokerage firms in the country and it is a publicly traded company. The firm offers banking services to its customers, though the interest rates are not as good as with best online banks.



Software and Charting

A number of calculations for the methods I use are best created with a software package that is designed specifically for trading. I have listed a few of the most popular software packages with which I have some experience. I DO NOT provide support for any of these vendors.

TradeStation Securities www.tradestation.com

Telechart2000 www.worden.com

MetaStock www.metastock.com

StockCharts.com www.stockcharts.com

Incredible Charts www.incrediblecharts.com

AmiBroker www.amibroker.com

NinjaTrader www.ninjatrader.com

eSignal www.esignal.com

Yahoo Finance www.finance.yahoo.com

TradeLog - Capital Gains Software www.armencomp.com

GainsKeeper - Capital Gains Software www.gainskeeper.com

Other resources

www.freestockcharts.com

A free charting website from the same company that offers Telecharts

www.finance.google.com/finance/stockscreeener

Fill in the boxes to screen stocks for your portfolio.

www.finviz.com

A comprehensive stock screener site

www.traders.com

Stocks and Commodities Magazine

www.investopedia.com

The online encyclopedia for investors and traders.

www.stocks.about.com

Various stock tutorials and resources.

www.stocktwits.com

A social network for stock traders