THE COMPLETE GUIDE TO *DAY* TRADING

A Practical Manual
From A Professional Day Trading Coach

Markus Heitkoetter

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A Practical Manual From A Professional Day Trading Coach
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Edited by Nicole Quinlan

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ISBN: 978-1-4196-9563-6

PRINTED IN THE UNITED STATES OF AMERICA

To my family -
for supporting me even in my craziest moments.

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Preface

Day trading can be simple, but don't make the mistake of thinking that it's easy.

I know that there are many websites and late-night infomercials that try to tell you differently. They make you think that you just have to read a few pages or attend an online class, and then, magically, you'll become a successful trader.

Don't be fooled.

Like in any other profession, you need a solid education before you get started. After all, the goal is to make more money than a lawyer or a doctor, but many aspiring traders expect to learn everything they need to know from an eBook that they might get somewhere on the Internet, most likely for free. And how could a small amount of free information teach you to make more money than people who have gone to school for years and years?

Right, the answer is: it can't.

Some aspiring traders think they don't have to learn a single thing. They believe that they can buy a "magic system" or "XXX software" that will place their trades for them and make them rich while they sleep. Or they rely on the advice of some "guru" for their trading decisions, blindly following his recommendations without knowing anything about the markets.

I'm glad you're different.

You picked up this book because you're serious about becoming a successful day trader. And, by reading this book, that's exactly what you'll learn how to do.

WARNING: Be aware, though, that just reading this book will NOT automatically make you an instant millionaire. You'll learn a lot of facts and concepts about day trading, but in order to make the most out of this book and become the trader you want to be, you'll have to adapt the ideas that you're about to learn to what you already KNOW.

Socrates said that *"Learning is remembering."*

And Richard Saul Wurman says:

> *"Facts in themselves don't solve the problem. Facts are only meaningful as they relate to a concept you can grasp … New ideas are not so much discovered as uncovered by moving from what you already understand into the realm of what you would like to understand."*
>
> Source: Information Anxiety, by Richard Saul Wurman, 1989

Let me give you an example:

I moved from Germany to the U.S. in 2001, and one of my first "tasks" here was buying a house. It should have been no problem – I mean, we do have houses in Germany. It's basically the same process, right?

Right – but where I come from, we measure in meters and kilometers. So, you can just imagine my confusion when my realtor started describing lot sizes in quarter-acre, half-acre, etc. What the heck? How big is an acre?

Of course, I didn't want to ask – no one likes to seem ignorant – but I looked it up. An acre is 43,560 square feet. Great. That didn't really help me. Now I knew the exact measurements, but I still couldn't picture the exact size of "an acre" in my head. I had no frame of reference.

But, I have it now. A friend of mine told me that an acre is about the size of an American football field without the end zones.

Poof. Understanding. A frame of reference.

The same is true in trading. You might already know many of the concepts presented in this book (e.g. that you should use a stop loss). And there might be some concepts that are new to you (e.g. using a time-stop when exiting a trade).

But don't worry: I'll present all of these concepts in a very practical way. You'll be getting a great deal of examples and scenarios to look at – this entire book is about you getting that "grasp" on trading that you'll need. And by the last page, you'll have it.

Remember Socrates: *"Learning is remembering."*

My Objective: I am determined that this book will save you both money and time when it comes to your trading goals. I'm convinced that it will help you become the trader you want to be.

Enjoy!

Markus Heitkoetter
January 2008

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Introduction: Why Day Trading?

If you're thinking about getting into day trading, then you've probably got a pretty strong motivation. More often than not, that motivation is money. You want to be rich. No, wait. Let me be a little more specific: you want to be wealthy.

Just to make sure that we're on the same page, let me touch on the key difference between being "rich" and being "wealthy:"

- "Being rich" means that you have a lot of money.
- "Being wealthy" means that you actually have **time** to enjoy your money, time to do <u>what</u> you want to do <u>when</u> you want to do it.

So, is day trading really the ultimate solution to becoming wealthy? Let's see.

Here's one way to become rich:

You work your way up to the position of an executive in a corporation and make hundreds of thousands of dollars a year. Of course, you'll be working at least 10 hours per day and at least 6 days per week.

Here are three ways to become wealthy:

1.) Starting Your Own Company or Internet Business
2.) Investing in Real Estate
3.) Day Trading

Option 1: Starting Your Own Company or Internet Business

Having your own company means that you'll have to find or create a product, market the product, sell the product, deliver the product to your customers, and collect the payments.

These days, there are many "Internet Marketing Gurus" trying to sell you on the idea that you can automate everything, which will allow you to sleep late, do nothing, and cash very fat checks on a regular basis. We both know that this is a dream, nothing more.

You can automate the routine, sure, but not the exceptions. And believe me: there are always exceptions when dealing with people – your customers. Plus, as long as you have computers involved, you need to keep Murphy's Law in mind: "Whatever can go wrong, WILL go wrong." Nothing could be truer!

Even if you *could* automate most of the delivery, you still have to find or create a product, set up a website, write salescopy, put the automation in place, and generate traffic. And since the Internet is evolving so quickly, you will constantly have to update your website and traffic generation methods.

Okay, so what if you skipped the Internet part? If you have a "physical" business, the headache might be even bigger: employees, vendors, lawyers, competitors, invoices, customers, production problems, office space, equipment, etc. I've known a number of small business owners who have simply given up and gotten a regular 9-5 job. Sometimes the reward just isn't worth the stressful lifestyle.

Option 2: Investing In Real Estate

Our second option on the road to wealth is investing in real estate. But with the market slowing down and the current credit crunch, it's not that easy anymore. Most lenders these days require a down payment of 10-20% for investment properties, so you also need substantial capital to even get into the business.

Another problem is the cost of a transaction. Whenever you buy or sell a house, you will most likely have to pay a Realtor's commission and face closing costs. Because of these factors, it's not easy to quickly buy and sell houses. A transaction can last several days or several weeks. And on top of that, you always have the possibility of problems with renters (if you are renting out), or with contractors (if you are "fixin' and flippin'") or with legal issues if you use those "creative techniques" that some of the late night infomercials are promoting. It basically boils down to one big pain in the neck!

You need an appraisal, too, and you might have to argue with the appraiser about the value of the house; you need a home inspection and might be surprised when you learn of all the things that need to be fixed before you can sell; and, last but not least, your buyer might have to obtain a mortgage. As you know, the mortgage industry has really become "interesting" in 2007 (to say the least), and buyers that were pre-approved and pre-qualified might learn the day before closing that they won't receive the promised loan. And all of these problems are just the tip of the iceberg. When it comes to hassle and problems, real estate investing is a flip of the coin, at best.

So, what's left?

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Option 3: Day Trading

In my opinion, it's the perfect way to become wealthy. Here are ten reasons why:

1.) **It's the total "equal opportunity" job**

Your race doesn't matter. Your skin color doesn't matter. Your education doesn't matter, whether you're a Ph.D. or a college drop-out. Your sex doesn't matter. Your origin doesn't matter. Your age doesn't matter. Your background and history don't matter. Even if you've been in jail for years, you could still make money with trading. Your language doesn't matter. Your looks don't matter. And your social status doesn't matter, as long as you have sufficient funds to trade.

2.) **No employees to hire**

You don't have to hire any employees, which means you don't have to worry about job interviews, payroll, employee evaluations, holidays, sick days, or employee performance. Your only "team member" is your broker, and if he doesn't perform, there are 10 others waiting in line for your business.

3.) **No inventory, office space, or other equipment (besides your phone and your computer)**

You don't have to buy or rent expensive office space, and you don't have to stock any products, which means you don't have to worry about expiration dates, damaged goods, shipping, handling, insurance, or displays and promotions of goods.

4.) **No vendors, no customers, no invoices, and no accounts receivable**

You won't have to deal with any face-to-face contact. You don't need any vendors, you don't need to satisfy any customers, you don't need to provide any customer support, and

you don't need to worry about any invoices, bounced checks, fraudulent credit card charges, returns, or charge-backs.

5.) The time required is minimal

Whether you have a regular job or run your own business, the chances are that you're working at least 40 hours per week. With day trading, you can trade either part-time or full-time. You can start trading for as little as one hour per week, or you can go for the maximum of 2 hours per day.
It's your choice.

6.) Low capital requirement

You don't need a lot of money to get started. This is not like buying property, for example, where you're on the hook for a monthly mortgage and other cash-draining expenses. In trading, you can start with as little as $1,000! (We'll talk about how a little later.)

7.) Returns are almost instantaneous

I'm talking "fast cash" in the sense that trading allows for quick liquidation. You can convert trades for cash within seconds. Where else in the world can you make money this fast and comfortably? You can buy and sell and buy again in minutes. You don't have to wait to see your profits. Try this with real estate or physical goods, where you might have to wait weeks, or even months.

8.) **Low transaction cost**

You pay less than $10 per transaction in trading. Compare that to real estate transactions, in which you have to pay sev - eral thousand dollars in closing costs, not to mention a 3-6% commission to your realtor.

9.) **It's simple to learn how to make money with day trading**

You don't have to go to college for years. And unlike most other professions, years of experience are not necessary either. After teaching hundreds of people how to make money with day trading, I firmly believe that everybody can learn how to become a successful trader.

10.) You don't need much to get started

In fact, there are only six things that you DO need:

a.) A computer
b.) An Internet connection
c.) A charting software
d.) A broker
e.) A properly funded trading account
f.) A good trading strategy

I could go on and on, but I think you get the picture. Throughout this book, we're going to cover a lot of material that will help you get started with trading successfully. Here are a few of the essentials:

- What exactly is day trading
- Who should be day trading
- Is it really possible to make a living as a day trader
- What you need to get started
- How much money you'll need to begin trading
- What markets are out there and which ones you should trade
- How to develop a profitable day trading strategy
- How to ensure that your day trading strategy actually works

In short: you will learn everything you need to know to start making money with day trading. Ready?

How to Get the Most Out of This Book

This book will help you become the trader you want to be, but it won't happen automatically. You will not instantly become successful the minute you finish reading.

Making money with day trading IS possible, but it requires time, discipline, effort, and commitment on your part.

Let me explain. Throughout the book, you'll learn key concepts that you can apply to your trading right away. The knowledge you accumulate is extremely important, because it's what you base your trading decisions on, the decisions that will determine your ultimate success or failure.

One of my key goals in this book is to help you expand your trading knowledge so that you can make well-informed decisions. I'll provide you with lots of valuable resources to help you learn what you need to know.

At the end of each chapter, you'll find **'Action Items,'** exercises relating to the topics recently covered. If you want to get the most out of this book, take a few minutes to complete these Action Items. The results you achieve will, in most cases, be directly proportional to the effort and commitment you invest in creating them.

It is my pledge to help you become the best trader that you can be, but I'll need your help to do it.

Part 1:
Day Trading Basics – What You Should Know

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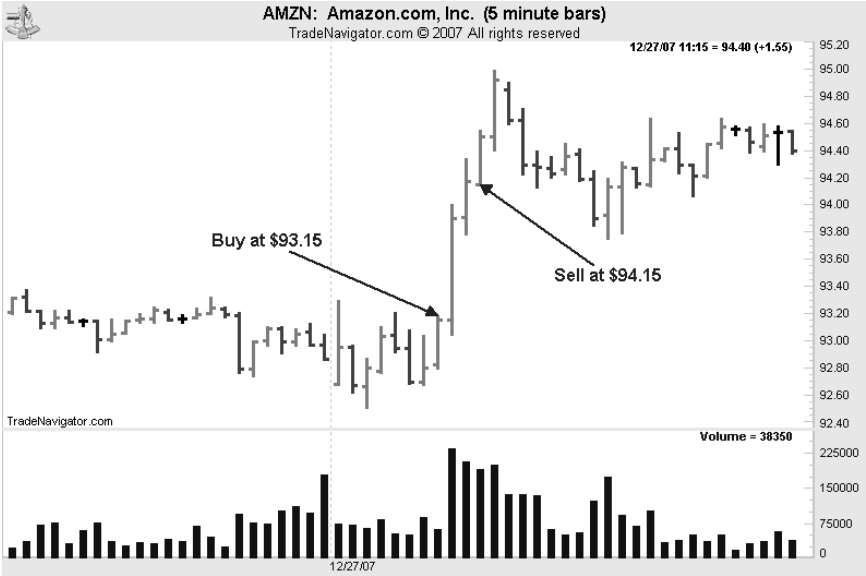
What Is Day Trading?

Day trading is the practice of buying and selling financial instru - ments throughout the day. As the day progresses, prices will rise and fall in value, creating both the opportunity for gain and the possibility of loss.

At 10:15am, a day trader might buy 1,000 shares of Amazon.com's stocks just as the price begins to rise on good news, and then sell it at 10:25am, when it's up by $1 per share.



In this example, the day trader makes $1,000, minus commission. With today's cheap commissions of $10 or less per trade, that's a quick $990 in just 10 minutes!

When traded strategically, the trends and fluctuations in the markets allow for quick profits to be made in brief periods of time.

Keep in mind, however, that day trading is specifically designed to result in smaller earnings on a regular basis; it is NOT designed to result in huge fortunes through a single trade.

Day trading can be very profitable, but it isn't a get-rich-quick scheme (though many seminars convincingly sell it as such). Nor is day trading a sure road to immeasurable wealth and success (as some hyped-up websites would have you believe).

Quite simply, day trading is just like any other business venture: in order to be successful at it, you need to have a PLAN. It would be very risky to dive in head-first without looking. However, with the right tools – and with the knowledge to use those tools efficiently and effectively – the risks of day trading can be greatly reduced. With perseverance and commitment, you CAN find trading success.

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Who Should Be Day Trading?

Day trading is not for everyone. Yes, there are many advantages, but there are also some "negative" factors. One of them is that you WILL face losses. As a trader, losses are part of our business. If you can't accept that fact, you simply shouldn't trade.

And you need a **PLAN**:

Traders who enjoy the most success in day trading, regardless of whether they're in it for a living or for some extra income on the side, generally have solid trading strategies and the discipline to stick to their trading plan.

Keep in mind that day trading is a very competitive field. In order to succeed, you need to maintain focus on a set of strategies which you can implement immediately, without hesitation. Remember, a proven, strategic trading plan can give you an edge over the rest of the market.

Unfortunately, even with a tested, proven trading strategy, you are not guaranteed trading success. It takes something else. It takes discipline.

A profitable strategy is useless without discipline. Successful day traders must have the discipline to follow their system rigorously, because they know that only trades which are indicated by that system have the highest probability of resulting in a profit.

Whether you're new to trading or have been trading for years, it's all too tempting to place the entirety of your trust in graphs, charts, and software. If only trading was as easy as that!

Simply purchasing trading templates and computer programs does not guarantee your success as a trader.

Too many hobby traders have tried that, and, unsurprisingly, they've failed. They bought the tools, but they didn't have the knowledge they needed to succeed. As in all things, education will do wonders for the aspiring – and experienced – trader.

Of course, this is not to say that software programs and markers are not helpful when it comes to day trading. On the contrary, many traders use technical indicators which are instrumental to their success – a few examples of these are the MACD, moving averages, and Stochastics. However, though profitable day traders DO follow their indicators, they are also aware that nothing is 100% foolproof.

You will not get rich on just a single trade.

Successful traders know that trying to hit a lucrative home run on just one trade is a sure way to get burned. The key is consistency. You need to devise a solid strategy that produces consistent trading profits, and you need to learn and adapt as your experience with day trading grows and evolves.

If you want to succeed with trading, then you MUST invest both time and money to acquire the **knowledge** that you need, the **discipline** to follow your trading strategy, and the **patience** to wait for the "perfect trade."

You need the following mindset:

1.) **Play Above the Line**

Playing above the line means taking OWNERSHIP for everything that's happening in your trading. Rather than blaming, making excuses, or denying that there's a problem, be AC-

COUNTABLE for your trading decisions and actions, and take RESPONSIBILITY for doing something about it.

There is no "bad market," there's just a "bad trading approach to the market." Nobody forces you to trade a certain market. If a market becomes un-tradable, you can change to another market. And you can change your trading approach and adjust your trading plan. There are many things YOU can do. As a trader, YOU are responsible for your trading results, nobody else.

2.) Have a Positive Attitude

Trading can be simple, but it is not easy. Along the line, you will face losses, but you need to get up every single morning believing in you, your strategy, and WINNING. Have you ever heard of "The Law of Attraction?" Basically, it states that in order to achieve success, you need to focus and concentrate on attaining that success. And the opposite applies too: if you focus on the negative – on losses – then you'll probably experience losses. It's extremely important that you ARE positive and that you STAY positive.

3.) Exercise Honesty

You overtraded this week? You let your emotions get the best of you? You didn't stick to the strategy? Fine – these things happen to the best of us. But don't lie to yourself, and don't make excuses. Take responsibility for your actions and your decisions. Admit a mistake, learn from it, and move on.

4.) Be Committed

Trading success will not happen overnight. It requires commitment, time, and effort on your part. There are already too many "traders" in the market who think they know everything they need to, who think they don't have to learn anything; they believe a "magic system" will place their trades for them and make them rich. You and I know that this is a sure path to failure.

> Trading is like every other profession: you learn the basics, you apply them, you gain experience and then you refine your trading. The learning never stops. Do you really expect to make millions of dollars after only investing a few hours of time into your education? You wouldn't trust a doctor whose only education was from free, downloaded Internet eBooks, would you?

There's no doubt about it: day trading can be a profitable and exciting way to earn money. With the right knowledge, you can radically reduce the risk, which will create even more opportunities for achieving trading success.

If you're not willing to spend the time learning the techniques of trading, reading about new and improved trading strategies, and working wholeheartedly in a fast-paced trading environment, then day trading is probably not for you.

However, if you have the drive, dedication, and discipline, day trading could seriously impact the shape and success of your financial future.

Action Items:

- ✓ Decide right now that you will have the discipline to follow your plan, that you will play above the line in your trading, that you will maintain a positive attitude, that you exercise honesty, and that you are 100% committed to your trading success.

- ✓ Start a trading journal. Most successful traders have one. Get your hands on a nice notebook and begin to record your trading progress and your feelings every day. You can start now. Write down today's resolutions; you will NOT use day trading to get rich quick. Circle it three times and read it frequently. It will help, trust me.

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Is It Really Possible to Make a Living As a Day Trader?

This question is asked over and over and over again by many, many people. The answer is: "Yes, it is possible!"

And, better yet, you yourself can do it.

Sometimes people don't believe me when I say that they can become successful, full-time day traders, but it's true. And I'm going to prove it to you right now.

Trading for a Living

Before we get started, I need you to ask yourself one very important question: "How much is 'a living?'" Many people want to be 'rich,' but they fail to quantify what 'rich' means to them. Are you 'rich' if you have one million dollars?

Maybe so, but if you told Donald Trump that he had one million dollars in his bank account, he'd wonder what had happened to the rest of his money. He'd be furious!

One million dollars to Donald Trump equals broke!

Over the past couple of years, I've taught hundreds of people how to make money with day trading.

I've taught people in countries where $2,000 allows you to live like a king in a 6,000 square foot mansion with a butler, a gardener, and a cook.

And I've taught people who live in California, where they have to make at least $20,000 just to pay for their mortgage, their utility bills, and gas for their cars.

I've taught musicians who wanted to make $5,000 per month, which is twice as much as they have made throughout their whole career.

And I've taught business executives and successful business owners, who needed at least $50,000 per month to maintain their current lifestyle.

As you can see, "making a living" is a very broad term.

Since I don't want to get into a deep discussion about "how much money is a decent living for *you*," let's just assume that you would be pretty happy if you were making $150,000 per year, and let's say that you are making this money with your trading. Does that sound reasonable?

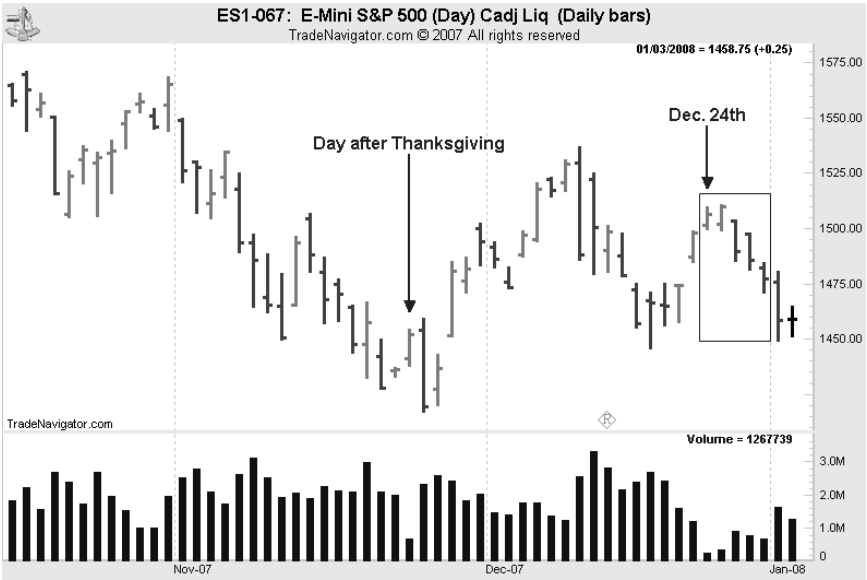
Let's break it down: $150,000 per year would be $12,500 per month, or, if you prefer, $3,000 per week. This is assuming that you are taking two weeks of vacation per year.

IMPORTANT: Don't set daily targets when you trade. In order to make money, two conditions have to be met:

1.) **YOU** have to be ready to trade.
2.) **THE MARKET** must be ready to be traded.

There will be days when YOU are not at your best (sickness, emotional stress, no time because of an emergency, etc.), and there will be days when the market is not ready to be traded (e.g. holidays, including the days before and after holidays, days before a major news release, like the Federal announcement regarding interest rates or the unemployment re - port, etc.).

Take a look at the following chart. The markets were open the day after Thanksgiving and on Dec 24th and 26th, but there was barely anybody trading, which you can see reflected in the volume bars. It's the same between the rest of the days after Christmas and through New Year's Day in 2008. Though the markets were open, the volume was very thin. During these types of low-volume days, markets can be easily manipulated and might behave very erratic, so it would be best to stay away from trading.



And that's why you shouldn't set daily goals in your trading: those goals will force you to trade on days when both of the previously mentioned conditions – you AND the market being ready – are NOT met.

It's important to start small and set a weekly goal for only ONE contract, or 100 shares. This goal should be LOW, very low, so that it is easy for you to reach it. Think about high-jumping: you train with a bar that's only three feet high. It's easy to jump. Then, once you manage three feet, you raise the bar another inch. And another. And another.

In order to trade successfully, you shouldn't raise the bar too high too fast. Put it at a level that you can manage every single time. You can always increase it at a later date, once you've proven that you can meet your goal consistently.

Example:

In the first four weeks of your trading, you might set your weekly target at $100 per contract. This might sound too easy for you, but keep in mind that 90% of traders lose money in the markets. When you can make $100 per contract consistently, you can start "raising the bar." Try $150 per contract per week. Raise the bar again and again, but make sure that you're still comfortable in achieving your goals.

When day trading futures, options, or forex, you can use leverage and trade multiple contracts on a rather small account. If you're thinking about trading the futures market, then you can easily find a broker who will enable you to trade one contract of almost any futures instrument that's out there – E-mini S&P, E-mini Russell, currency futures, interest rates, commodities, etc. – on a $2,000 account.

After awhile, you might raise the bar to $300 per contract per week. So, if you want to make $3,000 per week, then you need to trade ten contracts. The same applies to stock trading: if you can make $300 per week trading 100 shares, then you need to trade 1,000 shares in order to make $3,000 per week.

At this point, you might not have enough money in your trading account to trade in these increments, but don't worry – we'll get there.

The key element to trading success is having a sound trading strategy that produces consistent profits. If you can make money day trading one contract or 100 shares of stock, then you can make money day trading ten contracts or 1,000 shares of stock.

Ideally, to achieve your weekly goal, you'll have a high average profit per trade. The average profit should be at least 50% higher than your average loss, preferably even twice as high.

One of the strategies that I use and teach to my students calls for a profit target of $300 per contract and a stop loss of $200 per contract. You'll notice that the profit target is greater than the stop loss. That's the beauty of it: all you need is one net winning trade, and you'll have achieved your weekly goal of making $300 per contract.

So if you're lucky, you could achieve your weekly profit target on Monday morning with the first trade.

But what if you lose?

As everyone in trading knows, losses are a part of the business, and you can't avoid them. If that's something you have trouble accepting, then you shouldn't be trading. However, there's a huge difference between losing big on a regular basis and losing small in a controlled trading plan. You already know that you should keep your losses small; the key is to keep them smaller that your average wins.

Let's go back to the scenario I mentioned before: you have a trading strategy that produces $300 in profits for every win and costs you $200 for every loss. Now, if your weekly goal is $300, and if your first trade was a loss of $200, then you need to make two winning trades to achieve your weekly profit goal.

Let me take this a little farther and actually break it down for you: you've lost $200 on your one losing trade, and then you make $600 on your two winning trades ($300 each). Your net profit = $400. Goal achieved. Now, STOP TRADING. Otherwise, you'll end up giving back the money you just made to the markets. Lock in your profits!

Of course, you're not always guaranteed a week with only one loss. Let's look at a week that starts off with three losses. With three losses, you are now down $600 ($200 each). So you would need to have three wins that result in $900 ($300 each). Subtract the $600 you lost on the losing trades from the $900 you won on the winning trades, and your resulting net profit is $300. Goal achieved. Stop trading.

"Wait a minute – you're saying that I will achieve my goals with a winning percentage of only 50%?"

YES! That's exactly what I'm saying! Read the example above again: you lost $600 on three losing trades, made $900 on three winning trades, and came out with a net profit of $300. This means that you could pick a losing trade every other time and STILL achieve your weekly profit goals!

I want to stress this point again, because many traders neglect this im - portant concept of setting weekly goals. They define daily goals, which create an enormous psychological pressure, and then they trade markets when they shouldn't, and they lose.

So let's just assume for a minute that you do end up achieving an actual winning percentage of only 50%. Now, when you start trading again on Monday morning, what are your chances of having a winning trade? 50%! You have a one in two chance of meeting your weekly profit goal in just one, single trade!

So if you DO achieve your weekly profit goal on the first trade Monday morning, what next?

Stop trading for that week! Just enjoy life! It doesn't get any better than that.

Remember, you need to stick to your trading plan and your weekly goal. Do NOT enter into another trade once you've already achieved your weekly goal; the chance that your second trade may be a losing trade is too great, and you would be giving your money and profits back to the market. Overtrading and greediness are a trader's downfall, so resist them and stick to your strategies.

Now, you know that you can achieve your weekly profit goal with a winning percentage of only 50%. Throughout the course of this book, I will help you to get an even sharper edge in your trading, creating a trading strategy with an even higher winning percentage.

A Quick Recap:

The first step towards financial success is to define your weekly profit target. Next, you need to find a reliable, straightforward trading strategy that will help you achieve your profit goal. When you enter into a trade

and your trade hits either your profit target OR your stop loss, exit that trade immediately. Stick to your trading plans and strategies until you achieve your weekly profit goal, and then give yourself a rest until next week.

If you'll think back to the case I gave at the beginning of this section, in order to make $150,000 per year – assuming a 50-week year and two weeks of vacation – you'd need to make $3,000 per week. At a $300 profit per trade, this means that you would need to trade ten contracts (or 1,000 shares). Of course, this illustration can be applied to various amounts. If you wanted to make $225,000 per year with a weekly profit target of $300 per contract, for example, then you would have to trade 15 contracts (or 1,500 shares), and so on, and so on.

If you don't have a trading account that let's you trade the amount of contracts or shares that I'm talking about yet, then now is the perfect time to start building it. Remember, be patient with your trading, be smart, be slow, and be steady. Trading success doesn't happen overnight, but with the right strategies and structure, you can achieve profitable re - sults in a much shorter time period than you may have thought possible.

Plan your trades and trade your plan. THAT'S how successful traders make money.

Action Items:

- ✓ Start your trading plan now. You will find a trading plan tem plate in the appendix on page 245. Define how much money is "making a living" for you. How much money do you want to make with trading? Break down your overall goals into monthly and weekly targets.

More trading books in :
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How to Get Started - Define Your Goals and Make a Plan

When it comes to trading, many first time traders want to jump right in with both feet. Unfortunately, very few of those traders are successful; successful trading requires knowledge, skill and experience.

Before you dive in, you need to determine what your goals are. What do you hope to achieve with your trading activities? Why do you want to trade?

- To buy a new sports car?
- To buy a bigger house?
- To make $100,000 a year / month / week?
- To finance a college education for your children?
- To make a full-time income to support your entire family?
- Freedom to choose what, when, and who you do things with?
- To have a fun, exciting life full of extraordinary experiences?
- To work less and enjoy more time with your loved ones?
- Or are you just planning to make some extra cash on weekends?

Before you trade a single penny, really think about what you hope to achieve with that investment. Knowing what your goal is will help you stay motivated when you're facing a tough spell of trading, and it'll help you make smarter investment decisions along the way.

But be realistic:

Too often, people start day trading with dreams of becoming rich overnight. I'm not going to say that it is impossible (because it is possible), but let me remind you that it's also very rare. It's much safer to create a trading strategy that will allow your account to grow at a slower pace over time, which can ultimately be used for retirement or a child's education.

So let's talk about how to define your goals and make a plan for your day trading endeavors.

Here are the three important steps:

1.) Define Your SMART Goal

SMART is an acronym which stands for:

- **S**pecific
- **M**easurable
- **A**ttractive
- **R**ealistic
- **T**imeframe

Fortunately, when it comes to day trading, it's very easy to define a goal that meets all of these criteria. You simply specify exactly how much money you would like to make per month with your day trading.

Example:

I want to make $10,000 per month with day trading.

- **Is this SPECIFIC? –**

  Yes, a dollar amount of $10,000 is very specific.
- **Is this MEASURABLE? –**

Absolutely! Just check the balance of your trading account at the beginning of the month and at the end of the month. Your account balance is the easiest way to measure the achievement of your goal.

- **Is this ATTRACTIVE? –**

  That depends on you. $10,000 is definitely attractive for someone who currently makes $4,000 per month, but it wouldn't be attractive to someone who's already paying $10,000 just in mortgage payments for his 6,000 square foot home. Make sure that YOU are motivated by this goal.

- **Is this REALISTIC? –**

  We talked about this in the previous chapter. Successful people believe that there are no unrealistic goals; only unrealistic timeframes. Right now, your trading account may not be big enough for you to realistically trade enough shares or contracts to achieve your long-term trading goal, but if you follow the steps outlined in this book, it's very possible that your long-term goal WILL become realistic in the near future.

- **Does it have a TIMEFRAME? –**

  Of course it does: you want to make $10,000 per month; the timeframe is 30 days.

2.) Make a Plan

Developing a plan is essential to your success, but we're getting a little ahead of ourselves. We'll talk about your trading plan in detail in the second part of the book, "Your Trading Strategy – The Cornerstone to Your Trading Success." Just make sure you don't mix up the order: you first define your trading goals, and then you develop a trading plan.

Many traders look for a trading strategy first and then hope that the trading strategy will help them achieve their goals. That's putting the cart in front of the horse.

Regardless of what you're doing, you should first define WHAT you want to accomplish, and then plan HOW to achieve that goal. Otherwise you might find out that you started climbing up the wrong ladder right at the very beginning.

3.) Execute the Plan

This is where the rubber meets the road. Once you have your plan, you'll need to actually execute it. And naturally, that's where most of us fail.

Let me give you an example:

Amazon lists 18,361 books for "Weight Loss" and another 28,707 books for "Exercising and Fitness." That's a total of 47,068 books on the popular topic "How to Lose Weight" (compared to only 4,463 books in the category "Stock Trading and Investing").

If I wrote a book on weight loss, it would be a very, very short:

1.) Eat less.
2.) Exercise more.

Come on, it's simple: we all know that we can lose 10 pounds in 10 weeks if we just follow those two rules.

We reduce our calorie intake to 1,500 or 2,000 calories per day, and then we do some aerobic exercises at least three times a week for a minimum of 30 minutes.

We have a SMART goal ("lose 10 pounds in 10 weeks"), and we have a plan ("eat less and exercise more"), so why do we keep buying these books and magazines that promise a new diet, a new way to lose weight?

Because we fail to execute our plan.

And then we blame the plan: “it’s too hard,” “it’s impossible,” “it doesn’t work.” This isn’t true. We didn’t succeed because we were simply too lazy, or we didn’t have the discipline to execute our plan. But instead of working on the true problem – the execution – we change the plan itself, hoping that there’s an easier way.

Successful people will realize that their problem doesn’t lie in the plan, but in the execution.

Here’s what you can do in order to ensure your own motivation and discipline when it comes to executing your plan:

It’s important to focus on the big picture. It’ll help you stay motivated when your learning reaches a plateau, or when you face a couple of losses. All great accomplishments start with a great vision.

Once you’ve defined your SMART goal and the amount of money you want to make with trading, ask yourself this: “How would achieving this goal impact your family life?” and “how would it affect you personally?”

Take your time to answer these questions and write down the answers.

As you know, human beings are great at procrastination. We don’t like to be outside of our comfort zone, and that’s why sometimes we do nothing and just “hope” that we will achieve our goals. As you can imagine, the chances of achieving a goal by doing nothing are slim to none. So, answering the next question will help you to take action immediately.

Ask yourself: “Why should you act NOW?”

When you take the time to actually think about the answer, it will be a huge motivator. Little tricks like this will help you stay focused on your long-term goal, which will help you to execute your plan.

Action Items:

- ✓ Continue your trading journal. Write down the reasons WHY you want to trade and what you are trying to accomplish with your trading. Be specific! Define your smart goals. Dream big.

- ✓ Write down the impact that your trading success will have on YOUR life and the life of your family. This is an important step, because it'll help you get through the challenging times, which all traders experience.

How Much Money Do You Need to Get Started?

The answer to that question depends on the market you want to trade. Using a systematic approach, we'll determine the best market for you over the course of the next few chapters, but the information below will give you a basic idea of your options:

- If you want to day trade stocks, then you need at least $25,000 in your trading account.
- If you want to day trade futures, then you should have between $5,000 and $10,000 in your trading account.
- When trading options, you should have between $1,000 and $5,000 in your trading account.
- If you're thinking about trading forex, then you can start with as little as $500 in your trading account.

Financial considerations are always important, but don't make the common mistake of letting your current financial situation dictate which market you're going to trade.

Remember: you <u>first</u> define your goal, and <u>then</u> you plan how to achieve it.

If you don't have sufficient funds to trade the markets you've outlined in your goals, then start doing something about it now – save more money

or put in overtime hours. There are a lot of ways to make a few more bucks, and it's better to wait for the funds you need than to begin trading in a market that isn't right for you and your goals.

For those of you who already have the right amount of money in your savings account, let's talk about the question, **"How much money SHOULD you trade?**"

Many first-time traders think they should trade all of their savings. This isn't true! To determine how much money you should trade, you must first determine how much you can actually afford to lose, and what your financial goals are.

Let's begin by determining how much of your savings should remain in your savings account. It's important to keep three to six months of living expenses in a readily accessible savings account, so set that money aside, and don't trade it! You should never trade money that you may need immediately. Unless you have funds from another source, such as a re - cent inheritance, the remaining amount of money will probably be what you currently have to trade with.

Take a good look at how much money you can currently afford to trade. You don't want other parts of your life to suffer when you tie your money up in a trade, so make sure to consider what these savings were originally for.

Next, determine how much you can add to your trading activities in the future. If you are currently employed, you will continue to receive an income, and you can plan to use a portion of that income to build your investment portfolio over time.

Two more important things to remember:

- As outlined above, certain types of investments require an initial deposit amount to get started. This does not mean that you will be risking the whole amount (see the chapter "Determining Your Risk Tolerance" on page 27). Many traders are only willing to risk 10% of the initial deposit.
- Never borrow money to trade, and never use money that you can't afford to lose!

Action Items:

- ✓ Take a financial inventory. Considering the points mentioned above, define how much money you have to trade with right now.

- ✓ If you don't have enough money to start trading yet, make a plan of how you will save or earn the money that you still need.

- ✓ Continue your trading plan on page 245 and fill in the amount under "My Account Size."

Determining Your Risk Tolerance

Each individual has a risk tolerance that should not be ignored. Any good broker or financial educator knows this, and they can help you determine what your risk tolerance is and work with you to find investments that do not exceed that risk tolerance.

Determining one's risk tolerance involves several different things. First off, you need to know how much money you have to invest, and what your investment and financial goals are. (See the chapter "How to Get Started – Define Your Goals and Make a Plan," on page 17.)

For instance, if you plan on retiring in ten years, and you haven't saved a single penny yet, you'll need to have a high risk tolerance, because you'll need to do some aggressive trading in order to reach your financial goal.

On the other side of the coin, if you're in your early twenties and you want to start investing for your retirement, your risk tolerance can be low. You can afford to watch your money grow slowly over time.

Realize, of course, that your need for a high risk tolerance or your need for a low risk tolerance really have no bearing on how you feel about risk. Again, there is a lot in determining your tolerance.

For instance, if you entered a trade, and you see that trade go against you, what would you do?

Let's say you are facing a $100 loss. Would you sell out, or would you stay in the trade? If you have a low tolerance for risk, you would want to sell out. If you have a high tolerance, you would wait and see what happens.

This decision is not based on what your financial goals are. This tolerance is based on how you feel about your money.

And, of course, your account size plays a vital role in determining your risk tolerance. If you have a $2,000 account, then a $1,000 loss might make you nervous, since you are losing 50% of your capital.

But if your trading account size is $100,000, and you are facing a $1,000 loss, then you might be more relaxed, since it is only 1% of your account.

As you'll learn, emotions are a very important factor in trading; therefore, it's important to take the time to determine your risk tolerance. Talk to a professional if needed. A good trading coach, financial advisor, or broker should be able to help you determine the level of risk that you are comfortable with.

Action Items:

- ✓ Determine your risk tolerance. If you're unsure about how to go about doing this, get in contact with my company, Rockwell Trading®, and we'll provide you with a set of questions that will help you to determine your risk tolerance.

- ✓ Continue your trading plan on page 245 and fill in the amount under "I Am Willing to Risk…"

What You Need to Begin Trading

I n order to day trade, you'll need:

1.) A computer
2.) An Internet connection
3.) A charting software
4.) A broker
5.) A properly funded trading account
6.) A good trading strategy

A Computer

You don't need the latest computer, and you don't need the most expen - sive. Basically, any computer that you've purchased in the past two years will do the trick. Most charting software and trading platforms run on Windows, so if you're thinking about getting a MAC, make sure that the software you are considering is MAC compatible. Notebooks are fine, too. Just as a guideline, here are the minimum specifications:

- IBM or IBM compatible Pentium IV-class computer
- 1 GHz or greater
- Windows 2000, Windows XP
- 256MB RAM (use 1GB of RAM when running Windows XP)
- CD-ROM drive
- Minimum of 3GB of hard disk space

You'll also need a second screen. You should have your charting software on ONE screen for the entry and exit signals, and your trading platform on ANOTHER screen for entering the orders. A second monitor will cost you around $150-$250. Don't be cheap on monitors; you need to make sure that you can see your charting software in crystal-clear clarity. A 17" monitor will do the trick. A 19" is even better. Over 19" is pretty much overkill. You can have a bigger monitor, but you don't need one.

An Internet Connection

Don't be cheap here. Don't ever try to trade using dial-up or a modem connected to your phone. A reliable Internet connection is essential for your trading success. After all, the data you receive from the market is what you'll base ALL of your trading decisions upon, so you can't afford a delay.

Invest in a DSL or cable connection. No T1 connection needed.

A Charting Software

Online day trading has developed to the point where charting software is an indispensable tool of both professional and novice day traders alike. The times when you drew your own charts in a notebook using quotes from the morning newspaper are long gone. These days, powerful charting software packages allow you to access the market information in real-time; this information is displayed in a variety of ways, all of which can help you in carrying out your trades.

Choosing the "right" charting software is a very personal decision – it can be compared to choosing the right car. What another trader chooses may be different from what you choose, and vice versa. That's why it's important for you to carefully evaluate a list of features – with both advantages and disadvantages – before you make a decision on a data feed and charting package.

The bottom line is that you need to have a list of criteria, and you need to compare and contrast the available charting packages using that list. Make your choice based on the results. Here are some examples of criteria you may want to use:

- **Real-Time Data**

  You need a solid platform that can deliver real-time data instantly. This feature alone will exclude many of the options available, because a lot of web-based programs will have some sort of delay. When it comes to day trading and/or swing trading, you can't afford to deal with a delay, even if that delay would be perfectly acceptable in long-term trading.

- **Market Data Coverage**

  Check out the markets that are covered by the charting software. Most packages include the major U.S. markets, but if you need other international markets, like Asian or European markets, then you need to make sure that data is available in real-time.

- **Wide Variety of Indicators**

  Depending on your individual needs, you might be interested in a broad range of indicators and charting methods, such as bar charts, point-and-figure charting, or Japanese candlesticks. In addition, check to see if the charting software can display basic indicators like MACD, RSI, and Moving Averages easily. If you're serious about technical analysis, make sure that you can program your own indicators or modify the existing ones to your needs without too much hassle.

- **Competitive Rates & Money Back Guarantee**

  You need trading software that will not cost you all of your money before you even enter your first trade. It's important to shop around. However, finding a competitive rate does not mean that the provider's software is the cheapest. You have to be careful on this one – the old saying "you get what you pay for" definitely applies when it comes to trading. Weigh your options. You

don't want cheap trading software that offers you next to nothing, but you probably don't need the most expensive package – with features you won't even use – either.

And make sure that the provider you select will allow time for you to test how the software platform actually works. If you're uncomfortable with using it, you should be able to claim a refund within the first 30 days.

- **User Friendly Platform & Complete Training**

  Unless you're a skilled computer programmer, you need to have a platform that you can use easily, not one that requires a degree as a Computer Engineer. Trust me, those types of platforms ARE out there! You'll need software that allows you to back-test strategies and program custom indicators and trading systems without a lot of trouble.

  And, if you just can't seem to find trading software out there that is EASY to use, then find a software platform that comes with a detailed user guide. A guide will help you become familiar with the system and educate you at the same time.

- **Reputable Company**

  Choose a reputable company that has an established presence on the Internet for its platform and data feed. And naturally, choose a company that has excellent customer support service.

  Keep in mind that you can add other criteria to this list based on your trading goals, such as the ability to quickly switch between different timeframes. As I said previously: it's a very personal choice that only you can make.

The following section includes my own personal reviews of a few major software packages.

eSignal
(www.esignal.com)

eSignal is owned by Interactive Data Corporation, and it's been around in the trading industry for more than 20 years. In April 1999, it was launched on the Internet.

As of February 2008, the prices for eSignal range from $125/month (for eSignal Premier) to $195/month (for eSignal Premier Plus), which makes this package slightly more expensive than a number of other trading plat - forms out there. If you're an options trader, you'll have the capability to see 1,000 symbols through an options analysis package. In other words, you can expect to pay as much as $249 to $360 every month.

However, given that eSignal's charting and data feeds are coming from the same provider, there will be no issues that the software provider can blame on the data feed, or vice versa. (This "blame game" is something that every professional trader has – or will – experience at some point while using trading software).

In my opinion, eSignal's user interface is not the most intuitive available on the market today; it's often necessary for users to refer to the help system over and over again. However, the charts can be customized in many different ways, according to your needs, and once you get used to the various shortcuts, the charting platform is actually pretty effective for fast decision-making.

When it comes to a tutorial system, the company provides complete au - dio and video training to new users. There's no need to fear being a new - bie – you can familiarize yourself with the software in no time.

Now, after you set up a chart in a way that you're comfortable with – which is done by customizing sizes, colors, indicators, etc. – you can save this format and apply it to other charts without delay. The sets of charts and quote lists can be saved as 'Pages,' and it's possible to switch between these pages swiftly and easily.

Each and every window in the platform can be popped out of the main eSignal window, which is a tremendous help when it comes to getting the

best out of that multi-monitor systems of yours. Besides the charts, eSignal offers quote lists, level 2 screens, and news tickers to keep you updated. All of these features can be connected to one another. For example, picking a symbol in a quote list will make all of the linked charts, level 2 screens, etc., change to the same symbol almost immediately.

All of the standard technical indicators are available, and there's also a program using JavaScript language called EFS (which is the foundation language for eSignal Formula Script) for writing your own series of procedures; these procedures can be employed repeatedly all throughout the life of the programs. EFS can also be used for communicating with broker interfaces, and, of course, for back-testing.

If you really want to get into a more advanced customization, there are a couple of levels of API offered at additional cost, and these supply raw access to the eSignal data feed. A standard subscription will let you monitor up to 100 symbols, the next level up being 250, and if that's not enough, you can pay a little extra to get even more symbols to monitor.

The data feed itself is probably the best ingredient of the eSignal package. A trustworthy global market data feed, which eSignal has staked its well-known reputation in the active trader community on, is available right in front of you. To guarantee a nonstop transmission and perfect accuracy of data, the company maintains fully redundant ticker plants, and data can be exported through a flat file for you to open in Excel or another spreadsheet application.

eSignal is without a doubt one of the best data feeds you can find on the Internet. The charting product is powerful enough for most traders, with EFS adding to its effectiveness.

TradeStation
(www.tradestation.com)

Since its arrival in the online trading community in 1997, TradeStation has become the top choice for tens of thousands of high-rated traders around the world; it's won various awards from industry publications, including Barron's and Technical Analysis of Stocks and Commodities. It was also named Stocks and Commodities Magazine's Reader's Choice

Award for Best Trading Software five years in a row, from 1994 to 1999. It is generally accepted as the industry standard when it comes to chart - ing software.

TradeStation is probably the first trading platform in the world that gives you the ability to create, test, and fully automate your own rule-based trading strategies on a daily basis. When you're ready for your first trade, TradeStation can watch your trading rules and even carry out your trades 100% automatically.

It's also designed to help you discover some potential market oppor tuni- ties and then perform your trades more professionally than you could ever do on your own. TradeStation essentially monitors the markets for you tick by tick, in real-time on the Internet, and seeks out all of the op - portunities based on your trading plans.

The instant an opportunity arises based on your custom buy or sell rules, it's designed to automatically generate your entry and exit orders and send them to the marketplace within fractions of a second of the market move.

TradeStation even created a programming language called Easy Language that is very user friendly once you get the hang of it. You can easily create your own trading rules, such as when to enter the market and buy, or when to get out and sell. You can automate practically all of the trading strategies you could ever think of, including multiple orders, entries and exits, profit targets, protective stops, trailing stops, and more.

It allows you to back-test, program custom indicators, and modifies indi - cators to your needs. Then, with just a single click of your mouse, it will back-test your strategy on up to 20 years of authentic, intra-day market data, giving you the simulated results. TradeStation will provide you with information on all of the trades you would have positioned, your simulated net profit or losses, and much more, before you even risk one single penny from your real trading funds.

When you first set up TradeStation, it may be a little overwhelming for you to use the software. However, for $99.95 to $199.95/month, which allows you to utilize TradeStation's award-winning features, it is proba -

bly worth your time to become skilled and get acquainted with this trad - ing platform.

It is definitely no coincidence that TradeStation has become one of the most desirable trading platforms for active traders, both professionals and novices, through its dependability and the power of automation.

MetaStock
(www.metastock.com)

If you love using the technical analysis strategy, MetaStock, by Equis International (Equis has been acquired by Reuters), might be your #1 tool to trade. And, if you don't know anything about technical analysis, but you've always wanted to apply this kind of approach when it comes to your investments, then you might be interested in using this software as a learning tool.

As of February 2008, MetaStock is available for a one-time fee of $1,395.

You can use QuoteCenter, which receives real-time data directly from Reuters – the leading source of financial news to the world's media – and combine it with MetaStock Pro. The main program itself is very user friendly, and it's quite easy to familiarize yourself with all of its func - tions, even if you're a beginner. The program is also fully compatible with Microsoft Office, which means you can cut and paste data directly into Excel or Word.

Equis has provided all types of chart forms and features; trendlines, moving averages, resistance lines, support lines, and various other tools of the trade are accessible by simply clicking and dragging your mouse. You can also choose the Internet option to receive quotes, news, and op - tion symbols straight from Reuters, without any charge.

The new version, MetaStock Professional 8, includes all of the previous version's capabilities – such as extensive charting and analysis – and it's designed to work with a real-time data feed such as BMI or Signal Online from the Data Broadcasting Corporation.

Many traders say that one of the best features in Metastock is the search facility. The search facility will let you search your entire database of stocks and shares based on your specified criteria. The plan is to uncover any stocks that display according to your trading strategy. The program will then calculate how much money you could make using a particular trading strategy. The results will give you detailed information, such as when to buy and sell at what price, and how much was made or lost from each trade.

Equis will also give you a CD full of historical data from which you can create charts, along with the online connection you need to upgrade the database anytime you want. You'll receive a 550-page manual of Tech - nical Analysis, from A to Z, which will make even the novice trader able to master the software and technical analysis methods in no time. Not to mention that the 'HELP' menu even includes an interactive visual tuto - rial, so you won't get bored.

Genesis Trade Navigator
(www.genesisft.com)

Trade Navigator, the trading platform designed by Genesis Financial Technologies, Inc., is a sophisticated charting, technical analysis, and execution platform. Used in conjunction with many trading strategies, Trade Navigator can turn into a perfect, real-time automated trading in - strument, using indicators like Moving Averages, Seasonal, ADX, and Stochastics. Functions such as Single-Click Trading, Calendar, Indicator, Bracketing, Trailing Stop, and more are available right at your fingertips.

OHLC, Candlestick, Line, Mountain, HLC, HL, Histograms, and Points are also included in the platform, and the charts can be separated into panes. Panes can hold any single Indicator or Study, or even a mixture of the two, allowing you to customize the way each chart looks by simply clicking and dragging your mouse to draw, resize, move, or expand the trendlines, support and resistance lines, and other objects. Therefore, no matter what kind of display options you want to employ, Trade Naviga tor is the ideal tool for you.

The Trade Navigator Platinum can do all of the back-testing, developing, and analyzing for your trading strategies utilizing Tradesense, a simple

input language, which does not require you to be an expert in computer science to use it. It comes with a complete training video series, free training, and a manual. Tradesense is the core feature of the Platinum system, and you can learn it pretty fast. It combines common English and simple math symbols for powerful analytics and crucial input.

With Tradesense, you can take any strategy idea – whether it's from a trading book, a seminar, or even from your friend – and test it using a variety of order types (such as limit orders and stop orders) to develop and analyze its performance. Tradesense will spot the indicators you're looking for, and then automatically fill in the values for you.

Precision Tick is also another unique feature from the Genesis testing system; it allows you to back-test any strategy, and it ensures that every rule is executed precisely based on real-time market conditions. You also have the ability to create your next bar orders. Any strategy you put into the program can be completed with an "Action." Once certain criteria are met, whether Long or Short, it will let you place a given order.

With Trade Navigator, you can create your own custom indicators and strategies, you can trade direct from the chart, and you can use the Instant Replay mode if you want to practice your trading. Speaking of which, with Instant Replay, you can go back to a certain date in the past and observe the data as it fills in, watching the way it moves on the days that the bars were created.

It's like having your own time machine, which allows you to travel back in time and then move forward to the present time as you watch the chart changing in front of your eyes. Instant Replay mode is the perfect tool for any type of trader to plan for real-time trading without any risk at all.

Trade Navigator is available in three different versions: Silver, Gold, and Platinum. Prices start at $99 plus data updating fees of $25 per month for stocks, or you can pick the package of $65 per month for stocks, futures, indexes, and some options. To help you run the software immediately, Genesis allows you to use hundreds of pre-programmed indicators and parameters so that you'll be able to quickly identify the best strategy based on your approach.

Genesis also has a variety of training videos available and offers free webinars on a regular basis, to help you get the most out of their software package.

Charting Software Conclusion

Hopefully you now have a better idea of what type of trading software will best fulfill your needs. Remember, powerful charting software is what gives you the velocity and ability to carry out nearly instantaneous trades in response to breaking news. In time, you might want to move on to more sophisticated software as you become more experienced in the trading world.

Remember, don't purchase trading software before you compare all of the packages available. If you don't take the time to compare and contrast, you may get sucked into cheap software that doesn't have the functions you need; OR, you may get suckered into expensive software which has many features that you'll never use.

If you need any help setting up your trading platform, or have any other questions, you can always utilize the company's customer support.

Take advantage of free trials and money-back guarantees. Remember, selecting the right software for you is a very personal choice, and you won't know if it's right for you until you test-drive it.

A Broker

You may wonder if you really need a broker. The answer is yes. If you intend to day trade, then you must have a broker. And it doesn't matter whether you are trading stocks, futures, forex, or options: unless you are a member of the exchange, you won't be able to place your orders without a broker.

Stock-, futures-, and options-brokers are required to pass different tests in order to obtain their licenses. These tests ensure that the broker knows his business and will be able to support you if needed.

It's very important to understand the difference between a broker and a market analyst. An analyst literally analyzes the stock or futures market, predicting what it will or will not do, or how specific stocks or commodities might perform. A broker is there to follow your instructions to either buy or sell, not to analyze the markets.

In most cases, brokers earn their money from commissions on sales. When you instruct your broker to buy or sell, they earn a set percentage of the transaction. Many brokers charge a flat 'per transaction' fee.

There are two types of brokers: **full-service brokers** and **discount brokers**.

Full-service brokers can usually offer more types of investments, may provide you with investment advice, and are usually paid in commissions.

Discount brokers typically do not offer any advice or research; they just do as you ask them to do, without all of the bells and whistles.

So, the biggest decision you must make when it come to brokers is whether you want a full-service broker or a discount broker.

If you are new to investing, you may need to go with a full-service broker in order to ensure that you are making wise investments. They can offer you the skills that you lack at this point. However, if you are already knowledgeable about the market you want to trade, then all you really need is a discount broker to make your trades for you.

Selecting the right broker can be a tedious battle for most novice traders. There are more than a hundred online brokers today and additional choices are becoming available all the time.

The challenge lies with too many choices – it isn't easy to choose which broker is best for you amongst all of the many options out there.

This section, though, is all about providing you with some necessary tips for picking an ideal trading broker.

First off, you'll need to double your diligence if you're looking for a forex trading broker. Since the foreign exchange market is worth trillions of dollars, it offers lucrative opportunities for brokers to set up their firms online. And since the foreign exchange market is decentralized, it can be hard to identify quality brokers amongst all of the unscrupulous brokers with fraudulent practices.

Your chances of finding an honest and reliable forex trading broker will dramatically increase if you follow the guidelines below:

- Always request references that you can actually speak with.

- Do a check with the local regulatory agencies and make sure that the forex trading broker is registered. For U.S.-based brokers, see if they are registered as Futures Commission Merchants (FCM) with the Commodity Futures Trading Commission (CFTC), and registered with the National Futures Association (NFA).

- Compare the account details, such as the minimum deposit required, leverage, spreads, and so on. Ask them specifically if commissions are chargeable, lot fees, etc. This is to ensure that you do not incur hidden costs. Some sneaky brokers will deliberately give you an impression that they are the cheapest to use, but in actual fact, they'll hit you where it hurts when it comes to hidden charges.

- The trading platform needs to be user-friendly. Many traders, especially first-timers, find it challenging to navigate trading software. Just making sense of the charts and currency prices can be a challenge. So, if there are demo accounts, try them.

I've also included a list of questions for you to ask your broker in the appendices.

Remember, this broker or brokerage is going to be your teammate when it comes to making you a wealthy person. So be picky and be cautious.

A Properly Funded Trading Account

Obviously, you need money to trade. But you've also heard this warning several times: "Don't trade with money that you can't afford to lose." You might think that this is just the typical disclaimer that every professional in the trading industry has to use. But it's not. It's much more.

Let me give you an example:

A few weeks ago, I received an email from a trader who told me that his wife had given him a deadline: if he was not trading profitably within the next four weeks, he would have to stop trading altogether and get a 'real job.'

I'm not saying that this trader's wife didn't have ground to stand on, but, as you'll learn in the third part of this book, there's more to trading than just having a strategy. You might have heard that a trader's two biggest enemies are fear and greed. This is very often the case. That's why controlling your emotions is extremely important to your trading.

Now, imagine this trader's situation for me. He MUST be profitable every single week for the next four weeks. Do you think he will be cool and relaxed when he enters a trade? Do you think he will be in control of his emotions? If he loses a few trades, do you think he'll stick to his trading strategy and plan?

Or do you think he'll be afraid of losing money, which means having to give up what he LOVES to do? It will probably be hard to stick to a plan or strategy if he's getting hit with more and more losses. Don't you think it's pretty likely that he'll start making bad decisions and begin, in essence, to gamble his money in the markets, hoping for wins?

I can't stress enough how important it is not to put too much pressure on yourself or your trading performance. And in order to keep the pressure to a minimum, you probably shouldn't quit your day job just yet. Before becoming a professional day trader, your trading must be consistent, and your profits should be almost predictable. Give yourself some time to prove that you have what it takes to trade for a living.

As to the amount of money you actually need, that depends on you. Having too much money in your trading account can be just as dangerous as having too little. If you have $100,000 in your trading account and only risk $100 per trade, you might think of your losses as 'peanuts.' Even though we must learn to accept losses as a part of the business, we should still never think of them as 'peanuts!' There is a balance. You have to find it.

So, in order to avoid situations like the afore-mentioned trader got him - self into, fund your account appropriately – not too much and not too little. And be prepared for a period of time where you may not make a lot of money with it. As with everything, there is a learning process when it comes to trading.

For more information on the right amount of money to get started with, see the chapter "How Much Money Do You Need to Get Started?" on page 23.

A Trading Strategy

Last, but definitely not least: you need a trading strategy.

You can have the latest computer, six screens, a T1-Internet connection, the best broker in the world, and a well-funded trading account, but none of these will produce trading profits for you.

NEVER start trading without a trading strategy.

In the next part of this book, you'll learn how to develop a profitable trading strategy that works for you.

Action Items:

- ✓ Check your computer to see if it fulfills the minimum requirements outlined in this chapter. If not, determine how much it will cost to upgrade your computer. You do not have to upgrade your computer – or buy a new one – now, but you should know the cost if you're getting ready to trade.

- ✓ Check your current Internet connection and determine the cost for an upgrade if needed. Same as with the other trading elements: there's no need to upgrade now, but you'll want to know the cost once you start your trading business.

- ✓ Take a look at different charting software packages. Most of them offer a free 30-day trial. Get familiar with the software and make a decision based on the "ease of use" of the software, NOT on the price. You'll work with this software almost every day, so it's important to choose one that fits YOU best. When you start your trading career, you don't want to spend a lot of time learning the software. It should be intuitive and easy-to-use.

- ✓ Start calling several brokers to obtain quotes. The brokerage business is highly competitive, so you need to shop around for the best commission. But, as outlined above: do NOT base your decision purely on commissions. Your broker is your only team member, and you want to have a team member who you trust and who knows you. Try to find a "personal broker" who has a direct line and doesn't "hide" in a call center. Ask him what he can offer you. After a few calls you will get the feeling of a "good" broker.

Part 2:
Your Trading Strategy – The Cornerstone to Your Trading Success

How to Develop Your Own Profitable Day Trading Strategy

Developing a profitable trading strategy is not as complicated as you might be led to believe. Many people will tell you that it's extremely difficult to build your own trading system, but it's actually pretty straightforward.

The next part of this book will show you how to develop your own trading strategy in seven simple, but very important, steps.

Step 1: Selecting a Market

Step 2: Selecting a Timeframe

Step 3: Selecting a Trading Style

Step 4: Defining Entry Points

Step 5: Defining Exit Points

Step 6: Evaluating Your Trading Strategy

Step 7: Improving Your Trading Strategy

Step 1: Selecting a Market

With the fame of online trading, more and more financial instruments are available to trade. You have a variety of choices, not just stocks, options, and futures. In recent years, financial instruments like Exchange Traded Funds (ETFs), Single Stock Futures (SSF), and the Foreign Exchange Market (forex) have become available for the private investor.

In addition, the existing financial instruments have been enhanced. Exchanges started introducing electronic contracts and mini contracts of popular commodities like gold, silver, crude oil, natural gas, and grains. These futures contracts have become very popular amongst day traders, and the volume of the mini and electronic contracts quickly surpassed the volume of the pit-traded commodities.

These days, you can basically trade ANYTHING. For example, if you want to participate in the real estate market without owning properties, you can invest in Real Estate Investment Trusts (REITs), or even Real Estate Futures of a particular area, like Chicago or Denver (traded at the CME).

In this chapter, we'll focus on the four main markets: stocks, forex, futures, and stock options. We'll examine each of these markets according to the following criteria:

1.) **Low Initial Capital Requirements**

Low initial capital means that you can start your day trading activities with a low initial deposit. It's always better to trade

with small capital and then move up to larger capital when you're comfortable enough with the market.

2.) **Leverage**

Leverage is the second key. With sound risk management in place, highly leveraged markets allow us to place a small amount of capital into the market and realize larger profit potentials. This will enable us to build up a small account quickly.

3.) **Liquidity**

The third factor is liquidity. We'll focus on liquid markets to avoid problems caused by market manipulation and slippage. When trading a market, we want to ensure that we receive quick and accurate fills for our orders, and also that a large order placed by a market-maker or broker does not move the market in an erratic way.

4.) **Volatility**

The fourth factor is volatility. You can make money in any market, as long as it's moving. A market that's just going sideways and doesn't move in any direction is extremely difficult to trade. It's easier to trade a market that's either going up or going down.

Throughout the course of this book, you'll learn how to trade any market, but it certainly helps to know something about the market you're trading. So, we'll include a brief description of markets and participants in the beginning of each of the following sections.

Trading Stocks

The stock market is a private or public market for the trading of company stock at an agreed price. Companies are given a value by investors. The value of the company is divided into many shares. These shares can be bought or sold (raising or lowering the value of the company).

When you buy stocks, you essentially own a little piece of that company whose shares you just bought. You'll become a shareholder. So, the more shares you buy, the larger the portion of the company you own. If the value of the company rises, the value of your shares rises. If the value of the company decreases, the value of your shares decreases.

When the company makes a profit, you may receive some of that profit in the form of dividends; the profit is shared amongst all the people who own the stock.

Ownership of shares is normally called equity.

There are two main types of stocks – **preferred stock** and **common stock** – and there are many advantages to owning preferred stock over common stock. Here are the main ones:

1. When you're holding a preferred stock, then the dividend is paid to you before any dividends are paid to common stock holders.

2. A preferred stock typically pays a fixed dividend that does not fluctuate, unlike the dividend of a common stock.

3. Owners of preferred stocks have a greater claim on the company's assets. For example, in case of bankruptcy, preferred stock holders are paid first, before common stock holders.

However, as a day trader, you really don't have to worry about the different kinds of stocks or dividend yields, since you're just holding a stock for a few minutes or hours.

Avoiding Stock Trading Scams

If you have an email account, then you've probably received a great deal of emails with Free Stock Trading Tips. In these emails, somebody recommends a "hot stock."

If you were to follow these tips, you'd probably end up getting caught in a so-called "pump-and-dump" scheme.

Here's how it works:

These so-called stock picking services buy a certain stock that's usually trading at $0.02-$0.30. Many times, these stocks are not even listed on the exchanges, and the volume is typically only a few thousand shares per day.

After these stock picking services buy tens of thousands of these shares, they start recommending it to their subscribers. You'll find that it's not easy to buy these stocks since they're not listed on regular stock exchanges. And, if you ask your broker to buy this stock for you, you might end up paying 4-5 times more than normal in commissions.

The stock picking service is now hoping that many of their subscribers will start buying this stock. They typically say, "It's trading now at $0.02 and it should go up to $0.12." That would be a whopping 600% increase! Since stock traders are greedy by nature, many will probably start buying this stock, and since there is a sudden demand, the stock prices will go up – initially.

But, before the stock hits the predicted exit price, the stock picking service starts selling (or dumping) the shares that they bought BEFORE they recommended it to you.

Since they bought such a large amount of this stock, there's suddenly an enormous supply available again, and prices start falling. More and more investors panic and sell their stocks, which drives the stock prices even further down.

After a massive sell-off, the stock is generally trading at the same level it was BEFORE the stock picking service started recommending it. And, in some cases, it'll be <u>much</u> lower, resulting in a loss for whoever was drawn into the trap. So, investors are losing their money, and the only winner is the stock picking service.

Here's an example of a "pump-and-dump" scheme:

The following image is a screenshot from an online service that is offering "Free Stock Tips."

12/20/2007 **Free Penny Stock Pick: WHI**

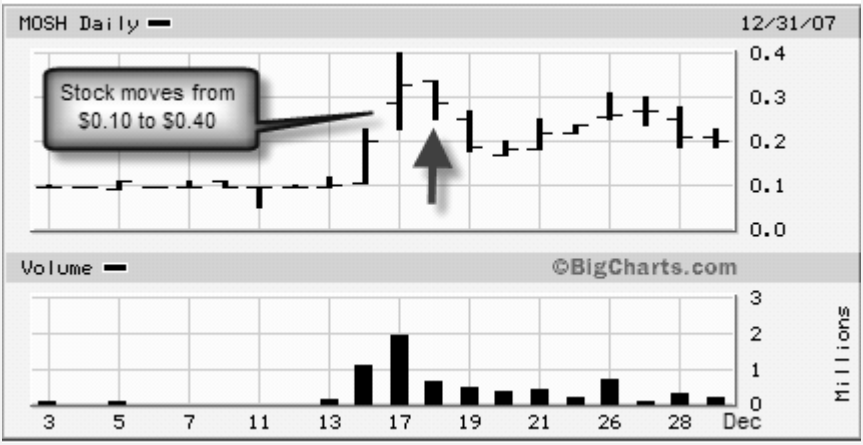
12/19/2007 **Free Penny Stock Pick: GSPG**

12/18/2007 **Free Penny Stock Pick: MOSH**

12/17/2007 **Free Penny Stock Pick: GTRE**

12/15/2007 **Free Penny Stock Pick: EXCS**

As you can see, they're recommending that you buy MOSH on 12/18/2007. Let's take a look at the chart for this stock:



(Dates are displayed along the bottom of the chart)

As you can see, stock prices start moving **two days before the "hot tip"** at unusually high volume. If you were to buy MOSH on Dec 18th, 2007, at the point of the **arrow,** as recommended by this service, you would have bought it at a price between $0.25 and $0.35 per share.

Note that a few days later, the "hot stock pick" is trading at $0.20, and you would have lost between 25-75% of your capital.

Let's check the stock market against our criteria:

1.) **Capital Requirements**

In August and September of 2001, the NYSE and NASD established the Pattern Day Trading Rule. This rule dictates that "if a trader executes four or more day trades within a five-business-day period then he must maintain a minimum equity of $25,000 in his margin account at all times." This means that you need at least $28,000-$30,000 if you want to day trade stocks, because you need a "cushion" if you experience losses.

2.) **Leverage**

When trading stocks, you can either open a "cash account" or a "margin account." When you open a cash account, you can buy or sell stock for exactly the amount you have in your account – i.e. your leverage is 1:1.

When you open a margin account, you can trade stocks on margin. Buying on margin is borrowing money from a broker to purchase stock. You can think of it as a loan from your brokerage. Margin trading allows you to buy more stock than you'd be able to normally. An initial investment of at least $2,000 is required for a margin account, though some brokerages require more. This deposit is known as the minimum margin. Once the account is opened and operational, you can borrow up to 50% of the purchase price of a stock.

Example: Let's say that you deposit $10,000 in your margin account. Because you put up 50% of the purchase price, this means you have $20,000 worth of buying power. Then, if you buy $5,000 worth of stock, you still have $15,000 in buying power remaining. In this case your leverage is 1:2.

If you have developed a good relationship with your broker, he might even allow you to borrow up to 80% of your initial deposit, giving you a leverage of 1:8.

3.) **Liquidity**

Currently there are more than 10,000 stocks available on U.S. stock exchanges. Around 900 stocks have an average daily volume of more than 2,000,000 shares traded, and more than 600 of them are traded with over 3,000,000 shares per day. If you focus on these stocks then you won't have a problem with market manipulation or slippage.

4.) **Volatility**

In 2007, the average daily movement of the stocks in the Dow Jones Index was between 1% and 2%, and many of these stocks moved even more dramatically than that:

- Alcoa, Inc. (AA) moved between 2% and 5% per day
- American Intl. Group (AIG) moved between 2% and 8% per day
- American Express (AXP) moved between 2% and 6% per day

And that's just naming the first three stocks of the Dow Jones. Volatility has NOT been a problem in the stock markets, especially in 2007.

Conclusion:

Stock markets have good liquidity and volatility, but the initial capital requirements are high ($25,000) and the maximum leverage is only 1:8.

Trading Forex

This market may sound really complicated and frightening to tackle, but trust me, it's not. Just like any other type of trading, the basic rule in the forex market is that you have to buy when the market is going up and sell when the market is going down.

The word "forex" comes from **For**eign **Ex**change, and forex is often abbreviated to FX.

Forex trading involves the buying and selling of currencies. In simpler terms, it's the exchange of one currency for another at an agreed upon rate.

If you've ever traveled to another country, chances are you've traded your currency against the local country's currency. If you've done this, you have a good idea of how forex trading works.

All the currency of the world is involved in the forex market. It may be confusing to choose which one to trade, but all you really need to know are the major currencies, which are the most frequently traded.

Here are the major currencies:

1.) U.S. Dollar (USD)
2.) Japanese Yen (JPY)
3.) British Pound (GBP)
4.) Swiss Franc (CHF)
5.) European Union Euro (EUR)
6.) Australian Dollar (AUD)
7.) New Zealand Dollar (NZD)
8.) Canadian Dollar (CAD)

The next thing you need to know is that forex is traded in currency pairs. Trading currency pairs means you're buying one currency while simultaneously selling another currency.

Examples:

The most heavily traded products in the forex market are typically:

- EUR/USD
- USD/JPY
- GBP/USD

It’s very important for you to know that the forex markets are extremely volatile. You can easily make (or lose) thousands of dollars in a single day.

Many forex brokers offer "free quotes and charts" and "no commissions," but keep in mind that nothing is for free. You are paying a spread – i.e. you CANNOT buy a currency and immediately sell it for the same amount.

It's like at the exchange booths when you’re on vacation: you might ex - change $100 into 80 Euro, but when you change the 80 Euro back into dollars, you only receive $96. The same concept applies when trading forex: you’re paying at least 2 "pips." This amounts to approximately $20, depending on the currency pair you're trading.

The forex markets can be tricky – they shouldn't be taken lightly.

Another disadvantage of forex trading is that you're NOT trading at an exchange**: there is no "Foreign Exchange."**

You're trading against your broker: if you're selling, then your broker is buying from you, and vice versa. And that's why your broker is giving you the quotes for free: he can basically give you *any* quote he chooses, since there are no regulations.

Example:

Take a look at these forex quotes. All three of the following screenshots were taken on Tuesday, January 1st, 2007, at 3:00pm U.S. Easter Time.

Note: The time in the first two charts is displayed at GMT (+6 hours)

I used three different websites to obtain these quotes:

Symbol*	Bid	Ask	High	Low	Open	Change	Time	Favs
XAUUSD	↓833.4	↓833.9	838.9	833.67	833.84	↑0.1	02:13	Add
XAGUSD	•14.78	•14.83	14.84	14.8125	14.83	•0	14:00	Add
EURGBP	↑0.7344	↑0.7348	0.7364	0.7342	0.73477	•0	15:01	Add
EURUSD	↓1.4586	↓1.4598	1.464	1.458	1.4598	↓-0.0005	15:01	Add
EURJPY	↑162.79	↑162.82	163.42	162.5	162.747	↑0.07	15:00	Add
EURZAR	↑9.9586	↑9.9886	10.0263	9.9625	10.0031	↓-0.0145	15:00	Add
EURCHF	↓1.654	↓1.6543	1.6576	1.6393	1.6541	↑0.0002	15:00	Add
EURCAD	↑1.4494	↑1.4502	1.4601	1.4488	1.4511	↓-0.0009	14:59	Add
EURAUD	↓1.6657	↓1.6667	1.6743	1.6651	1.6662	↑0.0005	15:00	Add
EURNZD	↑1.9033	↑1.9053	1.9118	1.9029	1.90544	↓-0.0001	15:00	Add
EURSEK	↑9.4423	↑9.4463	9.4511	9.4242	9.4401	↑0.0062	15:01	Add
EURSGD	↓2.0749	↓2.1249	2.1295	2.1004	2.1046	↑0.0203	15:01	Add

Name	Bid	Ask	Change	%Change	High	Low	Time
EUR/USD	1.4586	1.4589	0.0001	0.01 %	1.4611	1.4577	19:59
GBP/USD	1.9861 ↓	1.9866 ↓	0.00 ↓	0.00 % ↓	1.987	1.9838	20:00
USD/JPY	111.54	111.58	-0.12	-0.11 %	111.76	111.30	19:56
USD/CHF	1.1341	1.1351	0.0016	0.14 %	1.1347	1.1313	19:58
USD/NOK	5.4372 ↑	5.4462 ↑	0.0024 ↑	0.04 %	5.4474	5.4279	20:00
USD/DKK	5.1088 ↑	5.1138 ↑	-0.002 ↑	-0.04 %	5.1141	5.0989	20:00
USD/SEK	6.4687 ↑	6.4767 ↑	0.0088 ↑	0.14 % ↑	6.4747	6.43	20:00
USD/CAD	0.9936 ↓	0.994 ↓	-0.0042 ↓	-0.42 % ↓	0.9978	0.993	20:00
NZD/USD	0.7663	0.7671	0.0007	0.09 %	0.7663	0.7637	19:03
AUD/USD	0.8755	0.8758	0.0002	0.02 %	0.8769	0.8744	19:59
USD/MXN	10.911	10.941	-0.0046	-0.04 %	10.9156	10.894	19:02
USD/SGD	1.4395	1.44	-0.0014	-0.10 %	1.4409	1.4381	20:00

Solution by NetDania **Data Source: Comstock llc**

Major Currencies - Real-Time

Currency	Bid	Ask	Change	High	Low	Time
EUR/USD	1.4586 ↓	1.4593 ↓	-0.001 ↓	1.4748	1.4567	20:01.00
USD/JPY	111.5 ↓	111.6 ↓	-0.15 ↓	112.29	111.2	20:02.00
GBP/USD	1.9855	1.9874	-0.0006 ↓	2.0101	1.9788	17:59.00
USD/CHF	1.1333 ↓	1.1338 ↓	0.0013 ↑	1.1372	1.1199	20:01.00
USD/CAD	0.9936 ↑	0.994	-0.004 ↓	0.9986	0.9763	19:58.00
AUD/USD	0.8757 ↑	0.8759 ↓	0.0009 ↑	0.8827	0.8733	20:02.00
EUR/JPY	162.75 ↓	162.8 ↓	-0.26 ↓	165.5	162.3	20:01.00
EUR/CHF	1.6537 ↓	1.6542 ↓	0.00	1.6587	1.6381	20:02.00
GBP/JPY	221.52 ↑	221.59 ↑	-0.10 ↓	224.91	220.84	20:02.00
GBP/CHF	2.2506 ↓	2.2516 ↓	0.0033 ↑	2.2625	2.2241	19:59.00
CHF/JPY	98.401 ↓	98.431 ↓	-0.142 ↓	99.86	98.14	20:02.00
NZD/USD	0.7661 ↑	0.7666 ↑	0.0009 ↑	0.7794	0.7645	20:00.00
USD/ZAR	6.825	6.845	0.0255 ↑	6.8665	6.762	19:00.00
Gold	833.4	833.9	-4.80 ↓	843.8	829.4	07:13.00
Silver	14.78	14.83	0.00	14.92	14.66	19:00.00

Take a look at this day's high of the USD/EUR currency pair:

- The first data source reports it at **1.4611.**
- The second data source shows **1.4748.**
- The third data source reports a high of **1.4640.**

That's a difference of 137 ticks, which equals $1,370! Do you see the problem? Forex prices are completely subjective.

Mini-Forex Trading

Although the capital requirements for trading the forex markets are al - ready low, "Mini-Forex Trading" has become very popular recently. Mini-forex trading is good for people who have just started in the forex market and who don't have enough funds to open a regular account. It requires a smaller amount of capital compared to regular forex accounts – a minimum of $250.

On this account, you can trade up to 5 mini lots. A mini lot is only 1/10 th the size of a standard forex account.

Example:

On a regular account, a 25-pip stop loss is equal to a loss of $250. Since a mini-forex account is just 1/10th of the standard forex account, this stop loss amounts to only $25. Instead of trading in 100,000 units, you are trading in 10,000 units.

What are the perks of mini-forex trading?

Even with just a small stake involved, you still get to enjoy benefits such as a free trading platform – just like regular forex traders. A few other benefits include state-of-the art trading software, charts, and resources.

In this way, you can build up your confidence in your trading skills while slowly increasing your profits and trading position in the market. You get to manage your money on a small scale before going for the higher stakes in regular forex trading.

You can also develop a sound trading strategy without getting too emotionally involved in possible profits or losses. For practice, newbies can start with paper trading; in the real market, they can start small with mini-forex trading.

Conclusion:

Mini-forex trading requires a smaller amount of capital and less emotional investment, and it provides the perfect opportunity for you to slowly build up your skills and confidence as a trader. In a way, it prepares you for the higher stakes of the more advanced world of foreign exchange trading.

Let's check forex trading against our criteria:

1.) **Capital Requirements**

Many forex brokers let you start with as little as $1,000 in your trading account.

2.) **Leverage**

The typical leverage in the forex market is 1:100 – i.e. for every $1,000 in your trading account, you can trade $100,000. Recently, forex brokers started offering leverage of 1:200, allowing you to trade $100,000 for every $500 in your trading account.

3.) **Liquidity**

This is certainly not a problem in the forex market. Unfortunately, since the forex market is decentralized, and there's no official exchange, you can't get real-time volume data.

But, according to the Triennial Central Bank Survey of 2007, the average turnover in the traditional foreign exchange market is around $3.21 trillion daily, and it's still growing.

Here are the daily averages of turnover on the forex market over the last 15 years:

$880 billion (April of 1992)
$1.15 trillion (April of 1995)
$1.65 trillion (April of 1998)
$1.42 trillion (April of 2001)
$1.97 trillion (April of 2004)
$3.21 trillion (April of 2007)

Source: Triennial Central Bank Survey – December 2007, www.bis.org

4.) **Volatility**

You will find decent volatility in the forex market. It's not as great as in the stock market, but because of the extremely high leverage, even small movements can yield substantial profits. Here are the average daily movements for three different currency pairs:

EUR/USD - between 0.5% and 1% per day
USD/JPY - between 0.5% and 1.5% per day
GBP/USD - between 0.5% and 1.5% per day

Keep in mind that these moves represent approximately $750 - $1,500 per day for each $100,000 traded.

Conclusion:

Forex markets are extremely liquid and the capital requirements are as low as $1,000. The leverage is at least 100:1 and there's decent volatility. Overall, forex seems to be a good market to trade, but keep in mind that there are some disadvantages, too, as mentioned earlier in this section.

Trading Futures

Futures trading continues to grow in popularity, and many traders are jumping into this type of investing.

Futures trading offers many advantages, especially if you're new to trading. Yet many traders shy away from futures trading because they're not familiar it.

There's a lot of misunderstanding when it comes to futures. People often think that futures are extremely risky and difficult to trade. To some extent, that's true. Thanks to high leverage, futures trading IS more risky than stock trading.

However, futures trading – BECAUSE of the high leverage – also provides an excellent opportunity for the private trader.

So what are futures? Futures contracts, simply called futures, are exchange-traded derivatives. They are standardized contracts among buyers and sellers of commodities that specify the amount of a commodity, the grade/quality, and the delivery location. These futures contracts are typically traded at futures exchanges, like the Chicago Board of Trade (CBOT), the Chicago Mercantile Exchange (CME), the New York Mercantile Exchange (NYMEX), and others.

Below is a list of different types of futures contracts:

1.) **Currencies** – The currency market is probably the best-known commodity available, dealing in the British Pound, the American Dollar, the European Euro, etc.

2.) **Interest Rates** – Interest rates are traded in two ways on this market: long-term interest rates are represented by T-Bonds, while T-Bills are used for short-term interest rates.

3.) **Energies** – A variety of fuel commodities are traded on this market, including natural gas, heating oil, and crude oil futures.

4.) **Food Sector** – Sugar, coffee, and orange juice are just a few of the regular goods traded in this sector.

5.) **Metals** – Commodities in this market are fairly well-known, such as copper, gold, and silver.

6.) **Agricultural** – Futures in this market include wheat, corn, coffee, and soybeans.

Futures are not borrowed like stock, and therefore initiating a short position is just as common and easy as buying the futures.

A Little Bit of History

Trading on commodities began in early 18th century Japan, with the trading of rice and silk, and similarly in Holland, with tulip bulbs. Trading in the U.S. began in the mid-19th century, when central grain markets were established, and a marketplace was created for farmers to bring their commodities and sell them either for immediate delivery (called the spot or cash market), or for forward delivery. All contract trading began with traditional commodities such as grains, meat, and livestock.

Exchange trading these days has expanded to include metals, energy, currencies, currency indices, equities, equity indices, government interest rates, and also private interest rates. Contracts on the financial instruments were introduced in the 1970s by the Chicago Mercantile Exchange. These instruments became hugely successful and quickly overtook commodities futures in terms of trading volume and global accessibility in the markets.

All futures transactions in the United States are regulated by the Commodities Future Trading Commissions (CFTC), an independent agency of the United States government. Each futures contract is characterized by a number of factors, including the nature of the underlying asset, when it must be delivered, the currency of the transaction, and at what date the contract stops trading, as well as the tick size, or minimum legal change in price.

Here's a list of the five most popular futures contracts:

1.) **S&P 500 E-mini** – This contract has all of the advantages of the S&P 500, but the cost of investment is much lower. It can be traded electronically five days a week, almost 24 hours a day. It's become exceptionally popular in the futures markets.

2.) **E-mini NASDAQ 100** – As with the S&P 500, this contract is electronically traded; it tracks the movement of the NASDAQ 100. The margin amount required to trade is significantly smaller than a standard contract, and since not all traders have the funds to trade on the regular NASDAQ 100, this E-mini is the perfect solution.

3.) **Light Sweet Crude Oil** – Oil futures are one of the most well-known commodities out there. Every time you hear about "the price of oil" in the paper or on the news, this is the contract they're talking about.

4.) **Gold** – The gold futures contract is also popular. In the 1970s, the United States adopted the Gold Standard, creating an important place in the U.S. economy for gold. Since that time, the gold price has gone through regular, dramatic changes, and those changes are usually in the opposite direction of the U.S. dollar. The gold futures contract follows the changes in price per ounce of gold, and gold investments are frequently used in hedge funds.

5.) **E-mini Euro FX** – The E-mini Euro FX contract moves with the exchange rate between the European Euro and the U.S. dollar. As with the rest of the E-mini contracts, the margin amounts required to trade the Euro FX are much lower than the regular contract amounts, which means that this contract presents a fantastic opportunity for traders who don't have accounts large enough to trade the regular contracts.

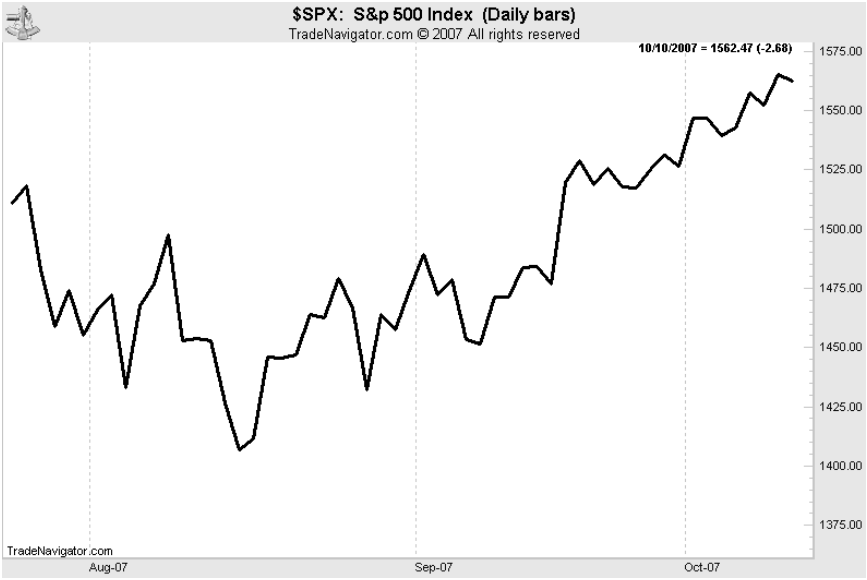
The growing popularity of futures trading stems from the fact that only a relatively small amount of money, known as initial margin, is required to

buy or sell a futures contract. By definition, these futures margins are a good faith deposit to ensure that the market participants are legitimate.

Whenever you open a position by buying or selling futures, you will pay a small initial margin. The advantage is that the initial margin on a stock future is much less than the cost of buying the actual stock outright.

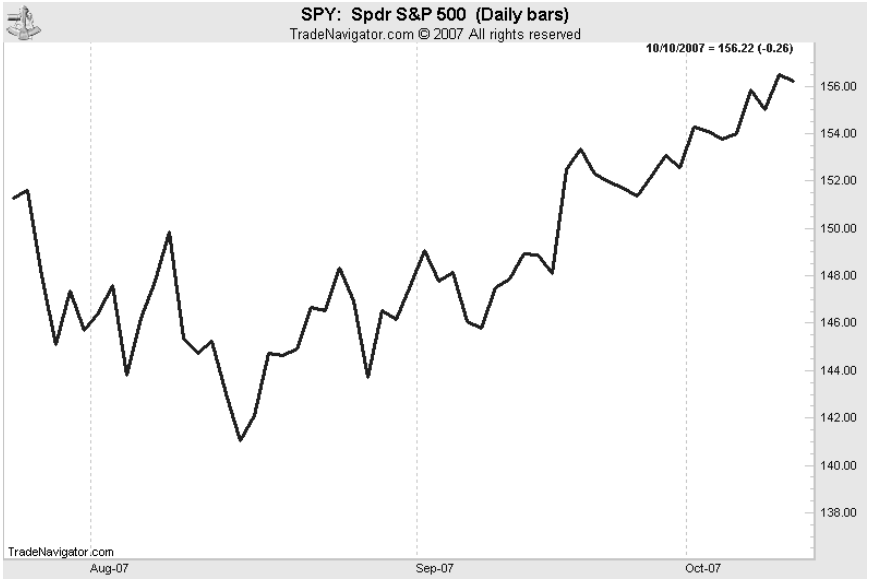
Example:

The following graphic shows an actual stock index, the S&P 500.



This index could rise from 1560 to 1570. As of October 12th, 2007, it is trading at around 1561.80. Some people think it's less risky to trade the whole market index rather than an individual stock. Therefore, the stock exchanges have introduced an artificial stock named the SPY (also called the SPYDER contract).

The SPY stock actually mirrors the S&P 500 Index, because tradition ally, you cannot trade the whole index. If you wanted to trade the whole S&P 500 index, you would literally have to buy all 500 stocks in the in dex. Obviously, you can't do this. In order to make it affordable for pri vate traders, the SPY is divided by ten.



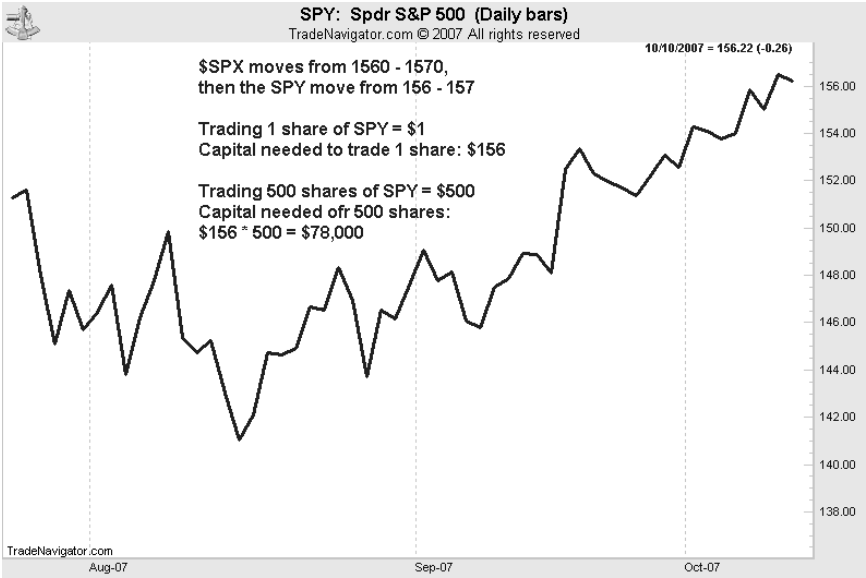
So, we're tracking the index, and the artificial stock is reduced by a fac - tor of 10 – it's trading at 156. If the SPX (the index) moves from 1560 to 1570, then the SPY will move from 156 to 157.

If you're trading one share of SPY, you will make or lose one dollar. And how much capital is needed in order to trade one share? 156 dollars.

So, for 156 dollars, you will be rewarded with a one dollar profit if the whole index moves by 10 points.

And, if you were trading 500 shares of the SPY, then you would make 500 dollars on a move of 10 points. Obviously, the capital needed for 500 shares is much higher than for one share. The capital needed is actu ally 156 dollars per share times the 500 shares that you would want to trade.

The total amount of capital needed to trade 500 shares would be 78,000 dollars.

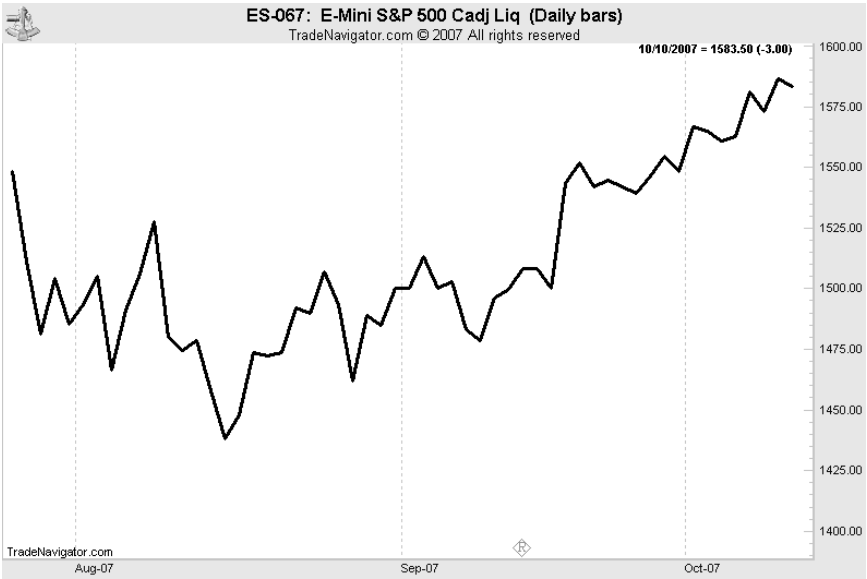


78,000 dollars is quite a lot. The thing to look at here is your return on investment, which is what most traders use to measure their success.

If you make five hundred dollars after investing 78,000 dollars, the re - turn on that investment would be 0.6%. That's a very small amount for a 10-point move in the underlying index.

This is exactly why we have the futures markets. There's enormous leverage in the futures markets because you only have to deposit a relatively small amount of money (initial margin).

Now, the following chart shows the futures contracts, the so-called E-mini S&P:



You'll see that the E-mini is tracking the index much closer – here we're looking at a current value of 1574.50. The important thing to know is that if the E-mini S&P – which is also abbreviated as ES – moves from 1560 to 1570, you would actually make 500 dollars per contract.

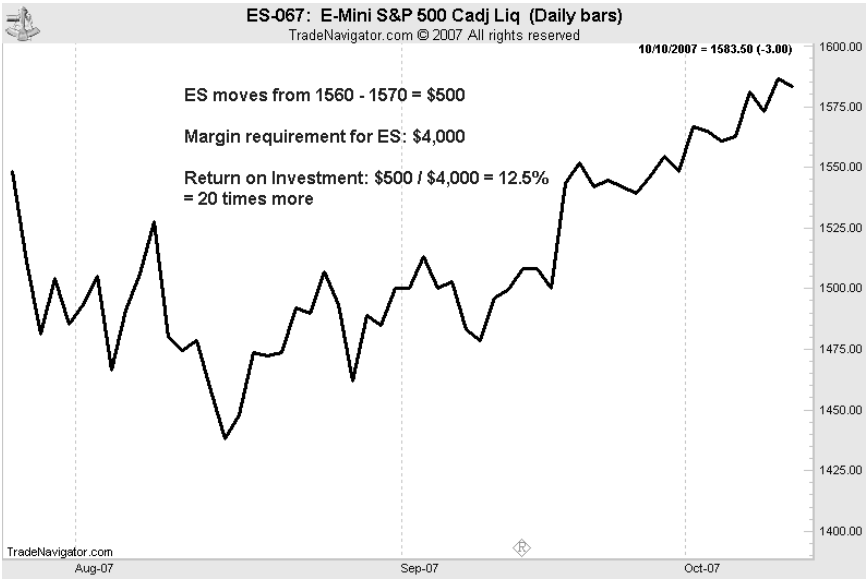
And how much of an investment is required to make 500 dollars off one contract in this move?

About 4,000 dollars.

The margin requirement for the E-mini S&P is approximately 4,000 dollars. And if you're day trading it, you even get a discount, which means you'll only have to pay 2,000 dollars. Sometimes, it's even as little as $1,000.

So, you can deposit 4,000 dollars and participate in a 10-point move for a profit of 500 dollars. Let's calculate our return on that initial investment.

Instead of 0.6%, we are looking at 12.5%. That's more than twenty times the return you would have gotten using the SPY contract.



Of course, this can be a double-sided sword. You can easily **make** 500 dollars, but if the trade goes against you, you would **lose** 500 dollars. So basically, trading one contract of the E-mini S&P is no different than actually trading 500 shares of the SPY.

The Futures Trading Myth

As you can see at the bottom of the previous chart, there are small Rs. These Rs indicate expiration dates. A futures contract is only valid for a certain period of time. In the case of the E-mini S&P, a futures contract is valid for 3 months. You might know this concept from options. Op tions also have an expiration date.

After the expiration date, a new futures contract starts trading and the old contract expires. You might have heard horror stories that if you are holding a position and the futures contract expires, then you will have to take delivery. So, according to these tales, if you are trading the grains – corn, for example – and the contract expires, you will get the corn deliv - ered to your doorstep.

No! That will not happen!

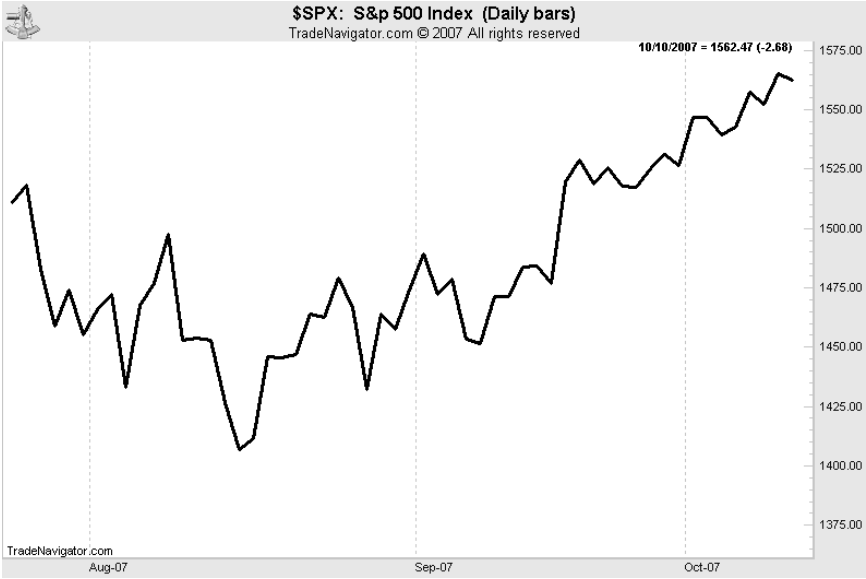
Basically, what will happen is this: before the futures contract expires, your broker will get in contact with you and send you some information. It will probably be something to the effect of, "Alright, in a couple of days, this futures contract will expire. We should get rid of this position or roll it over." Rollovers are when one contract expires, and the other contract actually starts trading. This is something your broker will take care of, so you don't have to do anything on your end.

Believe me, your broker doesn't have any interest in you getting a physi - cal delivery of corn, you don't have any interest in getting a physical de - livery of corn, and it's unlikely that anyone else has any interest in you getting a physical delivery of corn either. So, don't believe these horror stories.

Just be accessible to your broker, and you shouldn't have any problems. Make sure that he has a number where you can be reached so that he can inform you of what's going on.

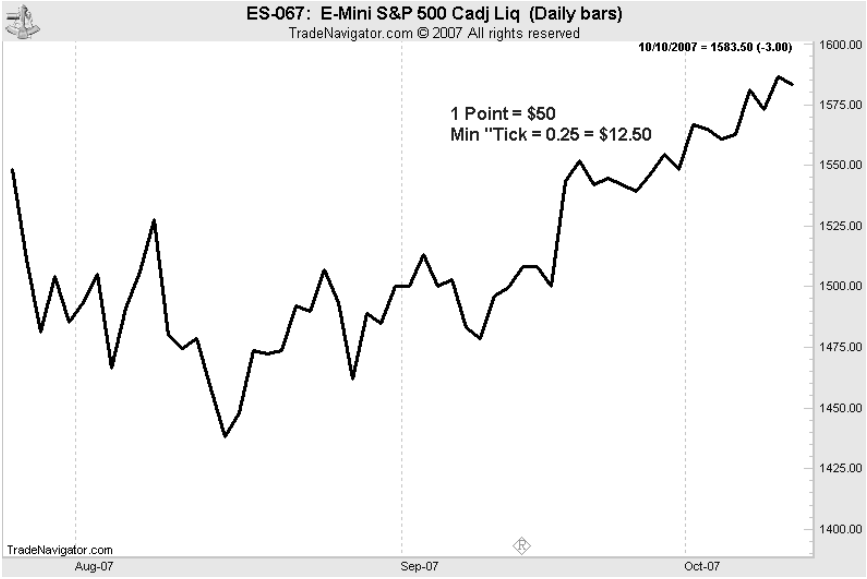
A Little More On Futures

Let's go back to the S&P 500 Index. As you can see by the decimals in the following graph, it's trading at one-cent increments.



In order to make futures trading a little easier, it's been simplified even further. If you look at the following example, on the very right side, it's trading in quarter increments. If the E-mini S&P futures contract moves from 1560 to 1570, you'll make or lose 500 dollars, depending on what kind of position you took. And if a 10 point move translates into a $500 gain or loss, then a 1 point move is worth $50.

When trading the e-mini S&P, the minimum tick movement (or minimum movement) is a quarter. So, you can see that it goes from 1550 to 1550 and a quarter, 1550 and a half, 1550 and three quarters, and then up to 1551. If the minimum movement is a quarter, then every tick move totals $12.50 (one quarter of $50). Very easy. There are four quarters in one point, so you just have to divide the 50 dollars by four.

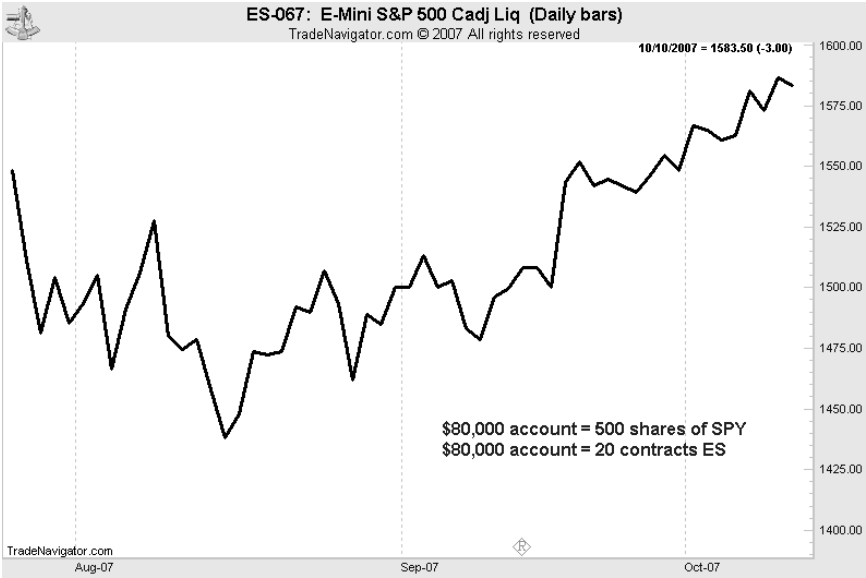


So, why is that important? Well, it's not really – all you need to know is that when trading one futures contract with anywhere between 2,000 to 4,000 dollars, you can make a return of 50 dollars per point. Keep in mind that you can also LOSE 50 dollars per point.

Remember, the 2,000 to 4,000 dollars we're talking about is the initial margin, which is the sum of money that a customer like you must deposit with the brokerage firm for each futures contract that you buy or sell.

Now, just think about this for a minute: let's assume that you have an 80,000 dollar account – what can you do with it? Well, you could buy 500 shares of the SPY stock. Or you could trade 20 futures contracts in the ES. If you choose to trade the 20 futures contracts instead of the 500 SPY stock shares, you'll make 10,000 dollars! If you stick with the SPY shares, you'll only make 500 dollars per 10-point move.

You can see the difference. You get a much bigger leverage on your account with futures trading, and a higher leverage is exactly what will help you grow your account (as long as you know what you're doing).



Margins and Accounts

There are two types of margins. The **initial margin** (sometimes called the original margin) is the sum of money that the customer must deposit

with the brokerage firm for each futures contract to be bought or sold. Initial margin is paid by both buyer and seller.

Additionally, the **maintenance margin** is the minimum amount which an investor must keep on deposit in a margin account at all times for each open contract. Typically, the maintenance margin is smaller than the initial margin. Assume, for example, that the initial margin needed to buy or sell a particular futures contract is $2,000. A likely maintenance margin requirement might be $1,500.

Another important thing to be aware of when dealing with margins is something called a **margin call.** If the margin drops below the margin maintenance requirement established by the exchange listing the futures, a margin call will be issued to bring the account back up to the required level. Basically, if you need to have $1,500 in your account for your open contracts, and you don't, then you can expect a margin call.

Another difference in trading futures vs. stocks is that your account is settled daily. Any day that profits accrue on your open positions, the profits will be added to the balance in your margin account automatically, not just when you close the position. When you are buying stocks, all the money that you make or lose will be either added or subtracted to your account <u>only</u> when you close the position.

So, when profits occur on your futures contracts, they will be added to the balance of your margin account, and on any day losses accrue, the losses will be deducted from the balance of your margin account.

Keep in mind, if the funds remaining in your margin account dip below the maintenance margin requirement, your broker will require that you deposit additional funds to bring the account back to the level of the required margin. Again, this is called a margin call.

Due to the low margin requirement, futures trading offers everyone an equal opportunity to make a fortune even with a small bank account.

Pros and Cons of Futures Trading

Futures trading is amongst today's most highly leveraged, potentially profitable financial pursuits. It allows traders to build up their accounts

fast. But, as stated before, if you take futures trading lightly, you could also wipe out your trading account in a matter of days. Therefore, it's crucial to your trading success that you diligently educate yourself in futures trading, and trade only with a proven and solid trading strategy.

If you're new to futures trading, it can be especially difficult to decide WHICH contracts to actually trade. There are a lot of options! The best approach would probably be to start with the more popular commodities, until you have a better idea of which contracts most fit you and your trading.

The more you know about the basics of futures contracts and commodities like this, the better your chances of trading success.

Let's check futures trading against our criteria:

1.) **Capital Requirements**

In order to trade a futures contract, you need to deposit an initial investment into your futures trading account. As of the writing of this book, most futures brokers require a minimum of $5,000, though I have seen some brokers who are willing to open an account with as little as $2,000.

2.) **Leverage**

The leverage depends on the futures contract you're trading and the contract value. Each contract requires an initial margin. Here are some examples for the most popular contracts (as of January 2008):

E-mini S&P – as low as $500 to trade a $75,000 contract (Leverage 1:150)

E-mini NQ – as low as $500 to trade a $45,000 contract (Leverage 1:90)

E-mini Gold – as low as $400 to trade a $27,000 contract (Leverage 1:67.5)

3.) **Liquidity**

Again, the liquidity depends on the futures contract you are trading. Here are some numbers:

E-mini S&P:	around 2,500,000 contracts/day
E-mini NQ:	around 500,000 contracts/day
Euro Currency:	around 200,000 contract/day

As you can see, the liquidity varies, and therefore you MUST check the volume of the futures market you are planning to trade.

4.) **Volatility**

You will find decent volatility in the futures markets. Like in the forex markets, the high leverage will allow you to make decent profits, even if the markets move just a few points. Here are some average daily moves:

E-mini S&P:	between 1% and 3% per day
E-mini NQ:	between 1% and 2.5% per day
E-mini Gold:	between 1% and 2.5% per day
Euro Currency:	between 0.5% and 1.5% per day

Keep in mind that these moves represent approximately $500-$1,500 per day for each contract traded.

Conclusion:

Futures markets can be very liquid, and the capital requirements are as low as $2,000. The leverage is at least 1:50, and there's decent volatility.

Futures markets are regulated and the spread is typically 1 tick (minimum movement of the contract). Commissions are usually below $5 per transaction. It's no surprise that many day traders choose the futures market for their trading endeavors.

Make sure to check the volume and liquidity of the market you want to trade, since there are huge differences between the markets.

Trading Stock Options

Stock options trading is quite similar to futures trading – they both in - volve the process of buying stocks at a pre-determined price and then selling them when the price rises above its original amount.

When you buy an option you have the right – but not the obligation – to buy (call) or sell (put) a specific underlying asset at a prearranged price on or before a given date.

Example:

Let's assume that you buy a call – a right to buy – 100 shares of ACME Holding Inc. at an agreed price of $40 per share (strike price), on an agreed date in March of 2008 (expiration date), and you pay $5 for the option.

If on – or before – the expiration date, ACME Holding Inc. is trading at less than $40 per share, then you would not exercise your option and you would have lost the price you paid on that option – $5.

But, if ACME Holding, Inc. is trading at $50 per share on or before the expiration date, your option is, in effect, worth $10. This is the difference between the price your option to buy ACME Holding, Inc. is set at – in this case, $40 – and the price at which it is actually trading – $50.

The reverse of this is a put (right to sell) option on an underlying asset. You might feel that the market is overheated at the present time, and you want to buy a put (right to sell) option.

This will give the individual who bought the put option the right to sell that option at an agreed upon price (strike price) on or before a specific date (expiration date).

A Little Bit of History

Options are one of the oldest trading vehicles which man has ever used. Around 600 B.C., Thales used the stars to predict that there would be a bumper olive harvest, and he bought options on the use of olive presses. When the harvest did in fact prove to be a great one, Thales was able to rent the presses out at a significant profit.

Let's check stock options trading against our criteria:

1.) **Capital Requirements**

Like stock trading, day trading stock options is subject to the Pattern Day Trading Rule introduced by the NYSE and NASD in August and September of 2001. This rule dictates that "if a trader executes four or more day trades within a five-business-day period, then he must maintain a minimum equity of $25,000 in his margin account at all times." This means that you need at least $28,000-$30,000 if you want to day trade stock options, since you need some money to buy options.

2.) **Leverage**

The leverage depends on the option you choose. Without going into too much detail, the price for the option depends on the time until expiration, the volatility of the underlying stock, and the "inner value" – i.e. if the option is already "in the money."

Nevertheless, you will notice that options offer high leverage.

Example: On December 27, 2007, IBM was trading at $110.16 per share. If you wanted to buy 100 shares of IBM, then you would have had to invest $11,016. The January Call, at a strike price of $110, with 23 days left to expiration, only cost $3.30, and you could buy the right to purchase 100 IBM shares within the next 23 days for only $330.

In this example the leverage is approximately 1:30.

3.) **Liquidity**

Options are typically not very liquid. Even if you trade options on the Dow 30 stocks, you will notice that only a few thousand options are traded per day. The reason for the low volume is the broad choice of options: at any given time you have several strike prices and multiple expiration dates available.

Fortunately, option prices are NOT subject to market manipulation since the value of an option is not determined by supply and demand, but by a mathematical formula created by Black and Scholes. But you do have a significant spread between the bid and the ask; in our IBM example, $0.10 or 3% of the option price.

4.) **Volatility**

Options that are traded "at the money" or "in the money" typically have a very high volatility. In our example, we chose an IBM "at the money" option with 23 days to expiration. The current price was $3.30, and throughout the day, it was trading as high as $3.95. The previous day's close was $4.30. Therefore, the intraday volatility for this option was almost 20%. Considering the previous day's close, the overall volatility was close to 30%.

Conclusion

Stock option trading offers similar advantages and disadvantages to stock trading – you need a minimum of $25,000 in your trading account if you want to day trade stock options. The leverage is higher than when you're trading stocks, but much lower than trading futures or forex. The liquidity is very low compared to the other markets, and the volatility is scary.

Stock options are a fantastic instrument to trade when traded on daily or weekly charts. Day trading stock options is extremely risky and difficult, and not for the novice trader.

Action Items:

- ✓ Decide which market you want to trade. Spend four more hours learning about the market you choose. Surf the Internet and read articles. Try to find out as much as you can about your preferred market without being overloaded with information.

- ✓ Continue your trading plan on page 245 and fill in the market you selected under "Selecting a Market."

Step 2: Selecting a Timeframe

When day trading, you'll obviously select a timeframe that is less than one day.

Popular intraday timeframes are 60-minute, 30-minute, 15-minute, 10-minute, 5-minute, 3-minute, and 1-minute.

When you select a smaller timeframe (less than 60 minutes), usually your average profit per trade is relatively low. On the other hand, you get more trading opportunities. When trading on a larger timeframe, your average profit per trade will be bigger, but you'll have fewer trading opportunities.

Smaller timeframes mean smaller profits, but usually smaller risk, too. When you're starting with a small trading account, you might want to select a small timeframe to make sure that you're not over-leveraging your account.

However, when selecting a very small timeframe like 1-minute, 3-minute, or 5-minute, you might experience a lot of "noise" that is cause by hedge funds, by scalpers, and by automated trading.

You might think that you see an emerging trend just to realize that it was only a short manipulated move and that the trend is over as soon as you enter the market.

Therefore I recommend using 15-minute charts. This timeframe is small enough for you to capture the nice intraday moves, but it's big enough to eliminate the noise in the market and correctly displays the "true trends."

When developing a trading strategy, you should always experiment with different timeframes. A trading strategy that doesn't work on a small timeframe might work on a larger timeframe and vice versa.

Start developing your trading strategy using 15-minute charts, and if you're unhappy with the results, change the timeframe first before changing the entry or exit rules.

Action Items:

- ✓ Continue your trading plan on page 245 and select an initial timeframe for yourself under "Selecting a Timeframe."

Step 3: Selecting a Trading Approach

After selecting a market, you need to decide which trading approach you would like to use.

The main question is whether you'll use fundamental or technical analysis to decide which instrument to trade and when to enter and exit.

Fundamental Analysis

Let's take a look at the definition of fundamental analysis:

> *"Fundamental stock analysis requires, among other things, a close examination of the financial statements for the company to determine its current financial strength, future growth and profitability prospects, and current management skills, in order to estimate whether the stock's price is undervalued or overvalued. A good deal of reliance is placed on annual and quarterly earnings reports, the economic, political and competitive environment facing the company, as well as any current news items or rumors relating to the company's operations."*

Source: www.daytrading.about.com

In other words, fundamental analysis is the study of basic, underlying factors that affect the supply and demand of the contracts which are be-

ing traded. Fundamental analysis looks at the CAUSE of market move - ment.

In the following graph, you'll find a snapshot of some "key statistics" for IBM. In addition to this company-specific data, you need to take the overall economic environment into consideration and start looking at various macroeconomic indicators, such as economic growth rates, inter - est rates, inflation rates, and unemployment rates.

As an example, interest rate hikes are seldom good news for stock mar - kets. This is due to the fact that many investors will withdraw money from a country's stock market when there is a hike of interest rates, causing the country's currency to weaken.

Knowing which effect prevails can be tricky. When the Fed announced an interest rate cut in December of 2007, the Dow Jones Index dropped 300 points. When the Fed cut interest rates in January of 2008, the Dow Jones Index jumped 200 points up.

In addition, economic reports with key data like the PPI, CPI, PMI, GDP, and, recently, even housing statistics, have proven to have a significant impact on the stock market.

Confused?

If the abbreviations and the "key statistics" on the following graph don't make sense to you, or if they confuse you, then you are not alone.

Fundamental analysis is not easy. That's why most market analysts have some background in economics, both macro- and microeconomics. Big trading companies like Goldman Sachs are employing analysts with Ph.D.s in economics, and you shouldn't try to compete with them.

Even if you decide NOT to trade stocks and want to focus on futures or the forex market, then you still need to take a look at crop and weather reports (if you are trading grain futures), interest rates and the country's economic data (if you are trading forex), or follow developments in the Middle East and the status of the pipelines and refineries all over the world (if you are trading energy futures).

Key Statistics

Get Key Statistics for: IBM GO

Data provided by Capital IQ, except where noted.

VALUATION MEASURES	
Market Cap (intraday)[5]:	173.11B
Enterprise Value (27-Dec-07)[3]:	175.22B
Trailing P/E (ttm, intraday):	16.22
Forward P/E (fye 31-Dec-08) [1]:	13.73
PEG Ratio (5 yr expected):	1.48
Price/Sales (ttm):	1.87
Price/Book (mrq):	5.83
Enterprise Value/Revenue (ttm)[3]:	1.82
Enterprise Value/EBITDA (ttm)[3]:	9.174

FINANCIAL HIGHLIGHTS	
Fiscal Year	
Fiscal Year Ends:	31-Dec
Most Recent Quarter (mrq):	30-Sep-07
Profitability	
Profit Margin (ttm):	10.40%
Operating Margin (ttm):	14.49%
Management Effectiveness	
Return on Assets (ttm):	8.19%
Return on Equity (ttm):	36.25%
Income Statement	
Revenue (ttm):	96.18B
Revenue Per Share (ttm):	66.152
Qtrly Revenue Growth (yoy):	6.60%
Gross Profit (ttm):	38.30B
EBITDA (ttm):	19.10B
Net Income Avl to Common (ttm):	9.93B
Diluted EPS (ttm):	6.76
Qtrly Earnings Growth (yoy):	6.30%
Balance Sheet	
Total Cash (mrq):	13.82B
Total Cash Per Share (mrq):	10.032
Total Debt (mrq):	35.32B
Total Debt/Equity (mrq):	1.719
Current Ratio (mrq):	1.035

TRADING INFORMATION	
Stock Price History	
Beta:	1.63
52-Week Change[3]:	14.77%
S&P500 52-Week Change[3]:	4.96%
52-Week High (11-Oct-07)[3]:	121.46
52-Week Low (01-Mar-07)[3]:	88.77
50-Day Moving Average[3]:	106.46
200-Day Moving Average[3]:	111.17
Share Statistics	
Average Volume (3 month)[3]:	7,982,700
Average Volume (10 day)[3]:	7,093,690
Shares Outstanding[5]:	1.58B
Float:	1.38B
% Held by Insiders[1]:	0.05%
% Held by Institutions[1]:	64.40%
Shares Short (as of 09-Nov-07)[3]:	13.24M
Short Ratio (as of 09-Nov-07)[3]:	1.5
Short % of Float (as of 09-Nov-07)[3]:	1.00%
Shares Short (prior month)[3]:	13.83M
Dividends & Splits	
Forward Annual Dividend Rate[4]:	1.60
Forward Annual Dividend Yield[4]:	1.40%
Trailing Annual Dividend Rate[3]:	1.50
Trailing Annual Dividend Yield[3]:	1.30%
5 Year Average Dividend Yield[4]:	0.80%
Payout Ratio[4]:	21%
Dividend Date[3]:	10-Dec-07
Ex-Dividend Date[4]:	07-Nov-07
Last Split Factor (new per old)[2]:	2:1
Last Split Date[3]:	27-May-99

Forward Annual Dividend Rate[4]: 1.60

Technical Analysis

Here is how technical analysis is defined:

> *"The basic foundations or premises of technical analysis are that a stock's current price discounts all information available in the market, that price movements are not random, and that patterns in price movements, in very many cases, tend to repeat themselves or trend in some direction.*
>
> *Therefore technical analysis involves the study of a stock's trading patterns through the use of charts, trendlines, support and resistance levels, and many other mathematical analysis tools, in order to predict future movements in a stock's price, and to help identify trading opportunities."*
>
> Source: www.daytrading.about.com

In summary, there are three main points that a technical analyst applies:

- Market action discounts everything. Regardless of what the fundamentals are saying, the price you see is the price you get.
- The price of a given security moves in trends.
- The historical trading patterns of a security will tend to repeat.

All three of the points above are important, but the first is the most critical. It's vital that you understand this point, because it's the basis of our approach to trading.

When you look at the price of any financial instrument as a technical analyst, you believe that it's the true value of the instrument as the market sees it.

I believe in technical analysis for a couple of reasons.

- The markets are driven by greed and fear, and not by supply and demand. An economic report itself is meaningless: it is traders' reactions to the report that moves the market.

  Price data is more "objective." You can interpret financial data and economic reports any way you want, but support levels are support levels, and a weekly high is a weekly high. It's easier to interpret hard facts more than financial statements, because many times these statements might be misleading.

  Example: IBM announces that it will meet the projected sales targets, and the shares drop like a rock, because traders hoped that IBM would exceed its goals. Another day, DELL announces that they will meet their targets, and the shares jump up, because traders didn't believe that DELL would make it due to the "difficult economic environment."

- It's easier (and therefore faster) to learn technical analysis. You can learn the basics by reading a couple of books, whereas you need to study micro- and macro-economics to master fundamental analysis. And even then, you might be fooled by the market.

An Example Of How Fundamental Analysis Can Fool You

On Friday, April 7th, 2006, the unemployment rate for March was published. The market expected an unemployment rate of 4.8%, and the numbers came in better than expected.

Only 4.7%. That's good news, isn't it? The market should move up, right?

WRONG! On that day the E-mini S&P dropped 20 points. Why?

Well, here are some comments from a news service:

"Not surprisingly, Friday's equity trade was dictated by the March employment report. More specifically, it was the Treasury market's reaction to it that set the stage for stocks."

"A lack of negative surprise caused the stock market to breathe a sigh of relief."

"The Treasury market had a very divergent reaction to the data, and it took the stock market down with it. For Treasury traders, the in-line data essentially provided no evidence that the Fed will be inclined to soon end its monetary tightening cycle."

Oops. So the stock traders thought there was good news and the market was moving up, but the treasury trader in the other room thought the un - employment data was bad news. So treasury instruments were rallying, causing the stock market to drop like a rock. But don't stocks lead the treasuries? Or do treasuries lead stocks?

The next day, another news item hit the ticker:

"Oil Prices Trading Above $69 per Barrel!"

But what does it mean? Should the stock market move up or down?

Here's a discussion I heard the next morning:

"As crude oil prices continue to plug higher, the debate over what it all really means will begin again. The question that will be batted back & forth: "Are sky-high oil prices indicative of a coming economic slow - down or looming inflation?"

And more important: how will the Fed react? Will they cease increasing interest rates or even lower the rates again? This would provide a boost for the stock market.

Or will traders fear that there's an economic slowdown which might re - sult in lower company earnings? This would move the market down.

As you can see, it's not the news that moves the market – it's the *reaction* of the traders *to* the news that makes the prices jump up and down.

Using a technical approach, you don't have to twist your mind to come up with an explanation for why the market behaves as it does. You simply believe that the factors which affect price – including fundamental, political, and psychological factors – have all been built into the price you see.

This means that anything which can affect the price of a financial instrument has already been factored into the current price by the market participants. Technical analysts look at charts the same way a doctor would look at x-rays: they examine the charts for information on the future direction of the markets.

Day Trading Charts

If you're new to the trading game, and you're not a Ph.D. in Economics, then charts are the way to go. The most basic charts are bar and line charts. In fact, even if you're an experienced trader, bar and line charts probably still have a special place in your daily trading life. These charts are simply indispensable.

"A picture speaks a thousand words." This proverb holds just as true for charts. Charting is the graphical expression of a financial market's behavior over a period in time.

Any market has four different trading points throughout one day. They are: opening price (O), closing price (C), absolute high price of the day (H), and the absolute low price of the day (L). All of these points appear on the charts.

The opening price (O) is the first trade of the day. Individual traders tend to place orders when the market opens, in reaction to the previous day's close. This price will normally be based on emotional decisions and could well indicate how the first half – or the whole day's trading – is going to pan out.

The closing price (C) is the last trade of the day. It is generally institutional investors that place orders towards the day's close. Unlike the opening price, the closing price will normally be representative of decisions made by reason and research – not gut feel.

The day's low (L) and the day's high (H) are pretty self-explanatory. The difference between the high and low on the charts is referred to as the Range.

The fifth variable displayed on a chart is typically the volume (V), speci - fying the number of shares, lots, or contracts traded during the time pe - riod between the open of the market and the close.

Purely looking at these five points on the charts will not be enough to plan future trades. You need to look at them over a series of time in order to evaluate trends in the market.

Day traders use trading charts to watch the markets that they trade, and decide when to make their trades. There are several different types of trading charts, but they all show essentially the same trading information, such as the past and current prices.

In the following section, we'll discuss the three most popular types of trading charts.

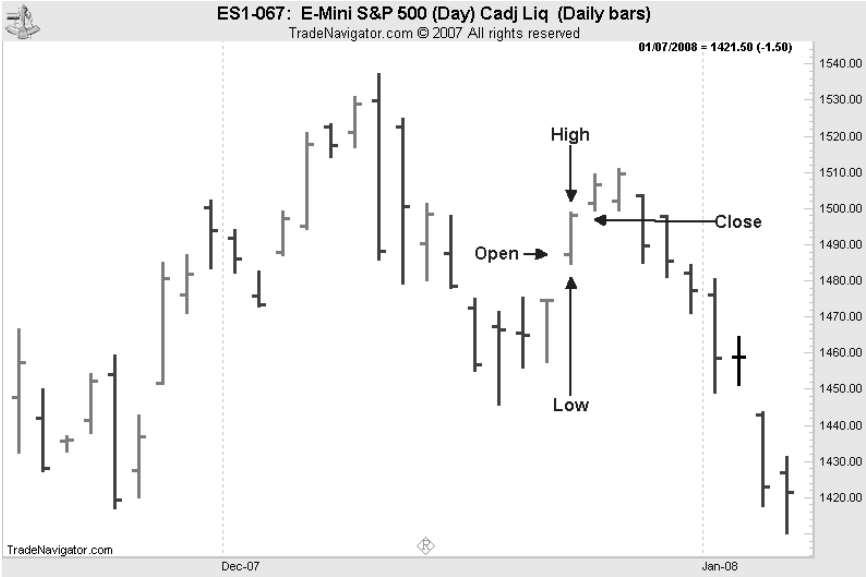
Bar Charts

A bar chart, also known as a bar graph, is a chart with rectangular bars whose lengths are proportional to the value they represent. Bar charts are used for comparing two or more values.

The bar chart is one of the most common charting methods. A bar chart indicates a single bar that extends from the high to the low of the trading period it is meant to depict. In addition, the opening and closing price levels could be displayed as small branches coming away from the main bar at the appropriate level. Closing prices are put on the right side of the bar. Opening prices are put on the left side.

How to Read Bar Charts

Bar charts consist of an opening foot, a vertical line, and a closing foot. Each bar includes the open, high, low, and close of the timeframe, and also shows the direction (upward or downward), and the range of the timeframe.



During live trading, you can read the bar chart like this:

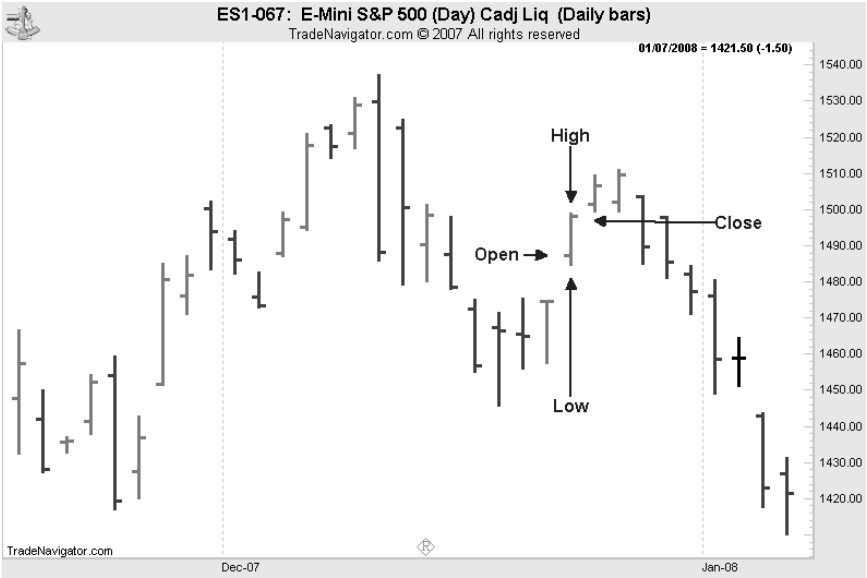
1.) **Open** – The open is the first price traded during the bar, and is indicated by the horizontal foot on the left side of the bar.

2.) **High** – The high is the highest price traded during the bar, and is indicated by the top of the vertical bar.

3.) **Low** – The low is the lowest price traded during the bar, and is indicated by the bottom of the vertical bar.

4.) **Close** – The close is the last price traded during the bar, and is indicated by the horizontal foot on the right side of the bar.
5.) **Direction** – The direction of the bar is indicated by the locations of the opening and closing feet. If the closing foot is above the opening foot, the bar is an upward bar, and if the closing foot is below the opening foot, the bar is a downward bar. Sometimes a charting software allows you to color these bars, in which case the upward bars are typically colored green, and the downward bars are colored red.

6.) **Range** – The range of the bar is indicated by the locations of the top and bottom of the bar. The range is calculated by subtracting the low from the high (range = high - low).



Candlestick Charts

Candlestick charts are not new – they've been used for hundreds of years by Japanese traders to predict and act on market movements.

Candlestick charting gives greater insight into human psychology.

In the 1700s, Homma, a Japanese trader in rice, noticed how the price of rice was influenced by human psychology as much as by the supply and demand situation. Homma used candlestick charts to trade rice and amassed a huge fortune in the markets. In fact, it was rumored that he never had a single losing trade!

Human psychology has never changed; it has remained constant over time – candlestick charting is just as useful today as it was hundreds of years ago.

Even though they may look a little complicated, there are some great reasons to use candlestick charts. Here are the main ones:

- **Complement Other Technical Tools**

  You can use candlestick charts as you would use the common bar chart, and you can combine them with traditional market indicators. Candlestick charts are a great way to spot opportunities, filter, and time trades with other indicators.

- **Spotting Trend Changes**

  Because of the way candlestick charts are viewed, they can give you visual warnings of market reversals much more clearly than traditional bar charts. If you look at candlestick charting, the human psychology of the move literally jumps out of the page at you.

- **Straightforward to Use**

  Candlestick charts use the same open, high, low, and close data

that traditional bar charts use, and are easy to draw. The different candle names are also easy to remember.

- **Define Market Momentums**

  The way the candlestick chart is drawn not only gives the direction of price, but also the momentum behind the move.

How to Read Candlestick Charts

Candlestick charts consist of a wide vertical line, and a narrow vertical line. Each candlestick includes the open, high, low, and close of the timeframe, the direction (upward or downward) of the timeframe, and the range of the timeframe.

During live trading, you can read the candlestick chart like this:

1.) **Open** – The open is the first price traded during the candlestick, and is indicated by either the top or bottom of the wide vertical line (the bottom for an upward candlestick, and the top for a downward candlestick).

2.) **High** – The high is the highest price traded during the candlestick, and is indicated by the top of the thin vertical bar (the wick of the candlestick).

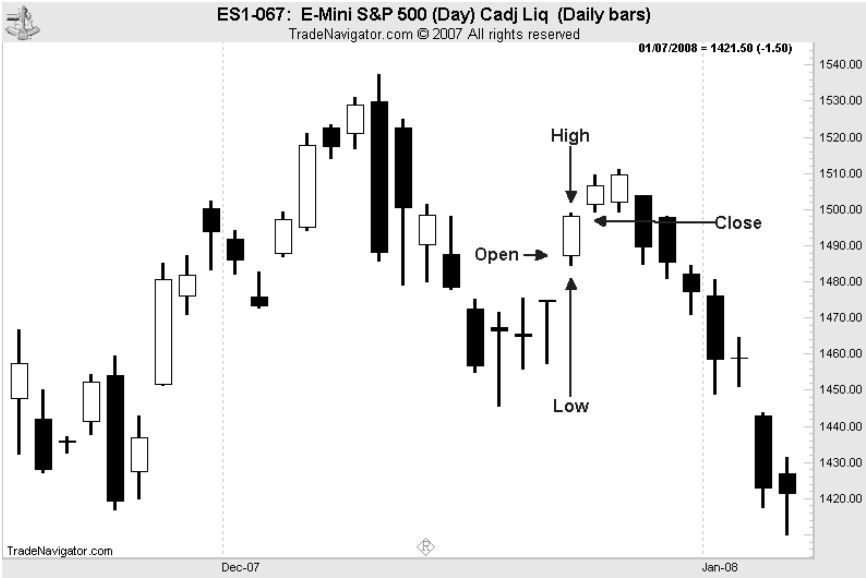
3.) **Low** – The low is the lowest price traded during the candlestick, and is indicated by the bottom of the thin vertical bar (the upside down wick of the candlestick).

4.) **Close** – The close is the last price traded during the candlestick, and is indicated by either the top or bottom of the wide vertical line (the top for an upward candlestick, and the bottom for a downward candlestick).

5.) **Direction** – The direction of the candlestick is indicated by the color of the candlestick (specifically the wide vertical line). Usually, if the candlestick is green, the candlestick is an upward

candlestick, and if the candlestick is red, the candlestick is a downward candlestick, but these colors can be customized. In the following chart, the upward candlesticks are colored white, and the downward candlesticks are colored black.

6.) **Range** – The range of the candlestick is indicated by the locations of the top and bottom of the thin vertical lines (the wicks). The range is calculated by subtracting the low from the high (range = high - low).



The candlestick chart body graphically illustrates the relationship behind the open, high, low, and close, and this adds an extra visual edge, due to the way they're drawn.

The candlestick has a wide part, called the "real body." This real body represents the range between the open and close of that day's trading.

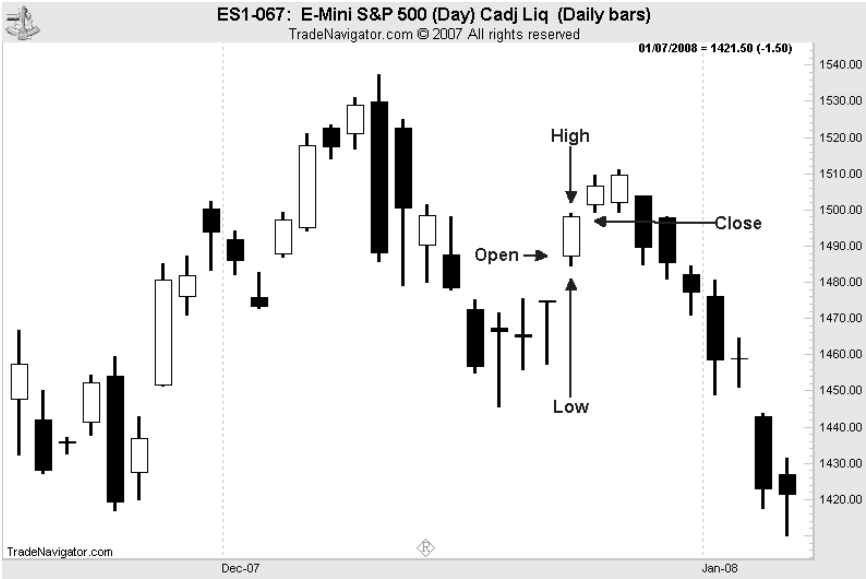
If the real body is filled with red, it means the close was lower than the open. If the real body is green, it means the opposite – the close was higher than the open.

Above and below the real body we see the "shadows." We see these as the wicks of the candle (which give them their name). The shadows actu - ally show the high and the low of the day's trading.

If the upper shadow on the red filled-in body is short, it indicates that the open that day was closer to the high of the day. On the other hand, a short upper shadow on a green or unfilled body shows the close was near the high.

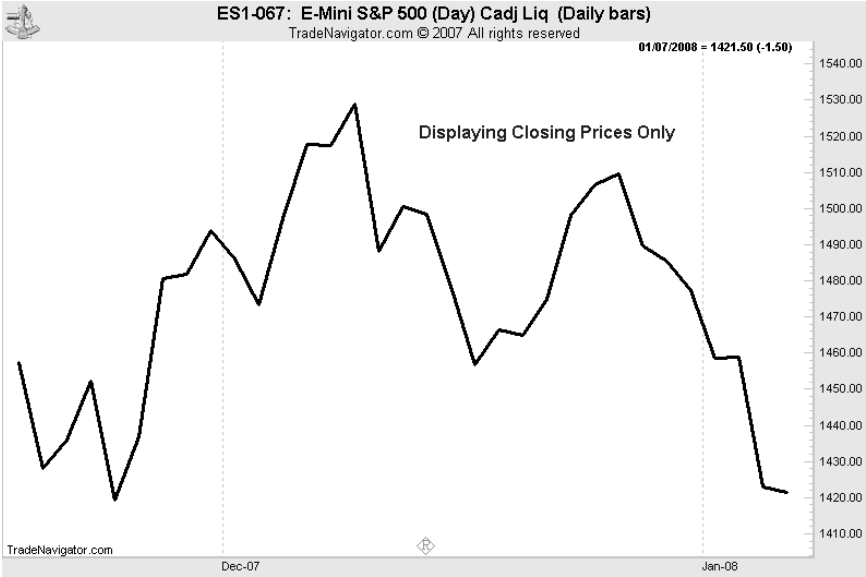
Regardless, of whether you're a day trader, a position trader, a system trader, or a trader who likes to make your own trades, there's really nothing to dislike about candlestick charts.

They're easy, and they're fun to use. Plus, they provide greater insight into market moves, along with the versatility to be used in any type of trading. If you aren't already using candlestick charting, then it's time to start.



Line Charts

A simple line chart draws a line from one closing price to the next clos - ing price. Line charts show the general price movement over a period of time. Some investors and traders consider the closing level to be more important than the open, high, or low. By paying attention to only the close, intraday swings can be ignored.



Line charts are also used when open, high, and low data points are not available. Sometimes only the closing data is available for certain indi - ces, thinly traded stocks, and intraday prices.

How to Read Line Charts

Line charts consist of individual points that are connected with straight lines. Usually, each point shows the close of the timeframe, but this can be modified to show any info – open, high, or low. Line charts also show the direction (upward or downward) of the timeframe.

Using Charts In Your Trading

Most charting software supports bar, candlestick, and line charts. Normally, you can customize the display and colors according to your wish.

You can use any reliable online charting service you want. Just make sure they provide the basic analytical tools (e.g. the capability to draw trendlines, and the option to add moving averages). There are so many charting services out there that it would be hard to mention any one in particular.

Let's just put it this way: charts are not the crystal ball of trading.

Charts do not foretell future market behaviors or predict market prices. They offer you a concise and accurate history of the price movements of a particular market. In that history lays a trend, and it is from this trend that you can extrapolate data on which to base your future projections of probable market behaviors and price changes. That's the greatest value that you'll get when it comes to using charts.

Technical Indicators

Let's keep it simple: money is made if you buy when the market is going up and sell when the market is going down. That's why technical analysts hold to the motto "the trend is your friend."

Finding the prevailing trend will help you become aware of the overall market direction and offer you better visibility – especially when short-term movements tend to clutter the picture.

Trends

The price chart of a security may appear like a random distribution, but this is not so.

About 30% of the time, a security will be in a definite trend. The rest of the time, prices will trade more or less in a sideways range. Our job is to recognize trends early, as they emerge from non-trends, or as reversals of prior trends.

Our goal is to buy or sell our security early in these new trends, exiting the trade profitably when the trend ends. This identification of trend, both its beginning and end, is the most important task we have as traders.

A simple definition of trend is basically the general direction of price movements. An uptrend is present when prices make a series of higher highs and higher lows. A downtrend is present when prices make a series of lower highs and lower lows.

When prices move without such a discernible series, prices are said to be trading sideways in a range, or trading trend-less. Once a trend is discernible, then trendlines can be drawn to define the lower limits of an uptrend or the upper limits of a downtrend.

It is essential that trendlines be drawn correctly. It is the recognition of the trendline and the violation of this trendline that is your key to successful trading and fortune building.

Does All of This Sound Too Simple?

I know that these simple definitions sound mundane, and that many traders would like to jump right into complicated indicators and complex trading strategies.

Don't make this mistake.

Trading can be simple: you buy when the market is going up and you sell when the market is going down. That's how money is made.

But if you don't know HOW to recognize when the market is going up, and when it's going down, then you'll lose money very quickly. So you MUST find an easy way to identify the direction of the market.

The easiest way to do so is using trendlines.

Indicators are another way to determine the direction of the market, but if you learn how to identify the trend using simple trendlines, then you'll never have to worry about indicators again.

The only two questions that remain are:

* When should I enter?
* When should I exit?

Just keep reading for the answers.

Uptrend

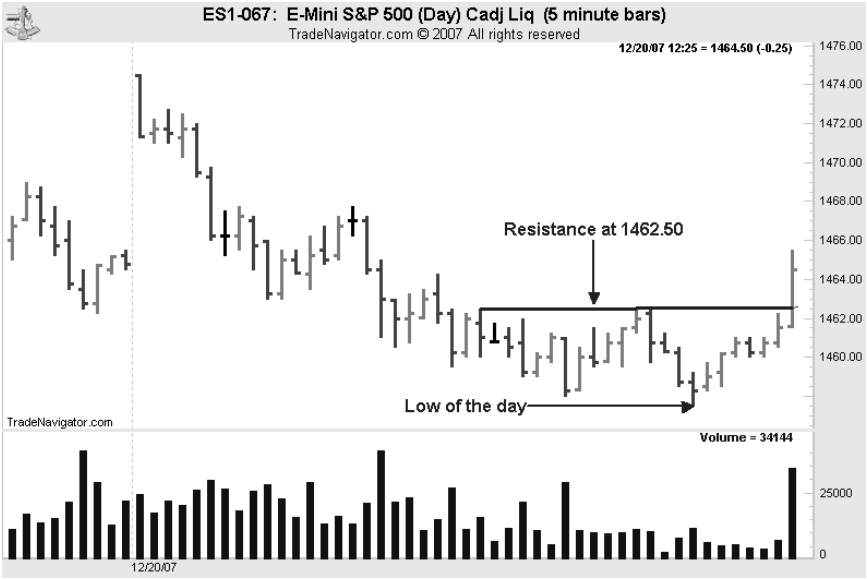
Let me show you exactly how to draw a trendline.

The following chart is a 5-minute bar chart of the E-mini S&P. The trading day is December 20th, 2007.

As you can see, prices have been moving down all morning, and then they started moving sideways during the lunch break.

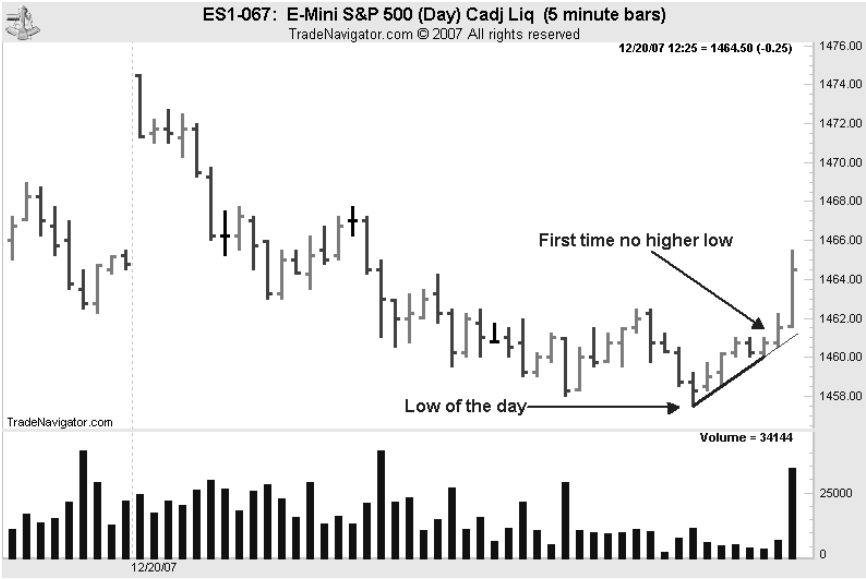
At 11:50pm (Central Standard Time) we see the low of the day.

Prices have found resistance at 1462.50, and at 12:25pm, prices break resistance on high volume. Obviously, prices are now in an uptrend, and it's time to draw our trendline.



In an uptrend, trendlines are drawn below the prices, while in a downtrend, trendlines are drawn above the prices.

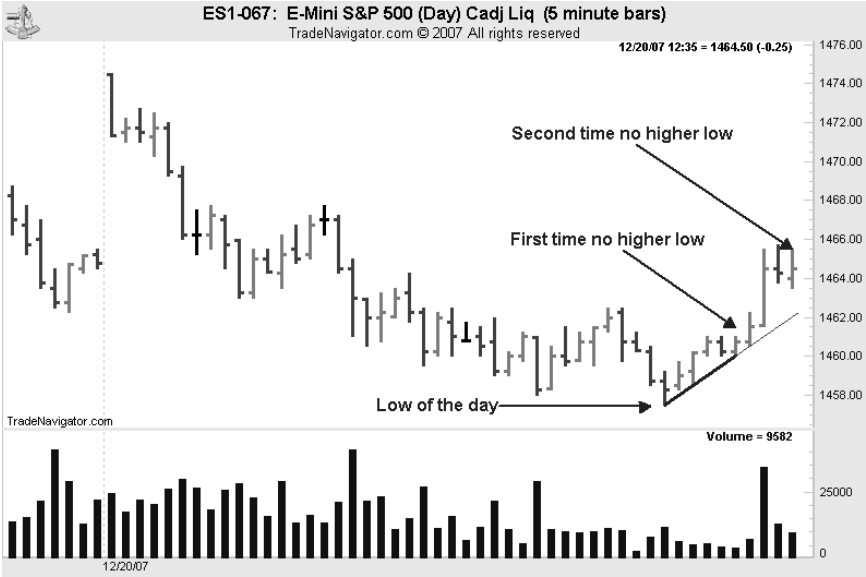
In order to draw a line, we need two points. The first point is the low of the day and the second point is the first retracement, when prices are no longer making higher lows.



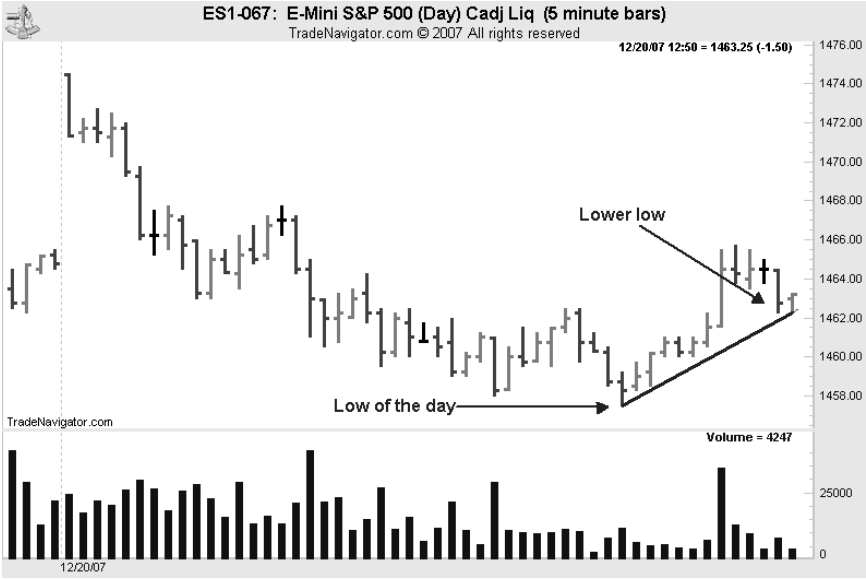
The first time prices are not making a higher low occurs at the 12:15pm bar, and we can draw our trendline. The dark part of the line is the **confirmed trend** and the light part of the line is the **projected trend**.

At 12:35pm, we see a lower low in an upward trend for the second time, but we do NOT adjust the trendline.

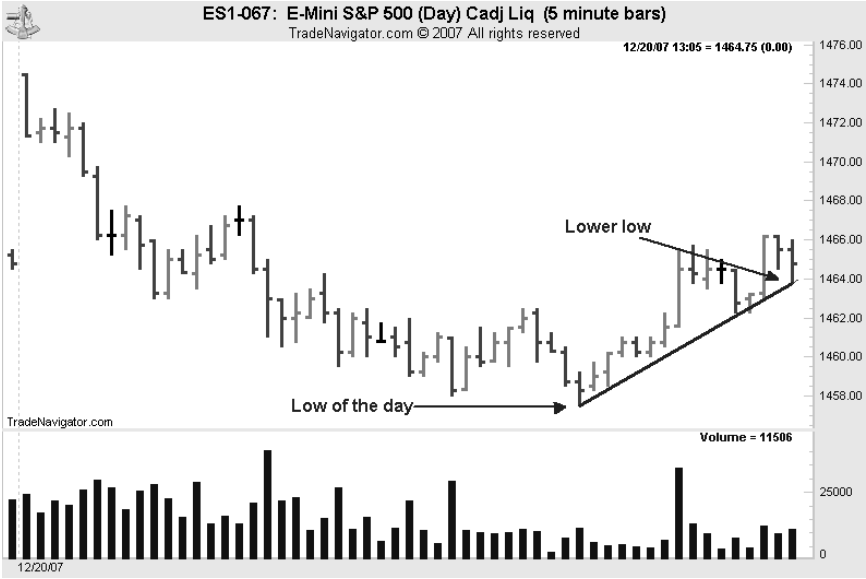
As a rule, trendlines can only become flatter, not steeper. Adjusting the trendline to the second lower low would make a steeper trendline; therefore, no change is made.



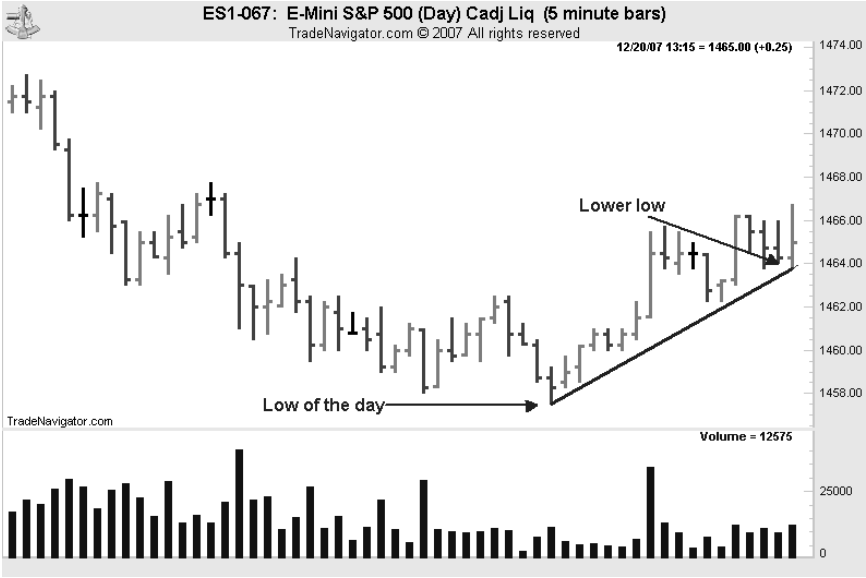
At 12:45pm and 12:50pm, a lower low is made again, and this time we adjust the trendline. It's only a slight adjustment and the trendline be - comes a little bit flatter. All previous prices are above the trendline, so the trend is still intact.



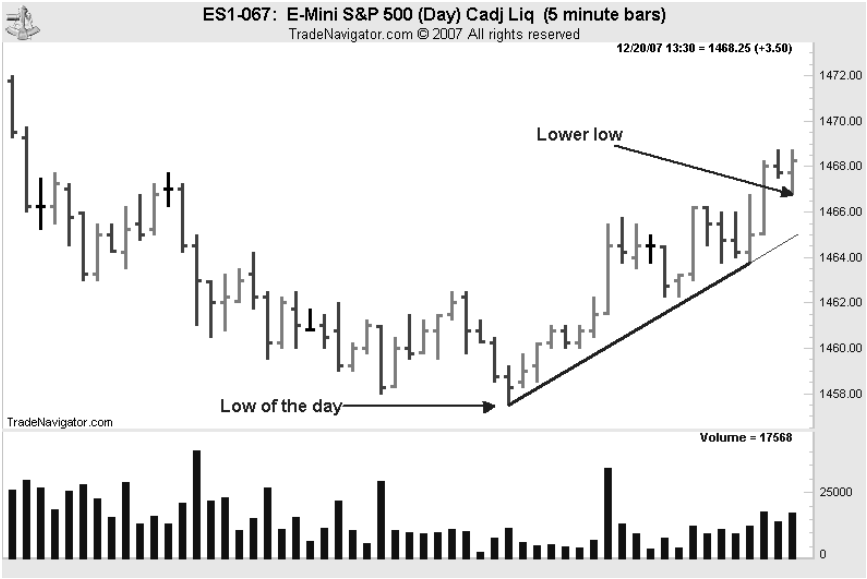
The next lower low occurs at 1:05pm, and we can extend our trendline. It's a simple extension: no adjustment is needed, and we see that the uptrend has now been in place for 40 minutes, since the breakout through the resistance level at 1462.50 at 12:25pm.



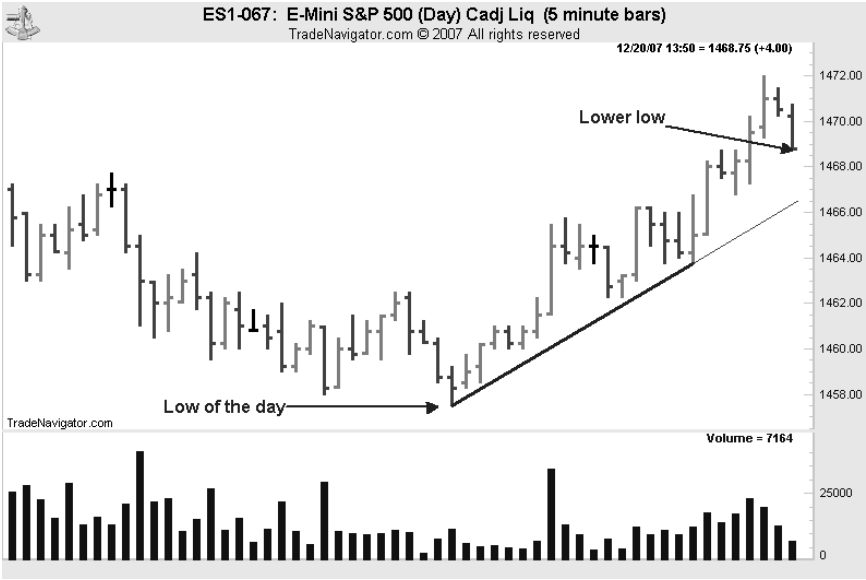
Ten minutes later, we get the next lower low, and we adjust the trendline accordingly. See how beautifully the previous lower lows are almost touching the trendline? A perfect trend.



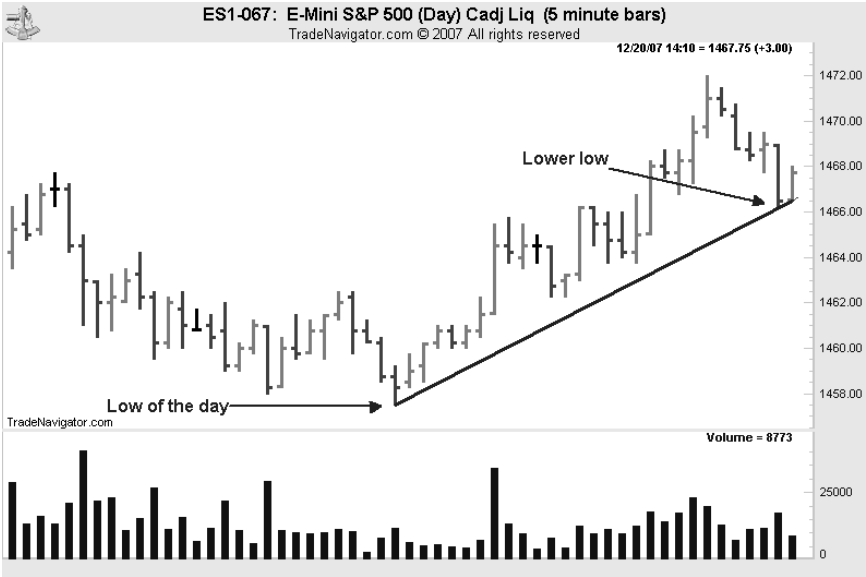
Again we see a lower low, but we don't adjust the trendline since it would make the line steeper. Remember the rule: we can only flatten the line, we can't make it steeper.



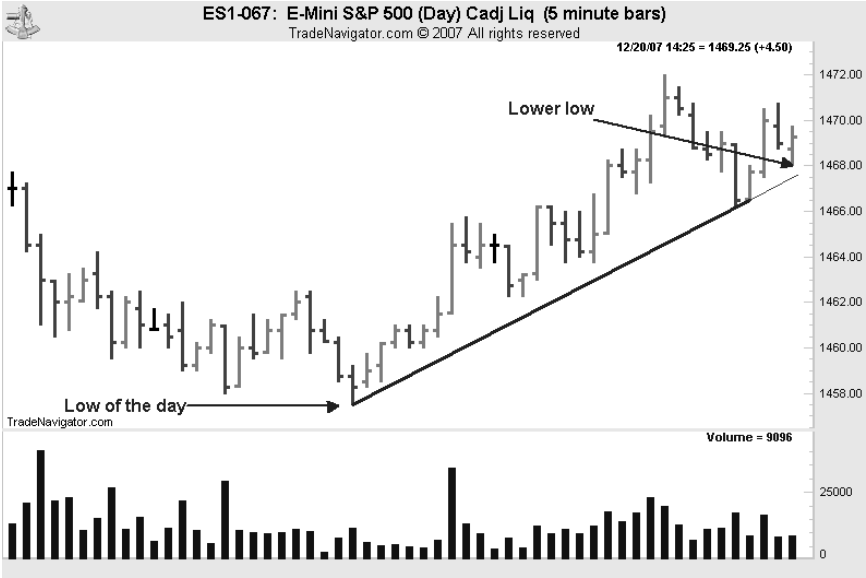
Another lower low occurs at 1:50pm, but we don't adjust the trendline.



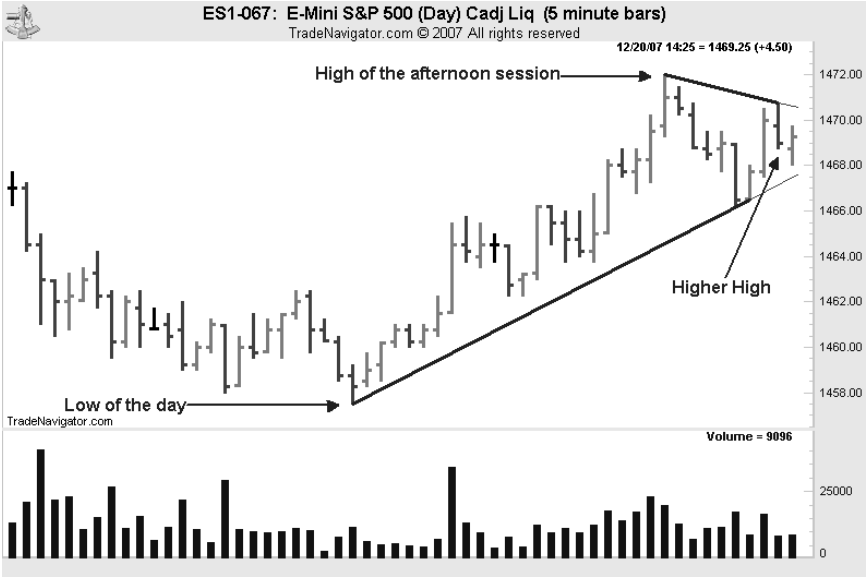
In this next chart, we see a series of lower lows, but only the lower low at 2:05pm allows us to adjust the trendline. The series of lower lows indi - cates that the trend is coming to an end.



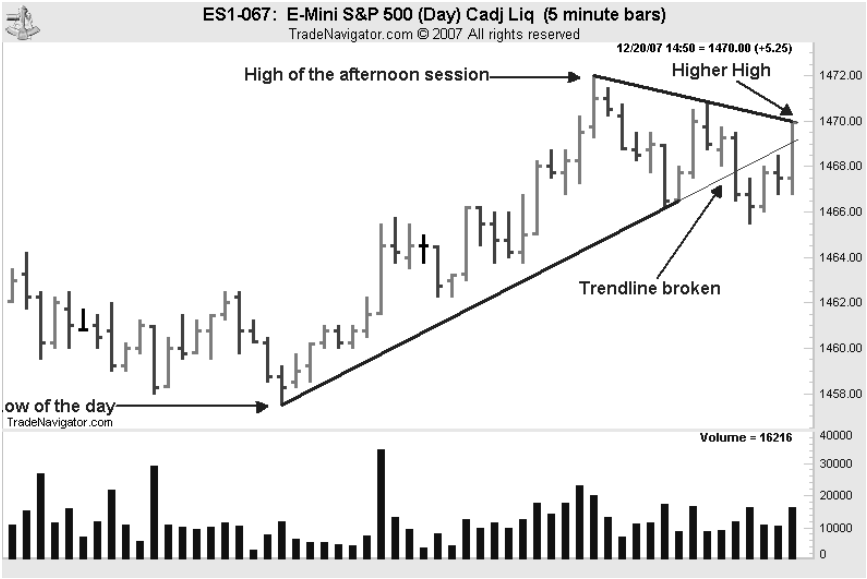
Fifteen minutes later, we have another lower low, but at the same time, we are experiencing a higher high after a series of lower highs. Lower highs are indicating a possible downtrend, and when we see the first higher high, it's time to start drawing a **downtrend line**.



It seems that our uptrend has come to an end. The uptrend line is broken, and we have another higher high that confirms our downtrend line.



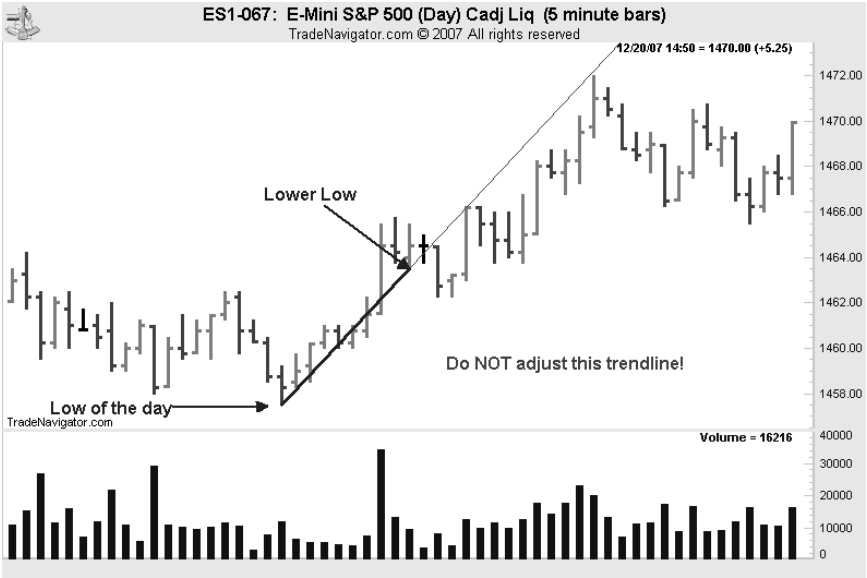
The uptrend was in place from 12:25pm until 2:25pm, for a full two hours. During this time, prices moved from 1462.50 (a break through the resistance level) to a high of 1472. The uptrend was broken at 1467.75.



There are two key things to remember about trendlines:

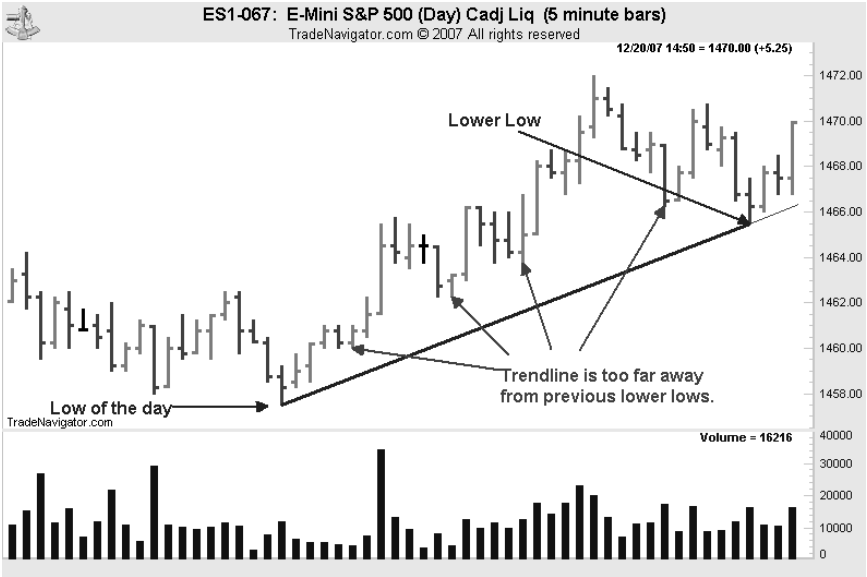
- **Never adjust a trendline so that it becomes steeper.**

  Don't run a trendline through price bars. An uptrend line is always below the price bars.



- **Keep a trendline close to the lower lows and don't move it too far away.**

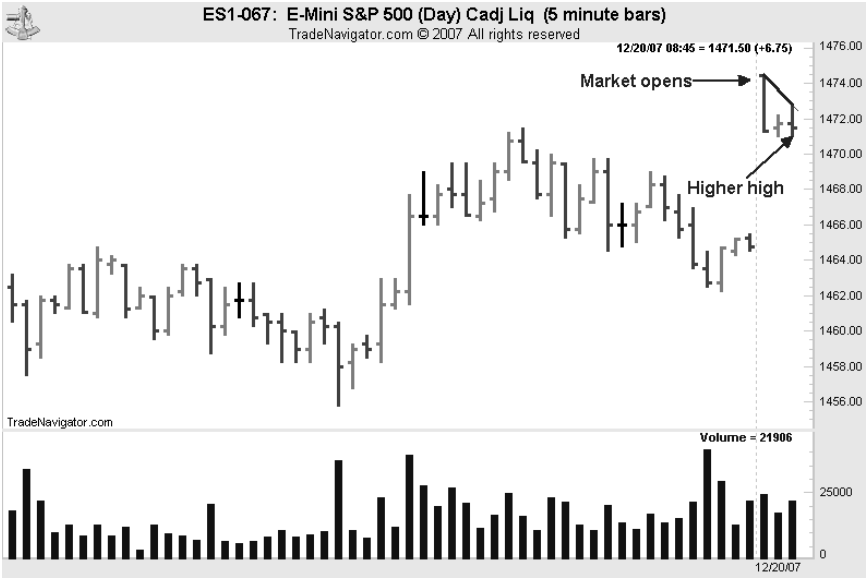
  If there's too much distance between your line and the lower lows, you risk missing a change in the trend.



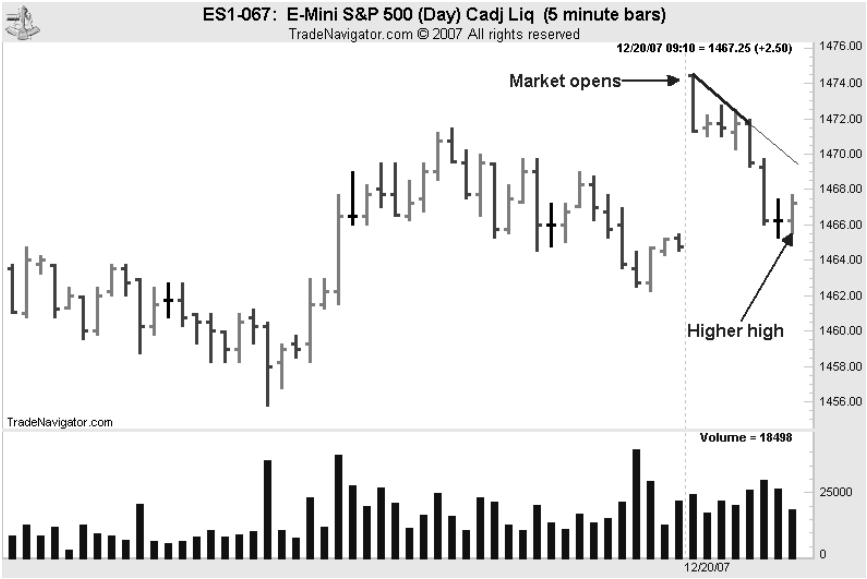
Downtrend

A downtrend line is constructed in a similar way to that of the uptrend line. The main difference is that you're looking for a higher high, and you draw the trendline ABOVE the price bars.

Here we have a 5-minute chart of the E-mini S&P on December 20th, 2007. The opening price is also the highest price, and 15 minutes after the opening, at 8:45am, we have the first higher high. So we can draw our downtrend line.

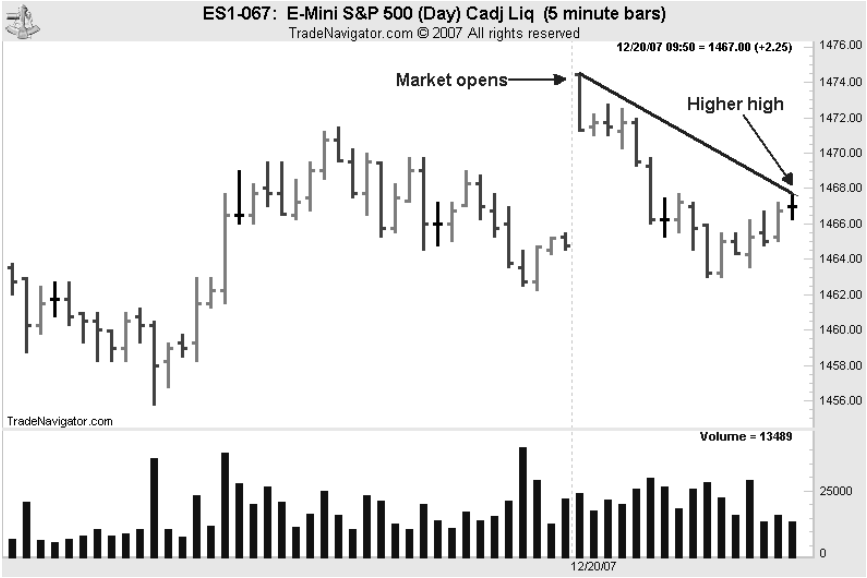


The market keeps falling, and at 9:10am, we see the next higher high. However, we don't adjust the trendline since it would mean making the line steeper.

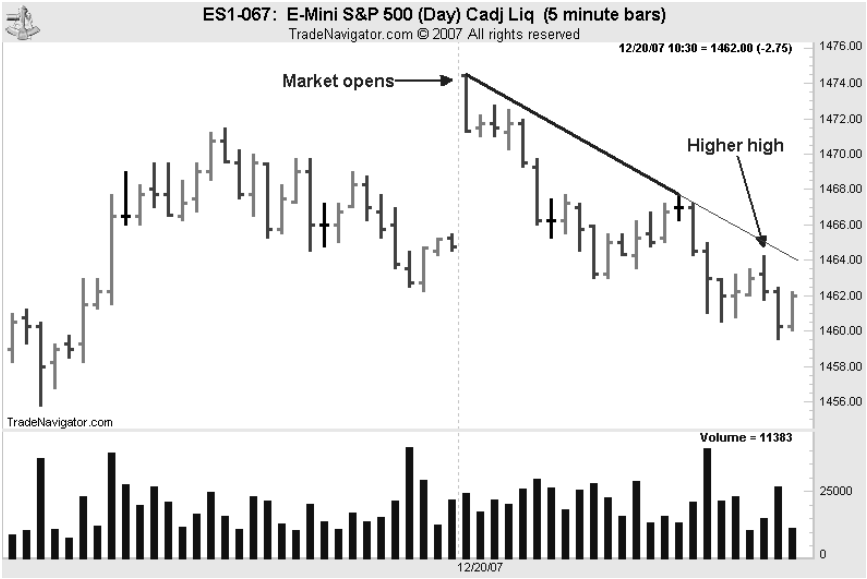


We see another higher high at 9:35am, but we still don't adjust the trendline. The 9:40am bar marks another higher high and confirms our previous trendline.

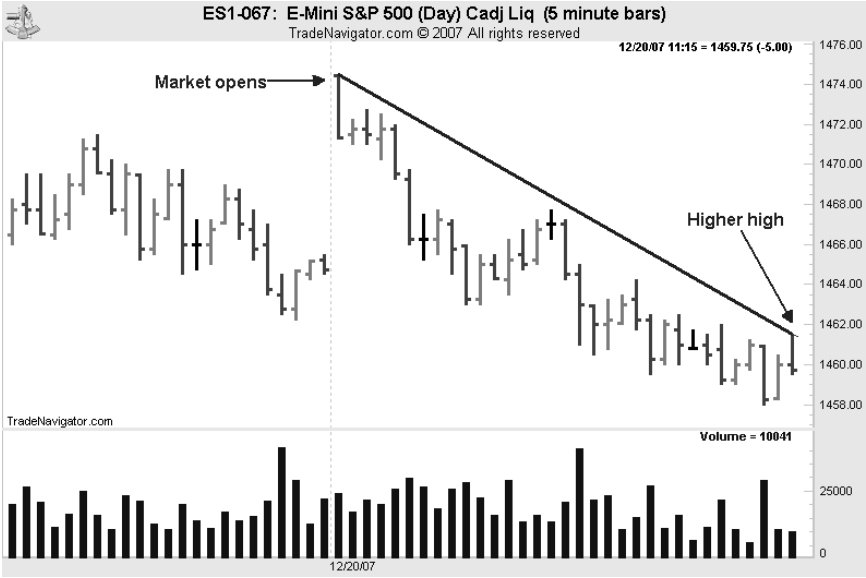
Ten minutes and two bars later, we have another higher high, and we can adjust our line. Note that it's still very close to the previous higher highs, so the adjustment is valid.



The market makes another higher high, but we don't adjust the trendline since it would make the line steeper. See how beautifully our trendline captures this downtrend?

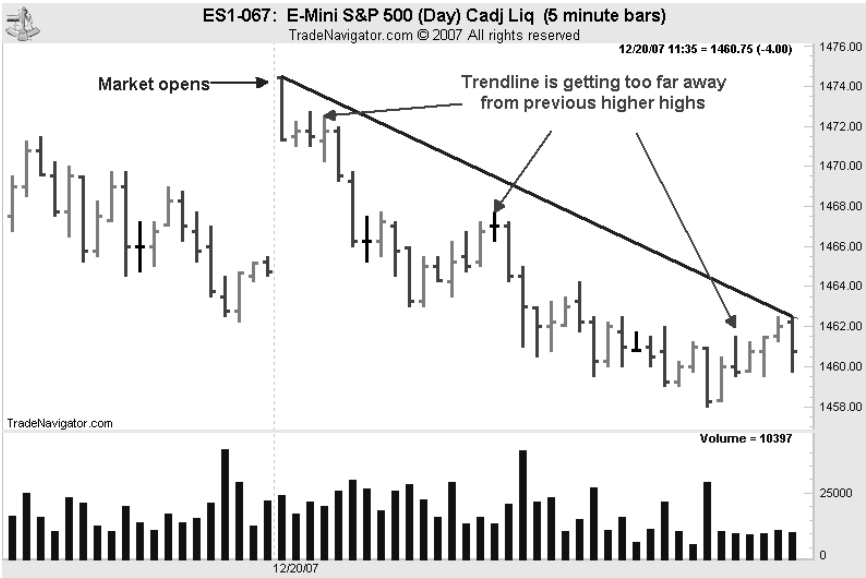


The trend continues, and at 11:15am, almost three hours after the open - ing, we can adjust the trendline again. The trendline is still very close to the previous higher highs.



Fifteen minutes later, we get the next higher high, but if we adjust the trendline, it will move it too far away from the previous higher highs; the downtrend is broken.

Adjusting the trendline would move it too far away from previous higher highs, and we risk missing a change in the trend.



Trendline Validity

The validity of a trendline is dependent on its duration and the number of times it's been successfully tested.

The longer the trendline has been in effect and the more times it has been successfully tested, the more important the trendline becomes. Consequently, when a trendline of long duration – which has been successfully tested many times – is violated, then an important reversal of trend is likely to have occurred.

Trading Range

This is a trading pattern that occurs in between an uptrend and a down - trend. It points to equilibrium in supply and demand. Sideways trends follow a horizontal direction, where the price stays relatively constant. Trading patterns are also used in order to set support and resistance lev - els, which are very useful for the technical analysis of charts.

Support & Resistance

Support and resistance levels are points where a chart experiences recur - ring upward or downward pressure. A support level is usually the low point in any chart pattern (hourly, weekly, or annually), whereas a resis - tance level is the high or the peak point of the pattern.

These points are identified as support and resistance when they show a tendency to reappear. It's best to buy near support or sell near resistance levels that are unlikely to be broken. Once these levels are broken, they invariably reverse their roles. Previous support becomes resistance and previous resistance becomes support.

Support and resistance levels are very important to your trading; it's critical that you understand them.

In uptrends, every time the price drops to the uptrend line and then re - sumes its advance, the trendline has acted as support to the price uptrend. Support can also be found at prices of previous support or resistance.

In downtrends, every time the price rises to the downtrend line and then resumes its decline, the downtrend line has acted as resistance to the up - ward move of market prices.

Consider the following: when price action drops to a certain level, the bulls (the buyers) take control and prevent prices from falling lower. Similar to support, a resistance level is the point at which bears (the sell - ers) take control of prices and prevent them from rising higher.

The price at which a trade takes place is the price at which a bull and bear agree to do business. It represents the consensus of their expectations. The bulls think prices will move higher and the bears think prices will move lower.

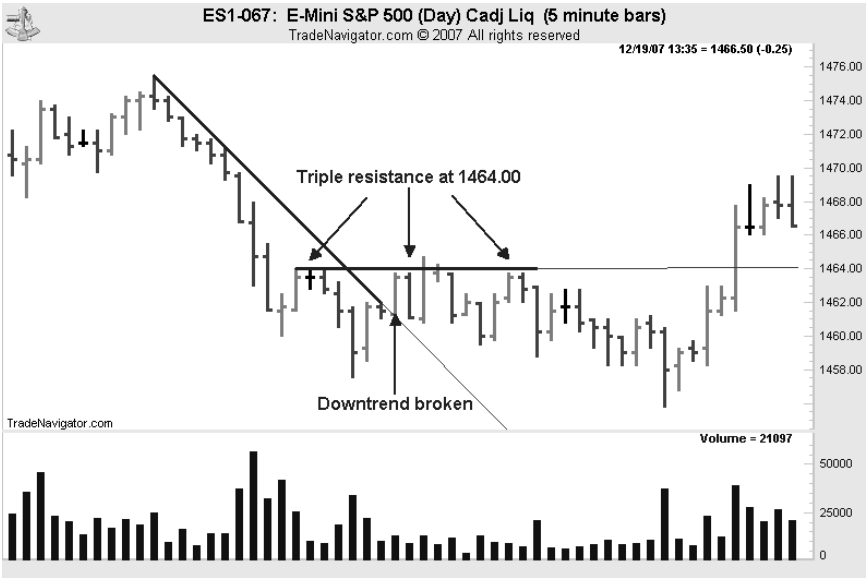
Support levels indicate the price at which a majority of investors believe that prices will move higher, and resistance levels indicate the price at which a majority of investors feel prices will move lower.

The development of support and resistance levels is probably the most noticeable and reoccurring event on price charts.

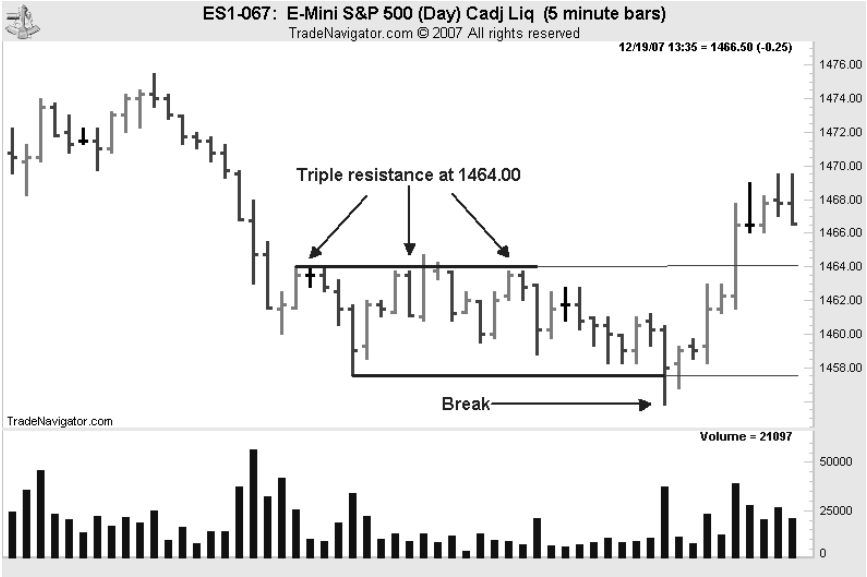
Example:

As you can see from the following chart, prices have been in a downtrend. On the same bar that broke the downtrend, prices went to the resistance level at 1464.00 and retraced. 10 minutes later, they went 2 ticks above the resistance level, but closed AT the resistance level.

For the next 2 hours and 30 minutes, prices never go above the resistance level of 1464, but they repeatedly test this level, eventually breaking out.



Whenever you can draw a resistance line, you can typically draw a corre - sponding support line, as shown in the following chart.



As you can see, the support line holds very well, even though it's broken later. However, the break isn't significant, since prices close above the support line.

A Little More on Support and Resistance

Support is the price level at which demand is thought to be strong enough to prevent the price from declining further.

The logic dictates that as the price declines towards support and gets cheaper, buyers become more inclined to buy and sellers become less inclined to sell. By the time the price reaches the support level, it's believed that demand will overcome supply and prevent the price from falling below support.

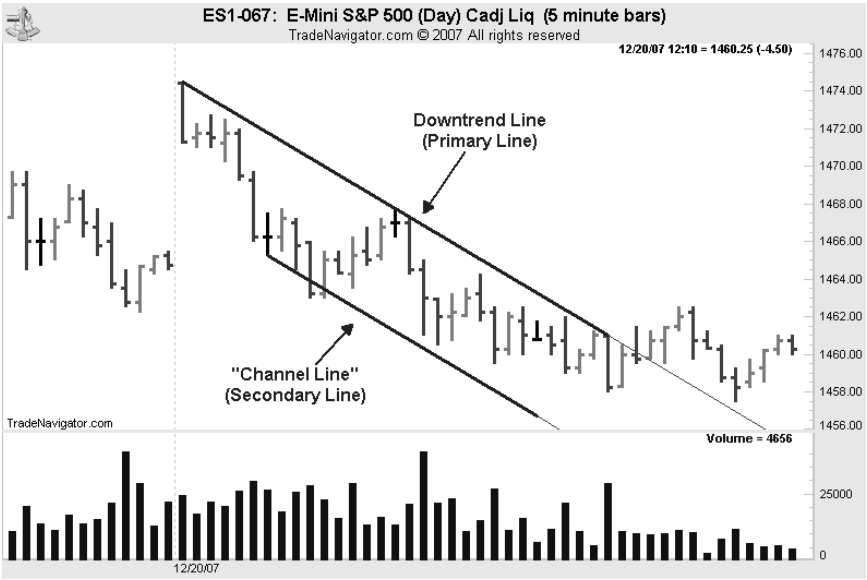
Resistance is the price level at which selling is thought to be strong enough to prevent the price from rising further.

The logic dictates that as the price advances towards resistance, sellers become more inclined to sell and buyers become less inclined to buy. By the time the price reaches the resistance level, it's believed that supply will overcome demand and prevent the price from rising above resistance.

Trendlines & Trend Channels

Trendlines are simple, yet helpful, tools in confirming the direction of market trends. An upward straight line is drawn by connecting at least two successive lows. Naturally, the second point must be higher than the first.

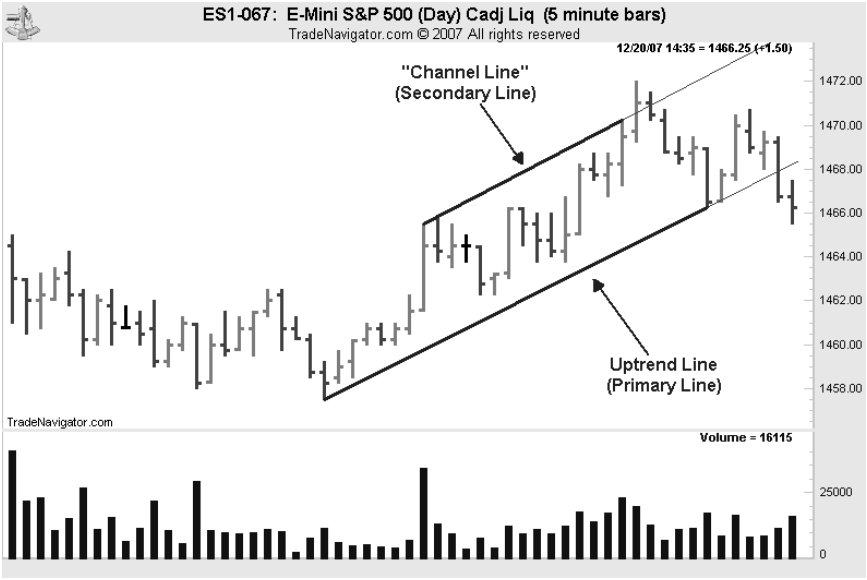
The continuation of the line helps determine the path along which the market will move. An upward trend is a concrete method to identify sup - port lines/levels. Conversely, downward lines are charted by connecting two points or more. The validity of a trading line is partly related to the number of connection points. Yet it's worth mentioning that points must not be too close together.



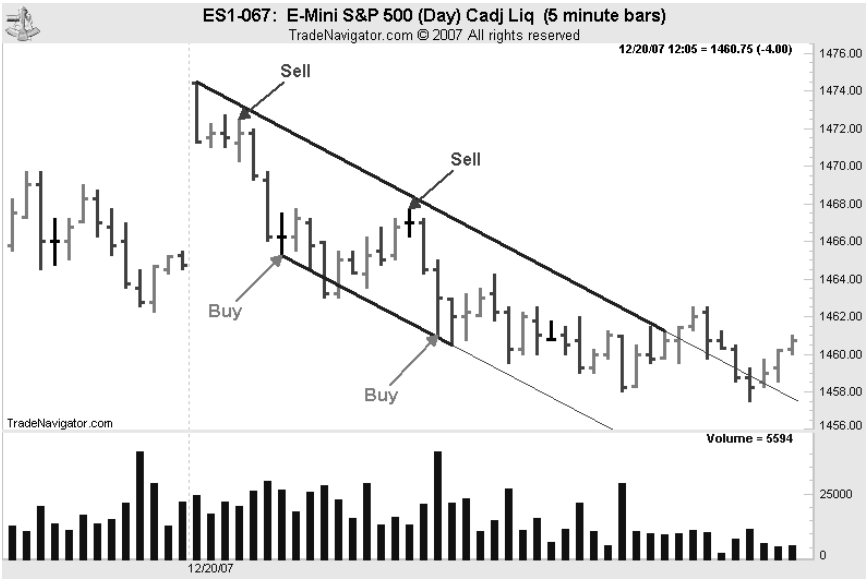
A channel is defined as the price path drawn by two parallel trendlines. The lines serve as an upward, downward, or straight corridor for the price.

Note that when drawing trend channels, you first draw the trendline and then construct the "channel line" as a parallel line to the primary trendline.

Trend channels are typically constructed to derive entry and exit points in an uptrend or downtrend.



In a downtrend, you'd sell at the primary downtrend line and buy back at the secondary channel line, as shown in the following example:



Popular Trading Approaches

By now, you know that any market is either trending or moving sideways. Therefore you'll apply one of the following two trading strategies:

1.) **Trend-following** – when prices are moving up, you buy, and when prices are going down, you sell.

2.) **Trend-fading** – when prices are trading at an extreme (e.g. upper band of a channel), you sell, and then you try to catch the small move while prices are shifting back into "normalcy." The same applies for buying.

Most indicators that you'll find in your charting software belong to one of these two categories: indicators for identifying trends (e.g. moving averages), or indicators that define overbought or oversold situations, which offer you a trade setup for a short-term swing trade.

Don't become confused by all the possibilities of entering a trade. Just make sure that you understand WHY you're using a certain indicator and WHAT that indicator is measuring.

Here are some examples of popular trading approaches:

Trend-following:

- Moving Averages
- Crossover of Moving Averages
- Turtle Trading
- Moving Average Convergence-Divergence (MACD)

Trend-fading:

- Williams %R
- Relative Strength Index (RSI)
- Bollinger Bands and Channels

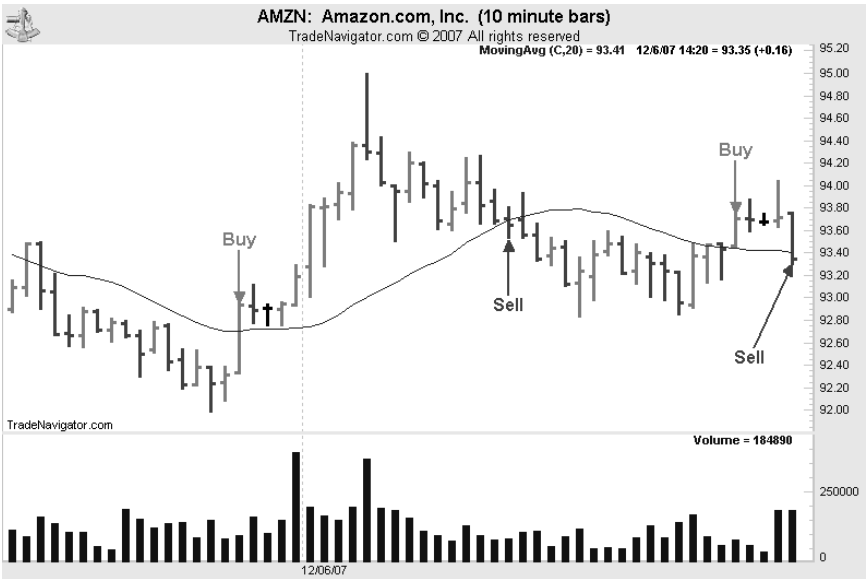
Simple Moving Averages

If you believe in the "trend-is-your-friend" tenet of technical analysis, moving averages (MA) are very helpful. Moving averages tell the average price in a given point of time over a defined period of time, typically the closing price. They're called 'moving' because they reflect the latest average, while adhering to the same time measure.

A weakness of moving averages is that they lag the market, so they do not necessarily signal a change in trends. To address this issue, use a shorter period, such as a 5- or 10-day moving average, which will be more reflective of the recent price action than the 40- or 200-day moving averages. The concept is simple:

- A buy signal is generated when the closing price moves above the moving average.
- A sell signal is generated when the closing price dips below the moving average.

Here's an example using the 10-minute chart of Amazon (AMZN):



You can see that this strategy works very well in trending markets (see first buy signal), but in sideways moving markets, you're getting whip - sawed (see second buy signal).

The Right Concept for the Right Market

Every day, a great deal of traders attempt to use strategies based on moving averages. And then they complain that these strategies don't work.

Keep in mind that this is a trend-following strategy – you should only apply it in trending markets.

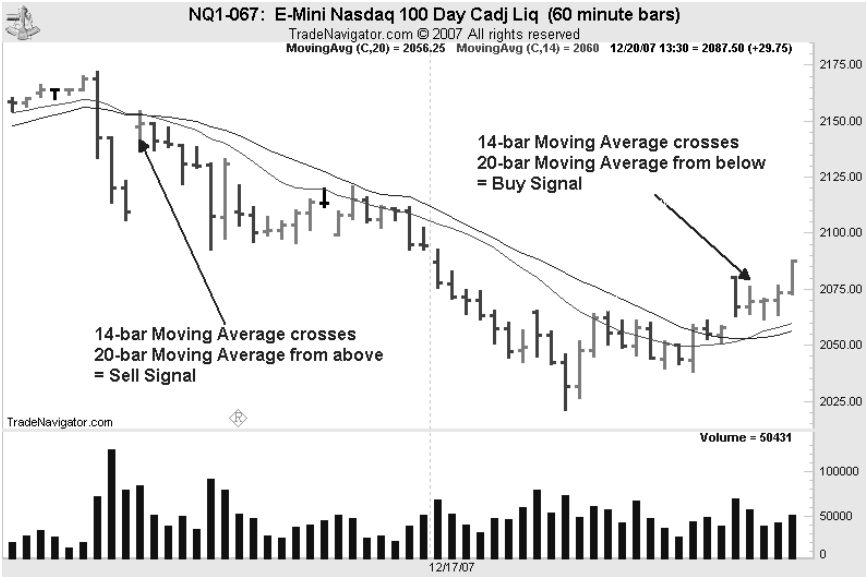
You might want to use trendlines or other indicators to ensure that the market you're watching is actually trending, and then use moving aver - ages to get your specific entry signals.

Crossover of Moving Averages

Another very popular approach is to use two moving averages: a "fast" moving average (e.g. 14 bars) and a "slow" moving average (e.g. 20 bars). The amount of days used for the slow-moving average needs to be larger than the amount of days used for the fast moving average.

- A buy signal is generated when the fast-moving average crosses the slow moving average from below.
- A sell signal is generated when the fast moving average crosses the slow moving average from above.

Here's an example of this strategy:

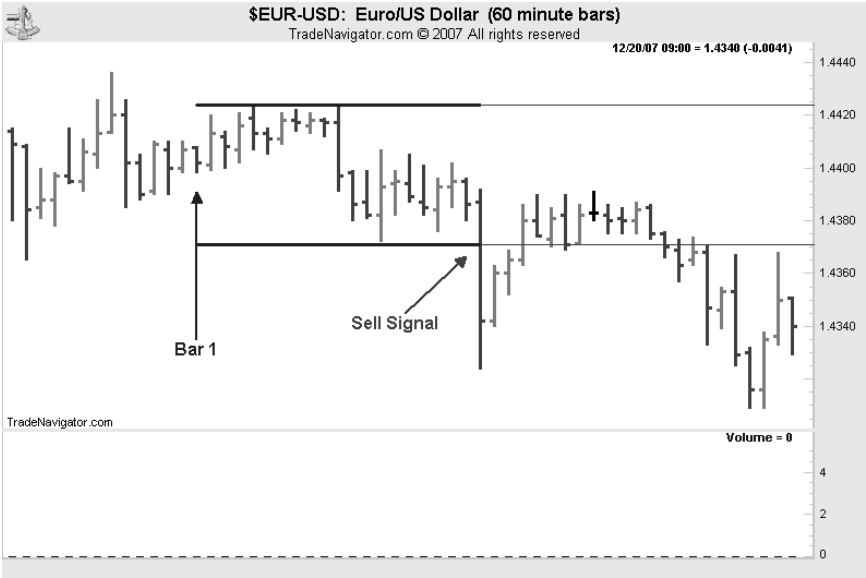


The upper line is the slow-moving average (20 bars), and the lower line is the fast moving average (14 bars).

Turtle Trading

You'll find plenty of articles on the Internet that will explain the turtle trading rules in detail. Basically, the turtles look at the high and the low through the past 20 days and generate the following signals:

- A buy signal is generated when the current prices move higher than the high of the previous 20 bars.
- A sell signal is generated when the current prices move lower than the low of the previous 20 bars.



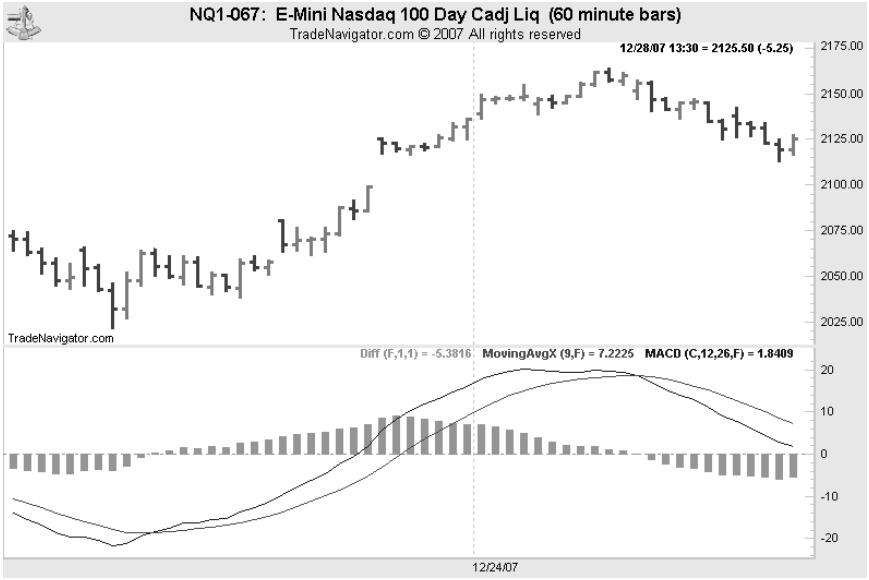
Prices moved below the 20-bar low at 1.4372 and generated a short sig - nal. Prices moved as low as 1.4324 (= 48 pips or $480) before retracing.

Please note that we just defined an entry signal. You still need to apply profit targets and stop losses (see the next two chapters).

Moving Average Convergence Divergence (MACD)

Another trend-following indicator is the Moving Average Convergence/Divergence (MACD), developed by Gerald Apple. This indicator shows the relationship between two moving averages of prices. The most popular parameter for the MACD is the difference between a 26-bar exponential moving average (EMA) and the 12-bar. This difference is then plotted on the chart and oscillates above and below zero.

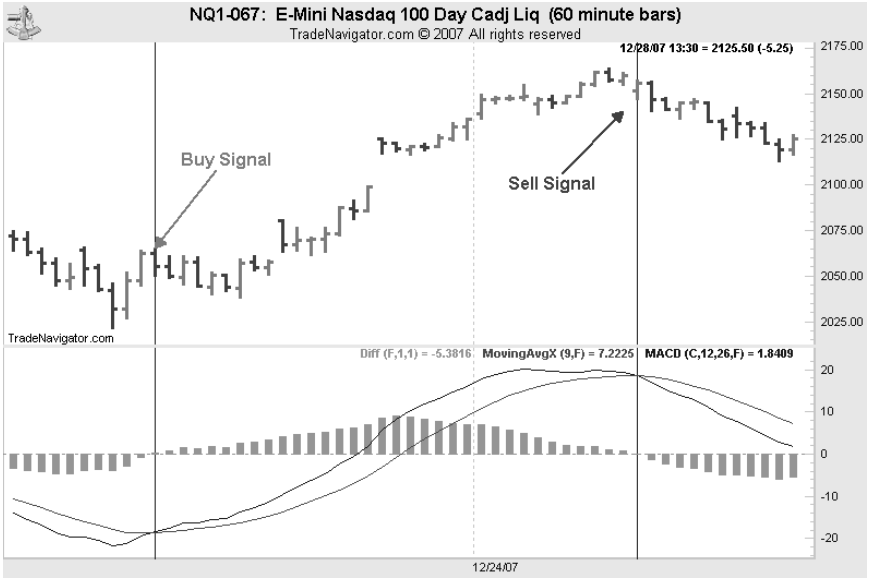
A 9-bar EMA of the MACD, called the "signal line," is then plotted on top of the MACD, functioning as a trigger for buy and sell signals (dark gray line).



Traders utilize the MACD in different ways, but the most popular is to use the signal line for entry signals:

- A buy signal is generated when the signal line (dark grey line) crosses the MACD (light grey line) from below.

- A sell signal is generated when the signal line (dark grey line) crosses the MACD (light grey line) from above.



Williams %R

One of the most popular overbought/oversold indicators is Williams %R.

This indicator was developed in 1966 by Larry Williams to help traders identify overbought and oversold positions in the market.

Williams %R, sometimes referred to as %R, compares a stock's close to the high-low range over a certain period of time.

The formula is quite simple: it subtracts the current day's close from the lowest intraday low of the last 'X' number of days, and then divides this distance by the highest high minus the lowest low of the last 'X' number of days. This computation tells us where, within the next day range, today's close is located. If it's high in the range it will be in the high percentiles, say over 80%. If we're closing low in the range of the last 'X' number of days, it would be in the 20% or lower area.

The index has many uses, but the simplest one is just allowing it to identify or suggest an overbought, oversold zone.

The index can be used in all markets and in all timeframes. Most traders use it successfully on intraday bar charts with a parameter of 14 bars.

As stated above, the indicator shows the relationship of the closing price to a high-low range over a specific period of time, typically 14 bars.

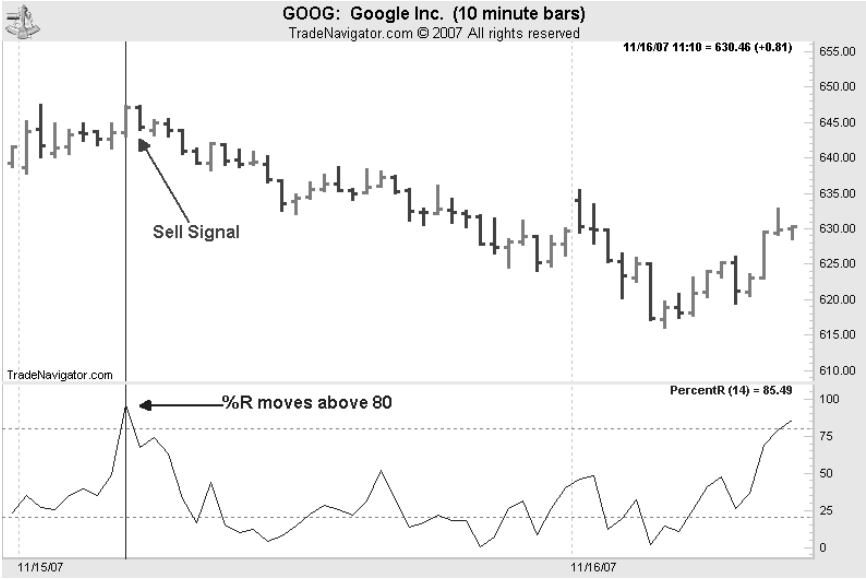
The result is plotted on a chart and oscillates between 0 and 100. The basic idea is that if prices are trading at the high of the high-low range (indicator reading close to 100), then the market is overbought, and if the current prices are trading close to the low of the specified range (indicator reading close to 0), then the market is oversold.

- A sell signal is generated when the indicator has a value above 80.

- A buy signal is generated when the indicator has a value below 20.

In this example chart, the %R moves above 80, indicating that Google (GOOG) is "oversold," and a sell signal is generated.

Williams %R works best in sideways-moving markets.

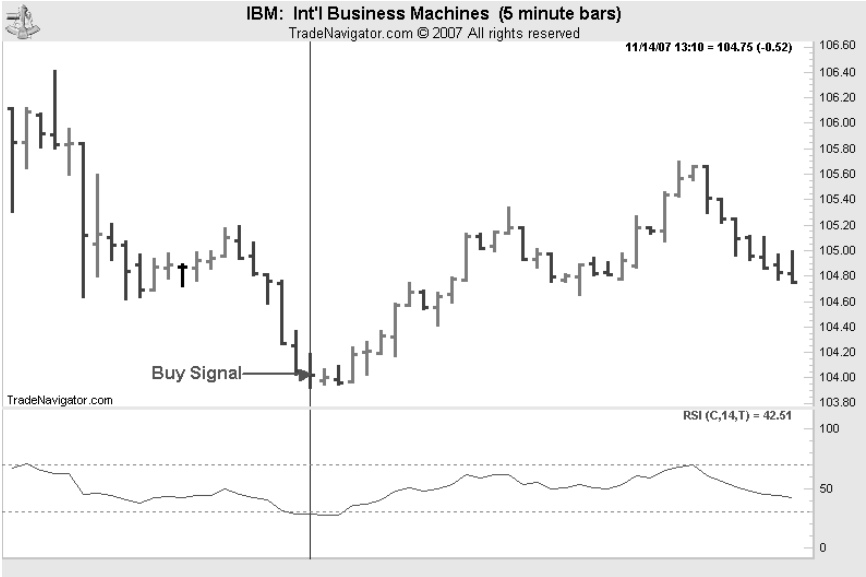


Relative Strength Index (RSI)

Another popular overbought/oversold indicator is the Relative Strength Index (RSI), developed by Welles Wilder. The RSI compares the magnitude of a stock's recent gains to the magnitude of its recent losses and turns that information into a number which ranges from 0 to 100. It takes a single parameter – the number of time periods – to use in the calculation. In his book, Wilder recommends using 14 periods.

- A sell signal is generated when the RSI crosses the 70-line (overbought-zone) from above.

- A buy signal is generated when the RSI crosses the 30-line (oversold-zone) from below.



The RSI dips below 30 and a buy signal is generated, coincidentally at the low of the day. By applying stop loss and profit exit strategies (see next chapter), profits could be realized quite quickly.

As with the %R, the RSI indicator works best in sideways-moving markets.

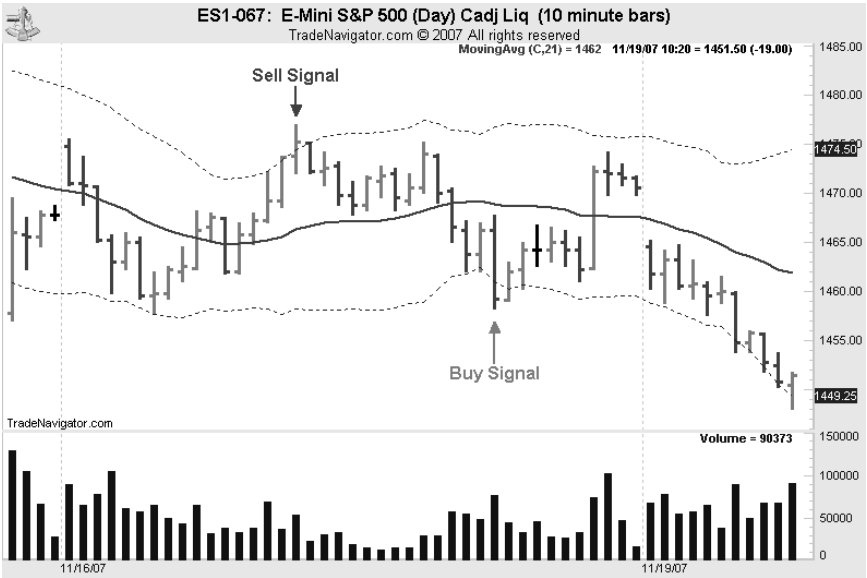
Bollinger Bands and Channels

Many traders are familiar with the concept of "Bollinger Bands."

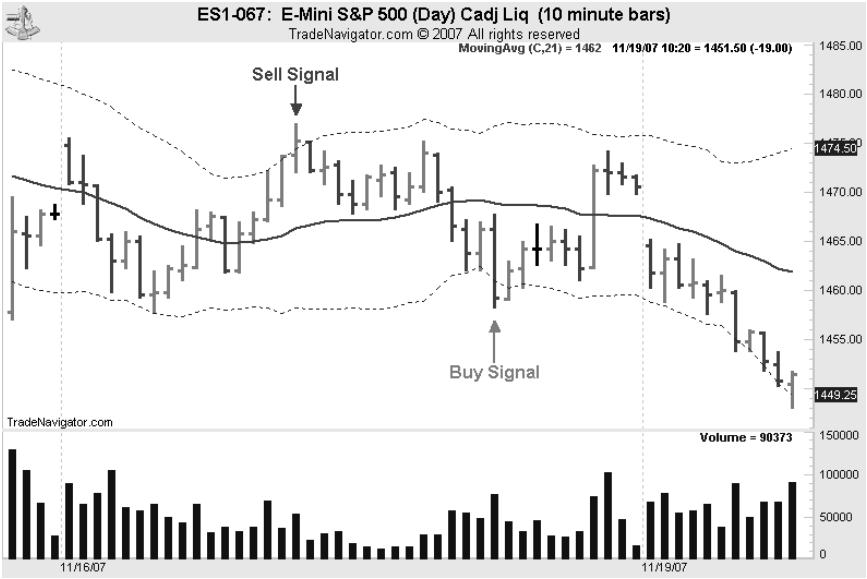
Bollinger Bands consist of a moving average and two standard deviations, one above the moving average and one below. The important thing to know about Bollinger Bands is that they contain up to 95% of the closing prices, depending on the settings.

The most popular setting is a 21-bar moving average (solid dark grey line) and 2 standard deviations for the upper and lower band (dotted grey line).

- A buy signal is generated when prices move below the lower Bollinger Band.
- A sell signal is generated when prices move above the upper Bollinger Band.



This is a 10-minute chart of the E-mini S&P. After lackluster trading in the morning, prices move above the upper Bollinger Band and generate a sell signal.



Two hours later, prices move below the lower Bollinger Band and create a buy signal.

This indicator works best in sideways-moving markets.

Trading Approaches

Before deciding on a trading approach, you need to identify whether the market is trending or moving sideways.

Don't fall prey to the common mistakes. Many traders simply decide on one trading approach and trade it all the time, whether the market is trending or not. That's a sure way to failure.

Successful traders use multiple trading approaches: they have at least one approach for a trending market and another approach for a sideways-moving market. Using the basic principles outlined on page 103, you can determine the direction of the market and use the right trading approach.

Don't make the mistake of using only **one** trading approach. Learn to identify whether a market is trending or not and adjust your trading strat - egy accordingly.

Action Items:

- ✓ Pick any chart in any timeframe and practice drawing trendlines. One of the most important skills of a trader is being able to iden - tify the direction of the market. Practice on as many charts as you can, until you can spot a trend within a couple of seconds.

- ✓ Select a trading approach that YOU are comfortable with. Make sure that you understand what the indicator you are using is measuring: WHY should you sell when it goes above 80? What EXACTLY does it mean?

- ✓ Select a second trading approach. As you know you should have one for a trending market and one for a market that is going sideways. Which approach will you use when?

- ✓ Continue your trading plan on page 245 under "Selecting a Trad - ing Style."

Step 4: Defining Entry Points

As you saw in the previous examples, most of the trading approaches or indicators already provide you with entry rules. When defining entry points, you want to keep it simple and specific. You can't freeze the market. A market is constantly moving, and you have to make your trading decisions fast.

Most trading approaches and indicators require a decision at the end of the bar. Even when you're watching 60 minute bars, and you've spent the past hour doing nothing except waiting for your signal, now – at the end of the bar – you only have a split second to make your decision.

Use as few entry rules as possible and be as specific as you can. The best trading strategies have entry rules that you can specify in only two lines.

Action Items:

- ✓ Practice identifying the entry rules of the two approaches you selected. Identify the underlying market condition (trending/ sideways) and apply the strategy you've selected. When should you enter? Only mark the entry points. Don't worry about exit points yet.

- ✓ Continue your trading plan on page 245 and write down your specific entry points under "Entry Signals."

Step 5: Defining Exit Points

This chapter is probably the most important chapter in the entire book.

I once heard the saying: “A monkey can enter a trade, but money is made (and lost) when you EXIT it.”

This couldn’t be truer. Most traders are right about the direction of the market when they enter a trade, but they end up taking a loss because they fail to capture profits at the right time.

Read this chapter again and again until you understand ALL of the concepts outlined here. Knowing HOW and WHEN to exit a trade will ultimately determine your success or failure as a trader.

There are three different exit rules you should apply:

- Stop loss rules to protect your capital.
- Profit-taking exits to realize your gains.
- Time-stops to get you out of a trade and free your capital if the market is not moving at all.

Stop loss and profit-taking exit rules can be expressed in four ways:

- A fixed dollar amount (e.g. $1,000)
- A percentage of the current price (e.g. 1% of the entry price)
- A percentage of the volatility (e.g. 50% of the average daily movement)
- Based on technical analysis (e.g. support and resistance levels)

In the following we'll discuss these exit strategies in detail.

Stop Losses

A stop loss is used to limit the potential loss if the trade goes against you. It's the level at which you'll close a trade on the basis that it has gone too far in the 'wrong' direction, and, therefore, negated the reason for you being in that trade.

Always use stop losses!

If you don't apply stop losses in your trading, you won't be trading for long – you'll end up wiping out your trading balance in no time. It can be too easy for a $300 loss to become a $5,000 loss. A good trader will know when to take a small loss and go on to the next trade.

I can't stress this enough: even the most experienced traders have a stop loss order in the market, whether they're trading forex, futures, options, or even stocks.

Remember that your trading capital is your business – if you burn it, there's no insurance. You're done. Once you've entered a trade, immediately place a stop. This safeguards you from losing your entire account.

Don't Forget Your Stop Losses!

It's important to ensure that your stop is canceled if you close your position. I mention this because I happen to know a trader who is very disciplined, who always enters a stop loss and a profit target order once he has established a trade. A few years back, this trader suffered a number of losses over the course of several days. So, naturally, he was quite happy to see that a trade finally moved in his direction.

According to his strategy, his stop losses were very small and his profit target was rather large, so if this trade reached the profit target, he would make up for all the losses of the past couple of days PLUS bring in a small profit on top of it.

And it happened: the market continued to move in his favor and he realized a profit.

He was so happy that he jumped up from his chair, ran into the kitchen, and told his wife all about the fantastic trade. FINALLY he had made some money. They enjoyed a happy cup of coffee together, and he couldn't stop talking about his strategy, the trade, and how it paid off.

And when he returned to his computer an hour later, he found himself in a losing position.

He couldn't believe it! How had this happened?

After a few minutes, it dawned on him: he had forgotten to cancel his stop loss. While he was celebrating his win, the market retraced and filled his order, and then continued to go up.

The stop loss order was a sell order, and now the trader had a short position in a rising market. All of his profits were gone.

The moral of the story:

Make SURE to cancel your orders, or use so-called "bracket orders," or "one-cancel-other (OCO) orders" for your profit target and stop loss. Your broker can explain these terms to you in detail.

The most important thing, regardless of how you approach the decision, is to know where you'll cut a losing position BEFORE entering the trade. Set the rules and ALWAYS follow them. With this in mind, let's talk about stop loss strategies.

Fixed Dollar Amount

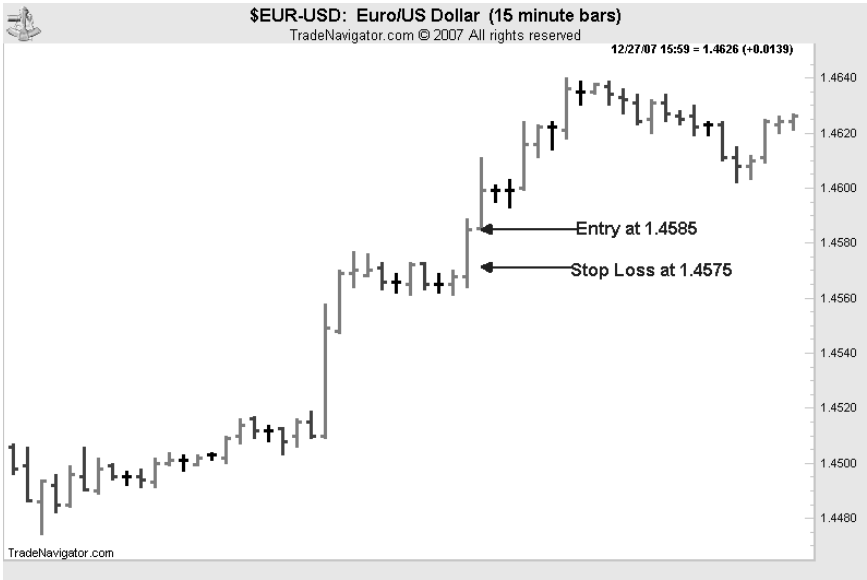
Easy, fast, and simple. Just specify a dollar amount that you're willing to risk, subtract it from your entry price, and place a stop loss order.

How to Use This Strategy:

Simply subtract the dollar amount you specified from your entry price.

Example:

Let's say you're trading the EUR/USD currency pair. You entered the market at 1.4585 and you want to risk $100. Since 1 pip (= 0.0001) equals $10, you place your stop loss at 10 pips (= 0.0010) below your entry price at 1.4575.



Just as a reminder:

If you're long a security, you'll sell it in order to close the position. If you're short a security, you'll buy it in order to close the position. I know this sounds obvious, but you wouldn't believe how many traders get confused; instead of closing their position, they will add to their position.

It's easy to make mistakes when the market starts moving fast and you get nervous. Many traders use post-its after they've entered a trade: you stick a 'SELL' post-it on your screen if you went long, and a 'BUY' post-it if you went short. This way, you ensure that you'll ALWAYS exit the position as planned.

When to Use This Strategy:

This strategy is perfect for beginners, since you don't have to perform complex calculations. You simply add or subtract your stop loss to or from your entry price and that's it. It works best if you're trading only one stock or one market, and if the security doesn't fluctuate too much.

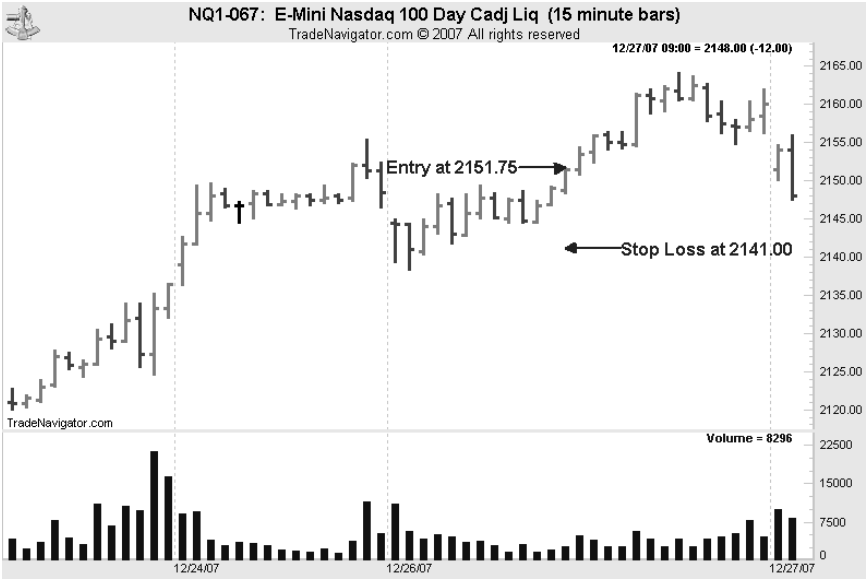
Percentage of the Current Price

How to Use This Strategy:

When applying this stop loss strategy, simply multiply the entry price by (1 - your stop loss (in percent form)) to get your exit point.

Example:

If you're trading the E-mini NASDAQ, and you've defined a 0.5% stop loss, then you would multiply your entry price of 2151.75 by 0.995 (1 - 0.5%) for an exit point of 2141.



When to Use This Strategy:

You should apply this exit strategy if you're trading multiple markets or different stocks. You'll find a more detailed explanation in the next sec - tion: "Profit-Taking Exits."

Percentage of the Volatility

This exit strategy is another way to specify stop losses in volatile markets. The underlying idea is to adjust your stop loss based on the volatility of the market: you apply a larger stop loss in volatile markets and a smaller stop loss in quiet markets.

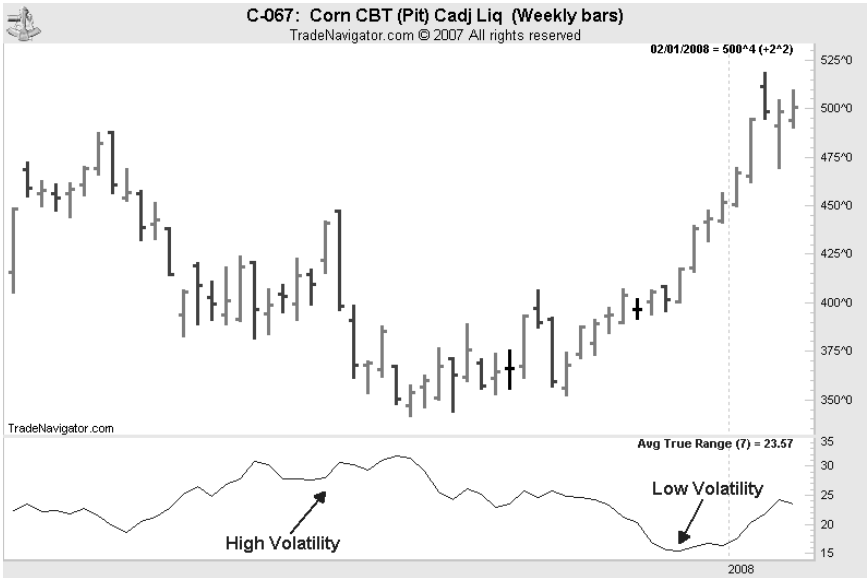
How to Use This Strategy:

Using this profit exit strategy requires two steps:

- First, you determine the average volatility of a market.
- Second, multiply this number by the percentage you specified.

Example:

The average daily range in corn is $16. You can use the Average True Range (ATR) function of your charting software to determine this number. Multiply it by the percentage you specified, e.g. 50%, and arrive at a profit target of $8. Then, subtract $8 from your entry point amount.



When to Use This Strategy:

This strategy is perfect for markets with high changes in volatility, like the grain markets. As you can see in the chart below, corn prices are more volatile in summer months than in the winter.

Using Technical Analysis

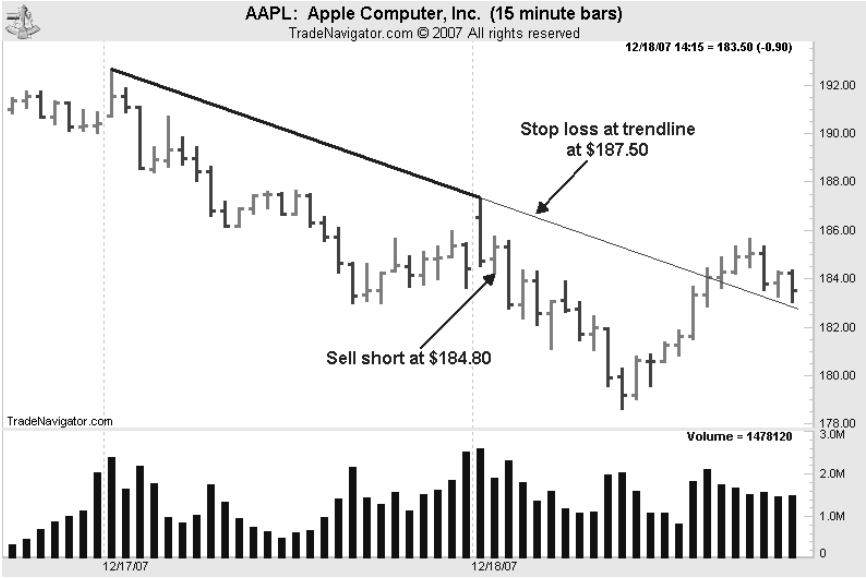
Many traders like to use major support or resistance points on the chart to determine their exits. Instead of support and resistance levels, you could use Pivot Points, Fibonacci Levels, upper or lower levels of trend channels, or Bollinger Bands, just to name a few.

How to Use This Strategy:

Simply use technical analysis to determine a potential stop loss.

Example:

In this example, we're using a simple trendline to determine our stop loss. The following chart is a 15 minute chart of Apple Computer (AAPL). We wait for the first bar of the day, and as soon as we realize that the stock is moving down over the first 15 minutes, we sell short at $184.80. We draw a trendline from the previous day's high to the high of this morning's bar and set our stop loss at the trendline, at $187.50.



When to Use This Strategy:

This strategy is perfect for traders who use technical analysis for their entry points. If you're using trendlines, indicators, or support and resis - tance lines, placing your stop at these levels will seem very natural.

Profit-Taking Exits

Once you're in a profitable trade, the next challenge becomes when to take that profit.

The main problem with taking profits is that, by our very nature, we humans (and especially traders) are greedy. After all, we want to make money. A lot of money. And we want to make it fast. "Get rich quick," right?

This is a definite problem, and many traders are way too greedy. They want to get rich on just one trade. And that's when they lose.

Here's the key to trading success: **small profits, consistently**.

Consistency is the key, because if your profits are consistent and predictable, then you can simply use leverage to trade size. Therefore you MUST know when to exit with a profit.

Good traders use a stop loss; great traders use a profit target.

Here are some different types of exit strategies for profitable trades.

Fixed Dollar Amount

This is the easiest way to exit a trade. Simply specify a dollar amount that you would be happy with, add it to your entry point, and place a profit target order in the market.

How to Use This Strategy:

Simply add the dollar amount you specified to your entry price.

Example:

Let's say you're trading 100 shares of IBM and enter at $110.13. Your profit target is $100, so you would exit the trade as soon as prices move up $1, to $111.13.

When to Use This Strategy:

This strategy works best if you are just trading one stock or one market, and if the security doesn't fluctuate too much.

Percentage of the Current Price

How to Use This Strategy:

When applying this profit exit strategy, simply multiply the entry price by (1 + your profit target (in percent)) to get your exit point.

Example:

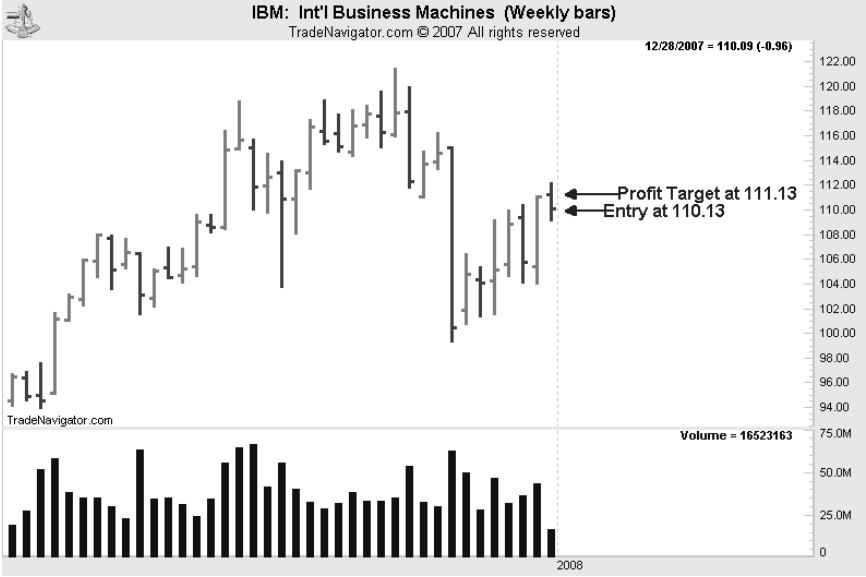
If you're trading IBM, and you've defined a 1% profit target, you would multiply your entry price of $110.13 by 1.01 (1 + 1%) for an exit point of $111.23.

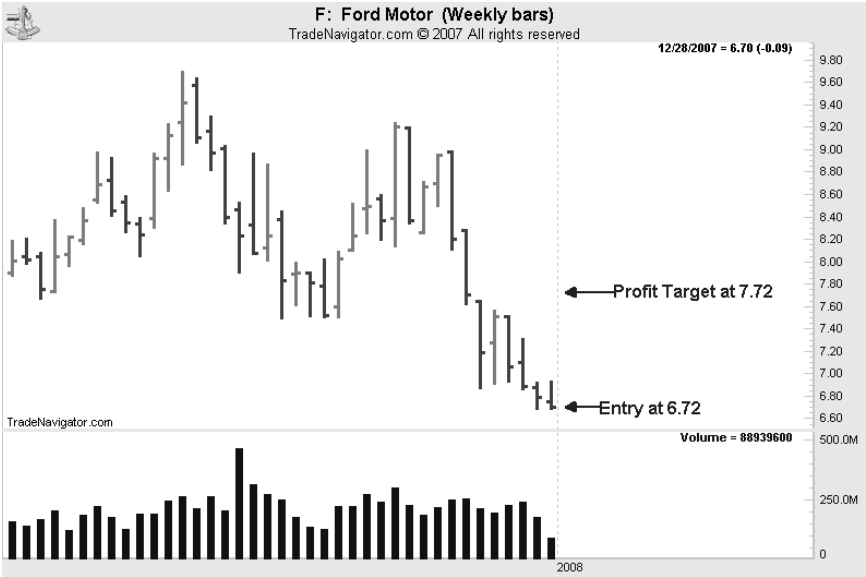
When to Use This Strategy:

You should apply this exit strategy if you are trading multiple markets or different stocks.

The reason is simple: let's say you're trading IBM and Ford. As I write this, IBM is trading at $110.13 and Ford is trading at $6.72. As in the previous example, let's assume that you're trading 100 shares each and you want to make $100 per trade. IBM would only have to move 0.9% to reach your profit target, but Ford shares would have to move almost 15% in order to reach your profit target.

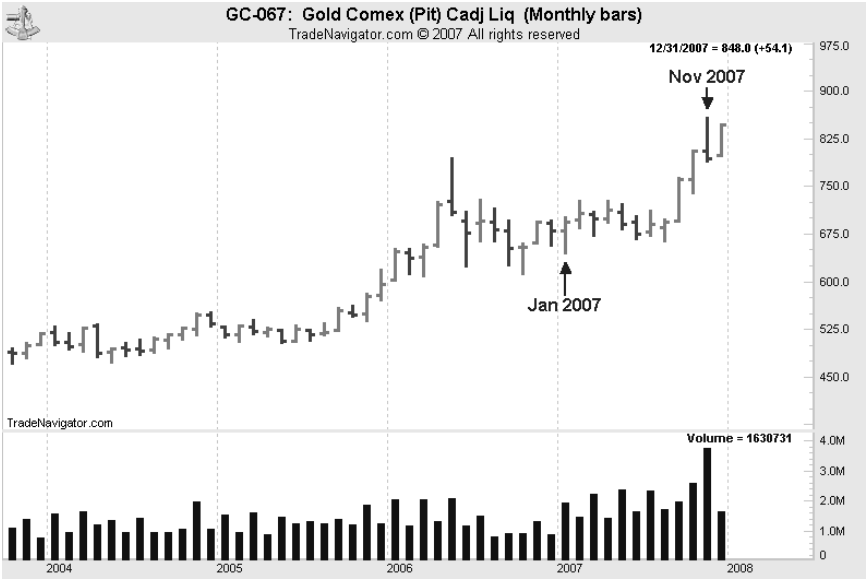
The following charts illustrate how easy it will be for IBM shares to reach the target price, and how difficult it might be for Ford shares to do so.


IBM: Int'l Business Machines (Weekly bars)
TradeNavigator.com © 2007 All rights reserved
12/28/2007 = 110.09 (-0.96)
Profit Target at 111.13
Entry at 110.13
TradeNavigator.com
Volume = 16523163
2008


F: Ford Motor (Weekly bars)
TradeNavigator.com © 2007 All rights reserved
12/28/2007 = 6.70 (-0.09)
Profit Target at 7.72
Entry at 6.72
TradeNavigator.com
Volume = 88939600
2008

It would make more sense to specify your profit target as a percentage of the price – e.g. 1%. In this case, IBM would have to move $1.1 and Ford only $0.07 to reach the profit target.

The same applies to markets with a high volatility, like gold or energy futures. In the beginning of 2007, gold was trading at $650. In November of 2007, gold was trading 30% higher, at $850. A $20 move in gold would have been 3% in January of 2007, but only 2.3% in November of 2007.



Percentage of the Volatility

This exit strategy is another way to specify profit targets in volatile markets. The underlying idea is to adjust your profit target based on the volatility of the market: you apply a higher profit target in volatile markets and a lower profit target in quiet markets.

How to Use This Strategy:

Using this profit exit strategy requires two steps:

- First, you determine the average volatility of a market.
- Second, multiply this number by the percentage you specified.

Please see the comments in the section on "Stop Losses" as an example.

When to Use This Strategy:

This strategy is perfect for commodity markets with high changes in volatility, like the grain and energy markets.

Using Technical Analysis

Many traders like to use major support or resistance points on the chart to determine their exits. Instead of support and resistance levels, you could use Pivot Points, Fibonacci Levels, upper or lower levels of trend channels, or Bollinger Bands, just to name a few.

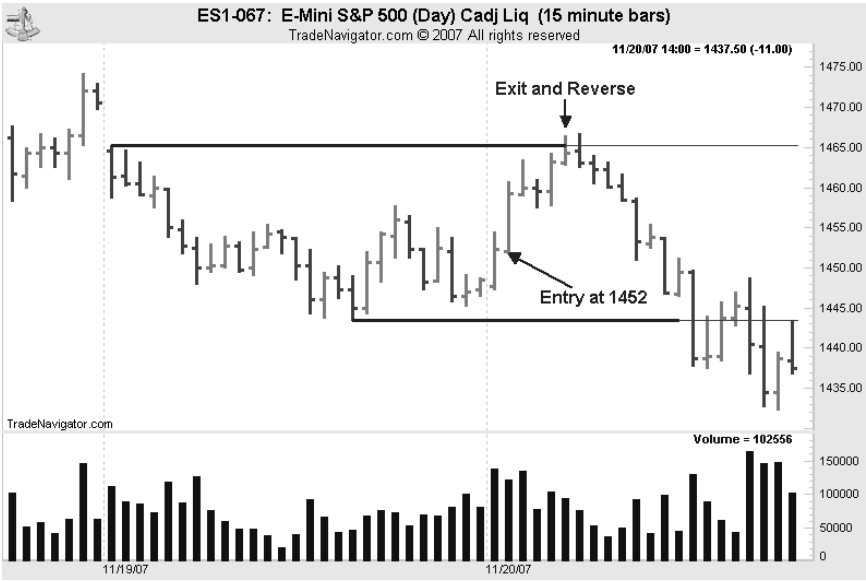
How to Use This Strategy:

Use the process of technical analysis to determine a potential profit target.

Example:

In this example, we're using the previous day's high and low as potential profit targets. The following chart is a 15 minute chart of the E-mini S&P. We wait for the first bar of the day, and, as soon as we realize that the market has been moving up in the first 15 minutes, we enter at 1452.

We set our profit target at the previous day's high – 1465.25 – for a total profit of 13.25 points = $662.50. Later that day, we reach our profit target, and we could reverse the position by going short. Now we can use the previous day low as a profit target and realize another profit of 21.75 points = $1,087.50.



When to Use This Strategy:

This strategy is perfect for markets that are moving sideways between major support and resistance lines.

Trailing Stops

Trailing stops are "hybrid" stops. When entering a position, the trailing stop is typically a stop loss, and as the trade moves in your favor, the trailing stop becomes a profit exit.

The main difference between the exit strategies mentioned previously and trailing stops is that you constantly adjust your stop while you're in a trade. All other exit strategies are "set-it-and-forget-it-strategies," in which you define stop loss and profit exit points the moment you enter the trade, and then leave them alone until you close the trade.

How to Use This Strategy:

This strategy can be used in conjunction with technical analysis by placing the stop at support and resistance lines or – more simply – at the previous bar's high or low. Another popular use of this strategy is placing the stops at trend-following indicators like Moving Averages or Parabolics. Some traders prefer using a fixed dollar amount.

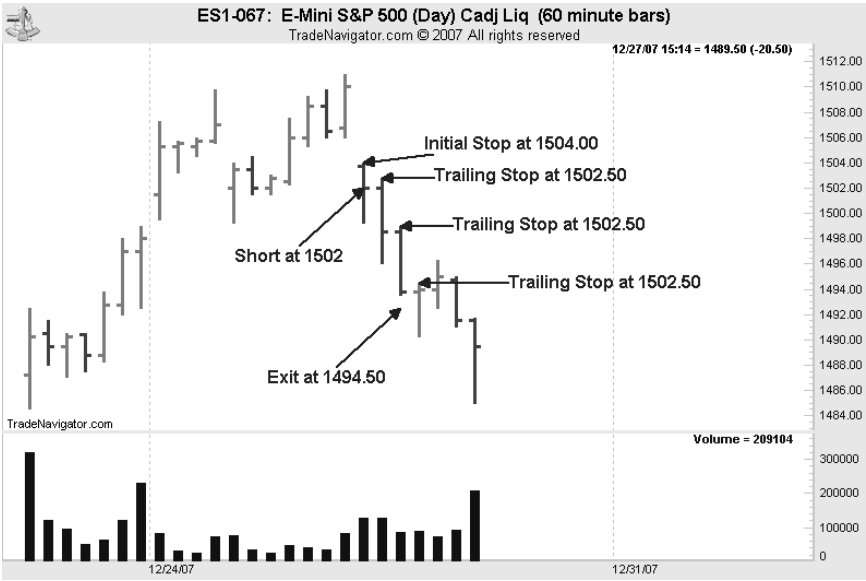
Example 1: Fixed Dollar Amount:

If you were to set a straightforward $300 trailing stop, and the security moved in your favor by $1,000, you could change your stop to only $300 behind the price and lock in $700 of profit.

Example 2: Technical Analysis:

Below is a 60-minute chart of the E-mini S&P. Let's say you went short at 1502. You would place your trailing stop at the high of the current bar at 1504. Once the next bar is completed, you move your stop to the high of this bar to 1502.50. 60 minutes later, you move your stop to 1499, and now your stop loss becomes a profit exit. Whatever happens to the trade now, you'll make at least 3 points (= $150). One hour later, you move your stop to 1494.50.

So, when prices retrace, you're stopped out at 1494.50 for a profit of 7.5 points (= $375).



When to Use This Strategy:

This strategy is perfect for trending markets. You should use this strategy to take advantage of longer-lasting trends. Keep in mind that this strategy requires your constant attention, since you MUST move your trailing stops according to your rules.

Taking Partial Profits

Nobody ever lost money taking profits.

You can combine the strategies outlined above for more sophisticated exit strategies. As an example, you could close half of your position once you've achieved a fixed dollar amount in profits, and let the other half continue to trade to the next support or resistance level.

Or you could take 1/3 of your profits at a predefined profit target, take another 1/3 at the next support or resistance level, and then apply a trail - ing stop to the remaining 1/3.

The possibilities are endless. That's why many professional traders focus on perfecting their exit strategy. In contrast, many amateur traders and beginners tend to focus on entry strategies.

Don't make the same mistake. Once you've defined sound entry rules, test different exit strategies to optimize your profits.

Time-Stops

A time-stop gets you out of a trade if it's not moving in any direction. You probably have a good reason for entering a trade. So, immediately after entering, you apply your stop loss and your profit target and wait. And wait. And wait. And nothing happens.

Time to bail out. If prices do not move at all, get out.

How to Use This Strategy:

Simply specify a "time-out," after which you will exit the market. Then set a timer and exit the trade after the specified time, regardless of whether you reached your stop loss or profit target.

Example:

A good time-stop is three times the timeframe you're using. If you're using 15-minute charts, you might want to abandon the trade if neither your profit nor your stop loss is hit after 45 minutes. If you're using 60 minute charts, get out after 3 hours.

When to Use This Strategy:

Always! Whatever the reason behind your entry signal, you want to see something happen. If nothing happens after a certain amount of time, the underlying assumption of your entry may be wrong. If you stay in the trade, then you're gambling not trading.

As traders, we want to make money fast. The longer you have your money in the market, the longer it's at risk. You can dramatically reduce the risk by applying a time-stop and exiting the market if it doesn't move. Free your capital and take the next trading opportunity. Don't gamble!

Action Items:

- ✓ Practice your exit rules: by now you should already be able to spot your entry points. Once you've determined your entry point on a chart, apply your stop loss rule and your profit-taking rule to determine your exit points.

- ✓ Continue your trading plan on page 245 and write down your specific exit points under "Exit Signals."

Step 6: Evaluating Your Strategy

Once you've determined which markets you want to trade, selected a timeframe, and defined your entry and exit rules, it's time to test and evaluate your trading strategy.

There are three ways to test your trading strategy:

- **Back-Testing**

  Back-testing is a method of testing which will run your strategy against prior time periods. Basically, you're performing a simulation: you use your strategy with relevant past data to test its effectiveness. By using the historical data, you're saving a ton of time; if you tried to test your strategy by applying it to the time periods yet to come, it might take you years.

  Back-testing is used for a variety of strategies, including those based on technical analysis. The effectiveness of back-testing relies on the theory that what has happened in the past WILL happen again in the future. Also, keep in mind that your back-testing results are quite dependent on the moves that occurred in the tested time period. It's important to remember that this increases the potential of risk for your strategy.

- **The Monte-Carlo Simulation**

  The Monte-Carlo Simulation is a problem-solving technique used to approximate the probability of certain outcomes by running multiple trial runs – called simulations – using random variables. It is a way to account for the randomness in a trading parameter – typically, the sequence of trades. In Monte Carlo simulations, the basic idea is to take a sequence of trades generated by a trading system, randomize the order of trades, and calculate the rate of return and the maximum drawdown, assuming that x% of the account is risked on each trade.

  The process is repeated several hundred times, each time using a different random sequence of the same trades. You can then pose a question such as "If 5% of the account is risked on each trade, what is the probability that the maximum drawdown will be less than 25%?" If 1,000 random sequences of trades are simulated with 5% risk, for example, and 940 of them have a maximum drawdown of less than 25%, then you could say the probability of achieving a maximum drawdown of less than 25% is 94% (940/1,000).

  Keep in mind that the data used in Monte Carlo Simulations is still historical data; therefore, one could say that this simulation is a more sophisticated way of back-testing.

- **Paper Trading**

  Paper trading is a method of “risk-free” trading. Basically, you set up a dummy account, through which you can test your trading strategy with paper money. There are two methods to this: you can either pretend to buy and sell stocks, bonds, commodities, etc., and keep track of your profits and losses on paper, or you can open an account online, usually through your broker (and usually for free).

  This is a fantastic way for new traders to kill a whole tree full of birds with one stone. First off, you’ll learn the tricks of the trade without putting your own money at risk. Second, you’ll be able to gain some much-needed confidence when it comes to maneu-

vering in the markets. And third, you'll be able to test out your trading strategy in real-time simulation.

This is probably the best way to test a trading strategy, since it doesn't rely on historical data. On the other hand, it's the most time-consuming strategy, since it might take weeks or months until you have enough data for a statistically relevant performance report.

How long should you back-test a trading strategy?

The more trades you use in your back-testing, the higher the probability that your trading strategy will succeed in the future. Look at the following table:

Number of Trades	50	100	200	300	500
<>Margin of Error	14%	10%	7%	6%	4%

More trades mean a smaller margin of error, resulting in a higher predictability of future performance.

Somebody with a Ph.D. in statistics once told me that you need at least 40 trades in order to produce statistically relevant results.

So, the question "How long should you test your trading strategy?" depends on the trade frequency.

How many trades per day does your trading strategy generate? If your strategy generates three trades per day (i.e. 15 trades per week), then you might get decent results after three weeks of testing. But if your trading strategy generates only three trades per month (i.e. 36 trades per year), then you should test your strategy for at least one year to receive reliable data results.

When testing a strategy, keep in mind that markets change.

Let me use the E-mini S&P as an example. In 2000, the average daily range was 100-150 ticks per day; in 2004, it was only 40-60 ticks per day.

If you back-test any trend-following day trading system in the E-mini S&P, you'll see that it worked perfectly until 2002, and then, suddenly, it fell apart. It seems that there were no more intraday trends. That's not surprising as the daily range of the E-mini S&P decreased by more than 50%.

What happened?

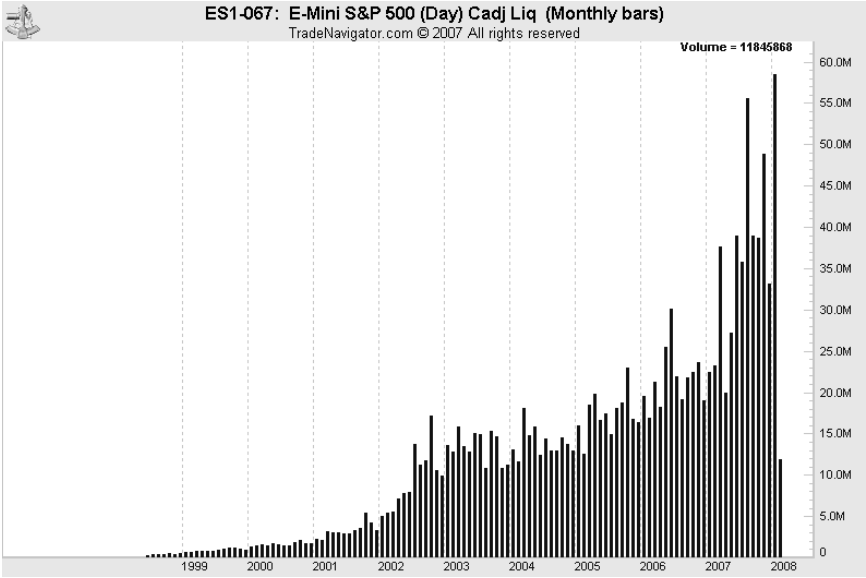
There are a couple of plausible explanations. Probably the best and most important one is the introduction of the Pattern Day Trading Rule in August and September of 2001, by the NYSE and NASD. If a trader executes four or more day trades within a five-business-day period then he must maintain a minimum equity of $25,000 in his margin account at all times. Because of this rule, traders stopped day trading equities and started trading the E-mini S&P futures instead.

Look at this graph showing the sudden increase in volume in the E-mini S&P in the beginning of 2001.

Many of these stock day traders used methods to scalp the market for a few pennies. Using the E-mini S&P, they suddenly had a much higher leverage and paid fewer commissions, and their methods were extremely profitable.

Unfortunately, these scalping methods kill an intraday trend almost instantly, making almost every trend-following approach fail.

Another reason for the dramatic change of the market was the introduction of the automated strategy execution in TradeStation. In 2002, the TradeStation customers who were using this feature increased by 268%. Overbought/oversold strategies became very popular, and when the market made an attempt to trend, these strategies immediately established a contrary position.



Conclusion

When back-testing, there are definitely things you need to be aware of. It's not enough to just run a strategy on as much data as possible; it's im - portant to know the underlying market conditions.

As outlined in previous chapters: in non-trending markets, you need to use trend-fading systems; and, in trending markets, you should use trend-following methods.

That's when clever back-testing helps you. If your back-testing tells you that a trend-following method worked in 2000-2002, but doesn't work in 2003 and 2004, then you should not use this strategy right now. And vice versa: when you see that a trend-fading method produced nice profits in 2003, 2004, and 2005, then trade it.

How to Read and Understand a Performance Report

While testing your trading strategy, you should keep detailed records of the wins and losses in order to produce a performance report. Many software packages can help you with that, but a simple excel sheet will do the trick just as well.

If you get in contact with us here at Rockwell Trading®, we can send you an excel sheet that will automatically produce a performance report for you after you've entered several trades.

Here's an example of a performance report:

Performance Report for Florian

Number of Trades		34
Total Profit	$	4,300.00
Avg. Profit per Trade	$	126.47
Winning Percentage		73.53%
Avg Winning Trade	$	206.00
Avg. Losing Trade	$	(94.44)
Profit Factor ($Wins/$Loss)		6.06
Max Drawdown	$	(200.00)

Total (Net) Profit

The first figure to look for is the total, or net, profit. Obviously you want your system to generate profits, but don't be frustrated when, during the development stage, your trading system shows a loss; try to reverse your entry signals.

You might have heard that trading is a zero sum game. If you want to buy something (e.g. a certain stock or futures contract), then somebody else needs to sell it to you. And, you can only sell a position if somebody else is willing to buy from you at the price you're asking.

This means that if you lose money on a trade, then the person who took the other side of the trade is MAKING money. And vice versa: if you're making money on a trade, then the other trader is losing money. In the markets, money is not "generated." It just changes hands.

So, if you're going long at a certain price level, and you lose, then try to go short instead. Many times this is the easiest way to turn a losing system into a winning one.

Average Profit per Trade

The next figure you want to look at is the average profit per trade. Make sure this number is greater than slippage and commissions, and that it makes your trading worthwhile. Trading is all about risk and reward, and you want to make sure you get a decent reward for your risk.

Winning Percentage

Many profitable trading systems achieve a nice net profit with a rather small winning percentage, sometimes even below 30%. These systems follow the principle: "Cut your losses short and let your profits run." However, YOU need to decide whether you can stand 7 losers and only 3 winners in 10 trades. If you want to be "right" most of the time, then you should pick a system with a high winning percentage.

Understanding Winning Percentage

Let's say you purchased or developed a system that has a winning percentage of 70%.

What exactly does that mean?

It means that the probability of having a winning trade is 70% – i.e. it is more likely that the trade you are currently in turns out to be a winner rather than a loser.

Does that mean that when you trade 10 times you will have 7 winners? No!

It means that if you trade long enough (i.e. at least 40 trades) then you will have more winners than losers. But it doesn't guarantee that after 3 losers in a row, you'll have a winner.

Example:

If you toss a coin then you have 2 possible outcomes: heads or tails. The probability for each is 50% – i.e. when you toss the coin 4 times, then you should get 2 heads and 2 tails.

But what if you tossed the coin 3 times and you got heads 3 times?

What is the probability of heads on the fourth coin toss?

50%, or less?

If you answered 'less,' than you fell for a common misconception. The probability of getting heads again is still 50%. No more and no less.

But many traders think that the probability of tails is higher now because the three previous coin tosses resulted in heads. Some traders might even increase their bet because they are convinced that now "tails is overdue." Statistically, this assumption is nonsense; it's a dangerous – and many times costly – misconception.

Let's get back to our trading example: if you have a winning percentage of 70%, and you had 9 losers in a row, what's the probability of having a winner now? It's still 70% (and therefore there's still a 30% chance of a loser).

Average Winning Trade and Average Losing Trade

The average winning trade should be bigger than the average losing trade. If you can keep your wins larger than your losses, then you'll make money even if you just have a 50% winning percentage. And every trader should be able to achieve that. If you can't, reverse your entry signals as described previously.

Profit Factor

Take a look at the Profit Factor (Gross Profit / Gross Loss). This will tell you how many dollars you're likely to win for every dollar you lose. The higher the profit factor, the better the system. A system should have a profit factor of 1.5 or more, but watch out when you see profit factors above 3.0, because it might be that the system is over-optimized.
.

Maximum Drawdown

The maximum drawdown is the lowest point your account reaches between peaks.

Let me explain:

Imagine that you start your trading account with $10,000, and, after a few trades, you lose $2,000. Your drawdown would be 20%.

Now, let's say you make more trades and gain $4,000, which brings you to $12,000 ($8,000 + $4,000 = $12,000). And after this, on the next trade, you lose $2,000. Your drawdown would be 16.7% ($12,000 - $2,000). The $12,000 was your equity peak; that was the highest point in the period we looked at.

If you started your account with $10,000 and the lowest amount you had in your account over a six-month period was $5,000, then you had a 50% drawdown.

You would need to make $5,000 from the lowest point in order to recoup your losses. Even though you lost 50% from your high of $10,000, you would need to make 100% on the $5,000 to get back to your original amount.

Measuring Drawdown Recovery:

Drawdown recovery can confuse many traders. If a trader loses 20% of his account, he thinks he needs to make 20% in order to get back to even.

This isn't true. If you started with $10,000 and lost $2,000 (20%), you would need to make 25% in order to get back to even. The difference between $8,000 and $10,000 is $2,000. If you calculate the $2,000 as a percentage of $8,000 (not the original $10,000) it works out to 25%.

A famous trader once said: "If you want your system to double or triple your account, you should expect a drawdown of up to 30% on your way to trading riches." Not every trader can stand a 30% drawdown.

Look at the maximum drawdown that your strategy has produced so far, and double it. If you can stand this drawdown, then you've found the right strategy.

Why double it? Remember: your worst drawdown is always ahead of you. It's best to plan for it now.

Conclusion

The above examples provide you with some guidelines, but it's up to you to decide whether the numbers in the strategy's performance report work for you or don't.

Ultimately, YOU'RE the one trading the strategy, and YOU'RE the one who has to feel comfortable with the expected results of your strategy.

Action Items:

- ✓ Start back-testing your trading plan on at least 40 trades. The more trades the better. You can download an excel sheet to record your trades from our website:

  www.thecompleteguidetodaytrading.com

- ✓ Analyze the performance report and decide if YOU feel comfortable with the statistics.

- ✓ Continue your trading plan on page 245 and write down your expectations for your trading strategy based on the results of your back-testing.

Step 7: Improving Your Strategy

There is a difference between “improving” and “curve-fitting” a system. You can improve your system by testing different exit methods. If you’re using a fixed stop, try a trailing stop instead. Add a time-stop and evaluate the results again.

Don’t look only at the net profit; look also at the profit factor, the aver age profit per trade, and the maximum drawdown. Many times, you’ll see that the net profit slightly decreases when you add different stops, but the other figures might improve dramatically.

Don’t fall into the trap of over-optimizing: you can eliminate almost all losers by adding enough rules, but your resulting strategy will be almost worthless.

Example:

If you see that on Tuesdays, you have more losers than on the other weekdays, you might be tempted to add a "filter" that prevents your system from entering trades on Tuesdays.

Next, you find that in January, you have much worse results than in other months, so you add a filter that enters trades only between February and December.

You add more and more filters to avoid losses, and eventually you end up with a trading rule like this, which I just saw recently:

> *IF FVE > -1 And Regression Slope (Close , 35) / Close.35 * 100 > -.35 And Regression Slope (Close , 35) / Close.35 * 100 < .4 And Regression Slope (Close , 70) / Close.70 * 100 > -.4 And Regression Slope (Close , 70) / Close.70 * 100 < .4 And Regression Slope (Close , 170) / Close.170 * 100 > -.2 And MACD Diff (Close , 12 , 26 , 9) > -.003 And Not Tuesday And Not Day Of Month = 12 and not Month = August and Time > 9:30 ...*

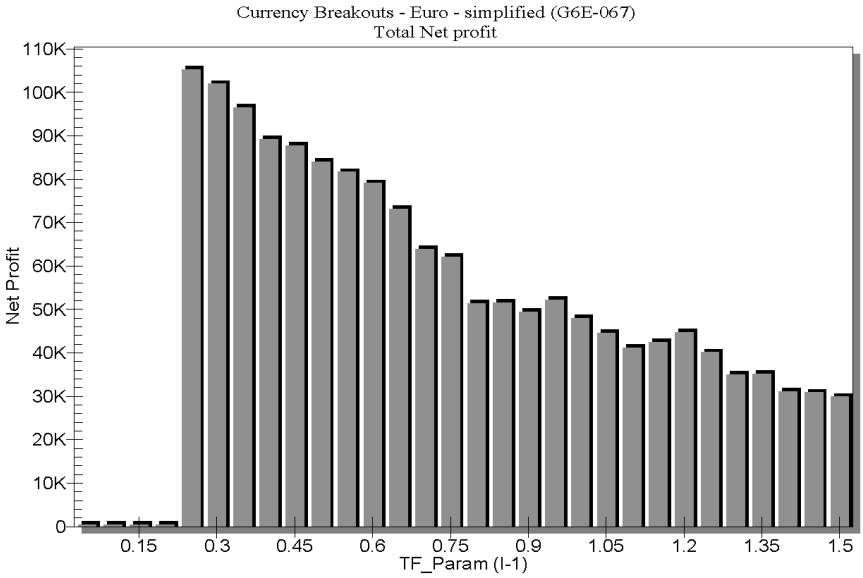
Though you've eliminated all possibilities of losing (in the past) and this trading system is now producing fantastic profits in your testing, it's very unlikely that it will continue to do so when it hits reality.

Determine the "Best" Parameter Without Curve-Fitting a Strategy

The underlying strategy in this example is a simple breakout strategy. The strategy contains a parameter called **TF_Param**.

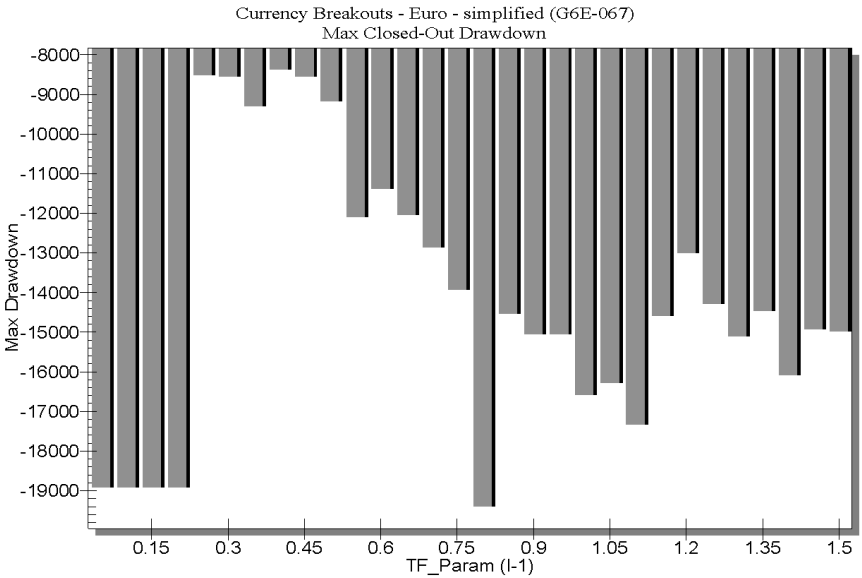
I'll explain how we optimized the parameter, and why we selected 0.3 as the current value for the parameter. I used **Genesis Financial Trade Navigator** (www.genesisft.com) to produce the test results and the following graphics.

First, I run the optimization and look at the net profit, since that's one of the most important figures:



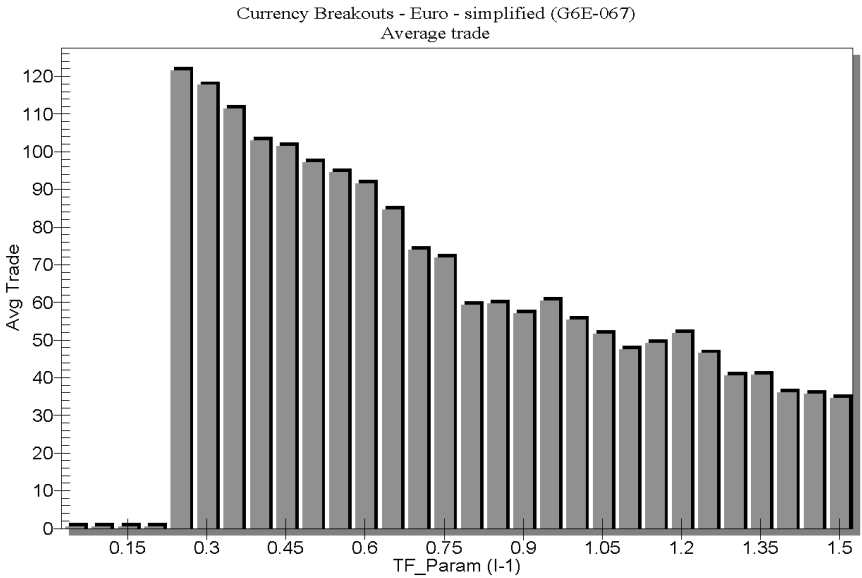
As you can see, a parameter between 0.25 and 0.7 produces robust results.

Next I am looking at the max drawdown.



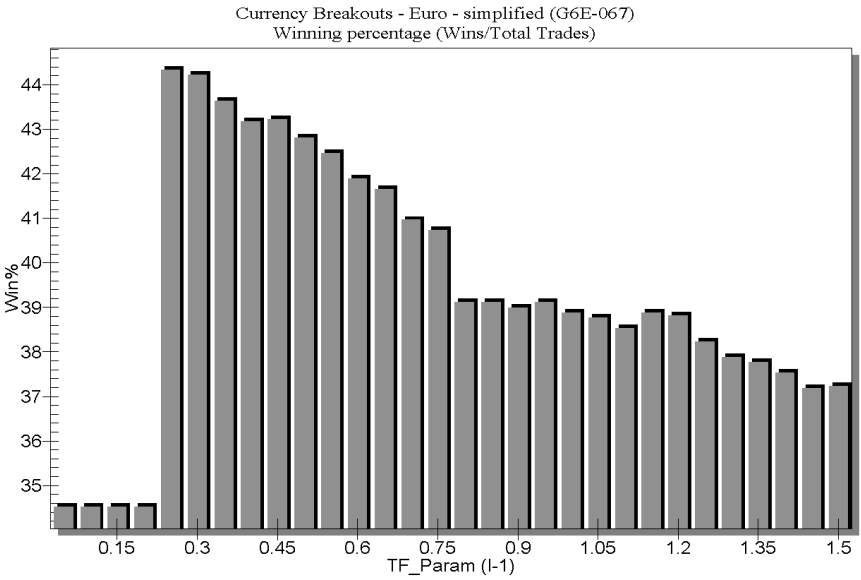
Any parameter between 0.25 and 0.5 produces a rather low drawdown, so using the combined information, I would pick a TF_Param between 0.25 and 0.5.

Now, I'm looking at the average profit per trade:



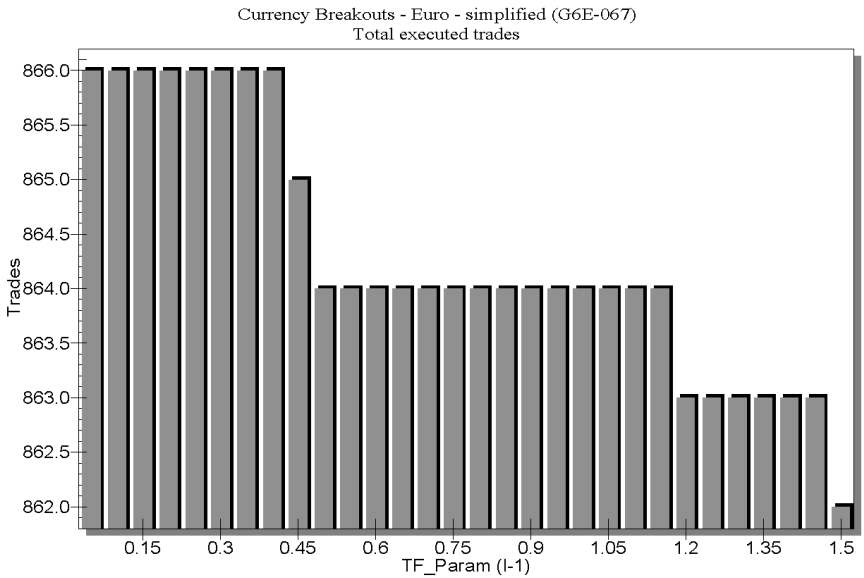
A parameter between 0.25 and 0.7 produces a decent average profit per trade, so the current selection of TF_Param between 0.25 and 0.5 is still a good choice.

Now, I'm looking at the winning percentage. The higher, the better:



Again a value of 0.25 to 0.7 for the variable TF_Param produces the best results. We leave our range for TF_Param between 0.25 and 0.5

As a last test, we look at the number of trades. Again, the higher, the better.



No surprises here: the lower the parameter, the more trades we get. A parameter value below 0.45 leads to the highest amount of trades.

Conclusion

By combining all the previous findings, we see that a TF_Param between 0.25 and 0.4 produces the best results.

That's why 0.3 is definitely a good choice. Even if the market changes slightly, the system would still produce excellent results.

Action Items:

- ✓ Try to improve your trading strategy by varying the parameters. As an example: if you used 14 bars in the RSI, try 10, 12, 14, 16, 18, and 20 bars.

- ✓ Try to improve your strategy by modifying the stops.

  Example: use a volatility stop instead of a fixed stop loss.

- ✓ Do the same with your profit targets. I know that this is time-consuming, but the good news is, once it's done correctly, you won't have to do it again for a very long time. I have been using the same trading strategy for four years now.

The 10 Power Principles – Making Sure That Your Trading Plan Works

Having a trading plan is like having a solid blueprint to build your home, or having a map when traveling to a new location. You already know that a professional trader won't survive in the markets without a good trading plan.

In the previous step, you learned:

- How to define your financial and trading goals.
- How to select the right market for your trading goals.
- What timeframe you should trade in.
- Different trading styles and how to find the right one for you.
- How to create a basic trading plan.

Now that you've defined your goals and created your trading plan, you need to make sure it really works. Thus far, everything might look great, but how can you be sure that the system works when you start trading it with real money?

Evaluating a trading strategy is easier than you think. In this chapter, you'll **find 10 Principles of Successful Trading Strategies** that we've developed and refined over the last couple of years.

You should use these Power Principles to evaluate your trading strategy, whether you developed it on your own or are thinking about purchasing one. By checking a strategy against these principles, you can dramatically increase your chances of success.

Principle #1: Use Few Rules – Make It Easy to Understand

It may surprise you that the best trading systems have less than ten rules. The more rules you have, the more likely that you've "curve-fitted" your trading strategy to past data, and such an over-optimized system is very unlikely to produce profits in real markets.

It's important that your rules are easy to understand and execute. The markets can behave very wildly and move very fast, and you won't have time to calculate complicated formulas in order to make a trading decision. Think about successful floor traders: the only tool they use is a calculator, and they make thousands of dollars every day.

Example:

Take a look at the trading approaches presented in the section "Popular Trading Approaches." The easy rules are: buy when the RSI drops below a reading of 20, or, sell when prices move above the upper Bollinger Band.

Avoid a trading strategy that has an entry rule like this:

> *Buy when the RSI is below 20, and the ADX is between 7 and 12, and the 7-bar moving average is pointing up more than 45 degrees, and there is a convergence between the price bars and the MACD, and, and, and...*

Do you really think that you could follow this strategy while you're watching the markets LIVE?

Principle #2: Trade Electronic and Liquid Markets

I strongly recommend that you trade electronic markets, because commissions are lower and you receive instant fills. You need to know as fast as possible if your order was filled and at what price, because you plan your exit based on this information.

You should never place an exit order before you know that your entry order is filled. When you trade open outcry markets (non-electronic), you might have to wait awhile before you receive your fill. By that time, the market might have already turned and your profitable trade has turned into a loss!

When trading electronic markets, you receive your fills in less than one second and can immediately place your exit orders. Trading liquid markets means you can avoid slippage, which will save you hundreds or even thousands of dollars.

Fortunately, more and more markets are now traded electronically. The recent addition of the grain futures markets in the summer of 2006 was a huge success: in January of 2007, the volume traded in the electronic contracts surpassed the volume traded in the pit markets. In December of 2007, the pit-traded corn contract traded with 621,800 contracts, while the electronic corn contract had a trading volume of 2,444,400 contracts.

Most futures markets, all forex currency pairs, and the major U.S. stock markets are trading electronically.

So why would you even want to trade Pork Bellies or Lumber?

Principle #3: Have Realistic Expectations

Losses are part of our business. A trading system that doesn't have losses is "too good to be true." Recently, I ran into a trading system with a whopping winning percentage of 91% and a drawdown of less than $500. WOW!

When I looked at the details, though, it turned out that the system was only tested on 87 trades and – of course – it was curve-fitted. If you run across a trading system with numbers too good to be true, then it's proba - bly exactly THAT: too good to be true.

Usually you can expect the following from a robust trading system:

- A winning percentage of 60-80%
- A profit factor of 1.3-2.5
- A maximum drawdown of 10-20% of the yearly profit

Use these numbers as a rough guideline, and you'll easily identify curve-fitted systems.

Principle #4: Maintain a Healthy Balance Between Risk and Reward

Let me give you an example: if you go to a casino and bet everything you have on "red," then you have a 49% chance of doubling your money and a 51% chance of losing everything. The same applies to trading: you can make a lot of money if you're risking a lot, but if you do, the risk of ruin is also high. You need to find a healthy balance between risk and reward.

Make sure your trading strategy is using small stop losses and that your profit targets are bigger than your stop losses.

Stay away from strategies that have a small profit target of only $100 and a stop loss of $2,000. Sure, the winning percentage will be fantastic, but 2-3 losses in a row can wipe out your trading account.

The perfect balance between risk and reward is 1:1.5 or more – i.e. for every dollar you risk you should be able to make at least $1.50.

In other words, if you apply a stop loss of $100, your profit target should be at least $150.

Principle #5: Find a System That Produces at Least Five Trades per Week

The higher your trading frequency, the smaller your chances of having a losing month. If you have a trading strategy that has a winning percentage of 70%, but only produces one trade per month, then one loser is enough to have a losing month. In this example, you could have several losing months in a row before you finally start making profits.

In the meantime, how do you pay your bills?

If your trading strategy produces five trades per week, then you have on average 20 trades per month. If you have a winning percentage of 70%, then your chances of a winning month are extremely high.

And that's the goal of all traders: having as many winning months as possible!

Principle #6: Start Small – Grow Big

Your trading system should allow you to start small and grow big. A good trading system allows you to start with one or two contracts, increasing your position as your trading account grows.

This is in contrast to many "martingale" trading systems, which require increasing position sizes when you are in a losing streak.

You've probably heard about this strategy: double your contracts every time you lose, and one winner will win back all the money you previously lost.

Let's take a look at the following table. It assumes that you are risking $100 per trade and then doubling up after each losing trade.

Your First Trade	$100	1 contract or 100 shares
Second Trade	$200	2 contracts or 200 shares
Third Trade	$400	4 contracts or 400 shares
Fourth Trade	$800	8 contracts or 800 shares
Fifth Trade	$1,600	16 contracts or 1,600 shares
Sixth Trade	$3,200	32 contracts or 3,200 shares
Seventh Trade	$6,400	64 contracts or 6,400 shares
Eighth Trade	$12,800	128 contracts or 12,800 shares
Ninth Trade	$25,600	256 contracts or 25,600 shares
Tenth Trade	$51,200	512 contracts or 51,200 shares
Your Total Loss	**$102,300**	**1,024 contracts or 102,400 shares**

As you can see from the chart, the losses are not really the problem; the main problem is the amount of contracts or shares that you're trading.

It's not unusual to have 4-5 losing trades in a row, and this strategy would already require you to trade 16 contracts, or 1,600 shares, of a stock after just 4 losses! If you're trading the E-mini S&P, you would need an account size of at least $63,200, just to meet the margin re quirements. And, if we assume that you're trading stocks around $100 (e.g. IBM or Apple), then you would need $160,000 in your account.

Now, you may ask how likely this type of situation actually is. The answer: very likely. That was the entire point of the previous few pages. Just think back to the example with the coins: an atypical negative trading run CAN and WILL happen.

This is why I do not recommend doubling up after each loss. If we trade in a disciplined, systematic manner, then when our atypical run DOES occur, we will still be in the game at the end of it.

Regardless of the strategy or method you use to trade, there will be occasions when you have losses, or even a string of losses. When these occur, it's important to have faith in your trading plan; don't try to double up your trades to "catch up" on your wins.

The main point I want to make here is that every trading system you find will go through times when it has more losses than wins.

This is to be expected, and it's where effective money management comes into play.

Principle #7: Automate Your Exits

Emotions and human errors are the most common mistakes that traders make. You have to avoid these mistakes by any means necessary, especially when the market starts to move fast. You might experience panic and indecision, but if you give in to those emotions, you'll suffer a much greater loss than you had originally planned for.

Your exit points should be easy to determine. The best solution for your exit points is the use of "bracket orders." Most trading platforms offer bracket orders, which allow you to attach a profit target and a stop loss to your entry.

This way, you can put your trade on autopilot, and the trading system will close your position at the specified levels.

Of course, this assumes that you have easy exit rules. A stop loss of $100, or 1%, of the entry price can easily be specified in today's trading platforms.

Exit rules like “2/3 of the average true range of the past 5 trading days” are more complex to automate. In the beginning, you should keep your trading as simple as possible.

If you can’t make money with simple entry and exit points, you won’t be able to make money with more complex trading rules. Think about driving a car: if you can’t drive a Ford, you definitely won’t be able to drive a Ferrari.

Principle #8: Have a High Percentage of Winning Trades

Your trading strategy should produce more winners than 50%. There's no doubt that trading strategies with smaller winning percentages can be profitable, too, but the psychological pressure is enormous.

Taking 7 losers out of 10 trades, and not doubting that system, takes a great deal of discipline, and many traders can't stand the pressure. After the sixth loser, they’ll start "improving" the strategy, or stop trading it completely.

It’s very helpful for beginning or novice traders to gain confidence in their trading, and if your strategy gives you a high winning percentage, let’s say more than 65%, your confidence will definitely be on the rise.

Principle #9: Test Your Strategy on at Least 200 Trades

The more trades you use in your back-testing (without curve-fitting), the higher the probability that your trading strategy will succeed in the future. Look at the following table:

Number of Trades	50	100	200	300	500
<>Margin of Error	14%	10%	7%	6%	4%

The more trades you have in your back-testing, the smaller the margin of error, and the higher the probability of producing profits in the future.

You need at least 40 trades for a valid performance report. As you can see from the table above, 200 trades are optimal, since the margin of error decreases fast from 14% to 7% with only an addition 150 trades.

If you test your system on more than 200 trades, the margin of error decreases at a slower rate. The next 100 trades only increase the confidence by 2%.

Principle #10: Choose a Valid Back-Testing Period

I recently saw the following ad:

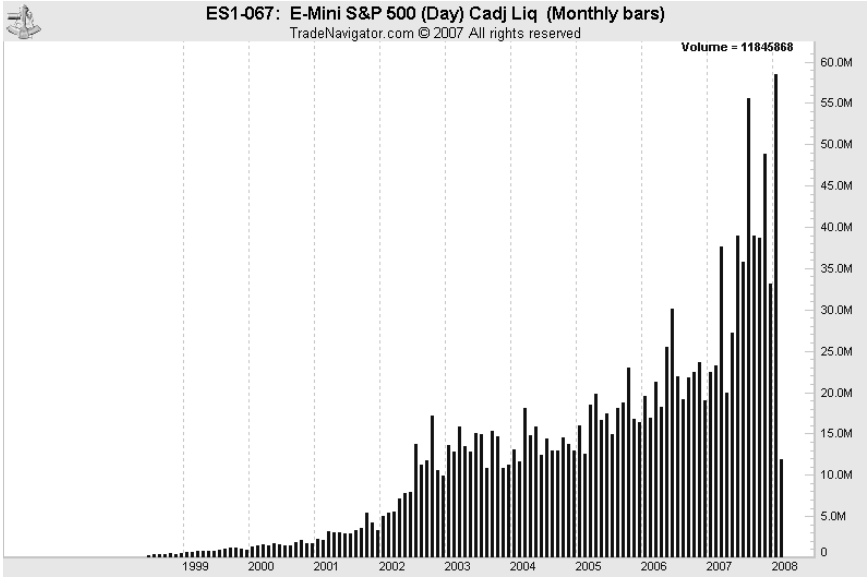
> *"Since 1994, I've taught thousands of traders worldwide a simple and reliable E-mini trading methodology."*

That's a very interesting claim…

The E-mini S&P was introduced in September of 1997, and the E-mini NASDAQ was introduced in June of 1999; therefore, NONE of these contracts existed before 1997.

Regardless, though, we only have to worry about the age of the contracts for back-testing purposes. And, if you develop an E-mini S&P trading strategy, then you should only back-test it for the past 3-4 years anyway.

This is because, even though the contract has existed since 1997, there was practically nobody trading it (see the following chart):



The same applies to strategies for the grain futures: they were introduced in August of 2006. Do not make the mistake of back-testing your trading strategy on the pit contract. When futures contracts start trading electronically, they attract a different kind of trader than their pit-traded counterparts; therefore, the characteristics of the two markets can be very, very different.

It would be foolish to think that the markets remain the same once they can be electronically traded. Faster fills and lower commissions allow a different kind of trading strategy, and the markets WILL behave differently than during the times when only pit traders traded them.

Action Items:

- ✓ Take a look at your trading strategy and run it against these 10 Power Principles. How many principles apply?

- ✓ If your trading strategy doesn't fulfill all 10 Principles, is there any area in which you can improve it?

Part 3:
The Secrets to Day Trading Success

There's More To Trading Than Just Having a Strategy

Congratulations. You made it to the third part of the book. You've learned about the basics of day trading and you know how to develop a profitable trading strategy.

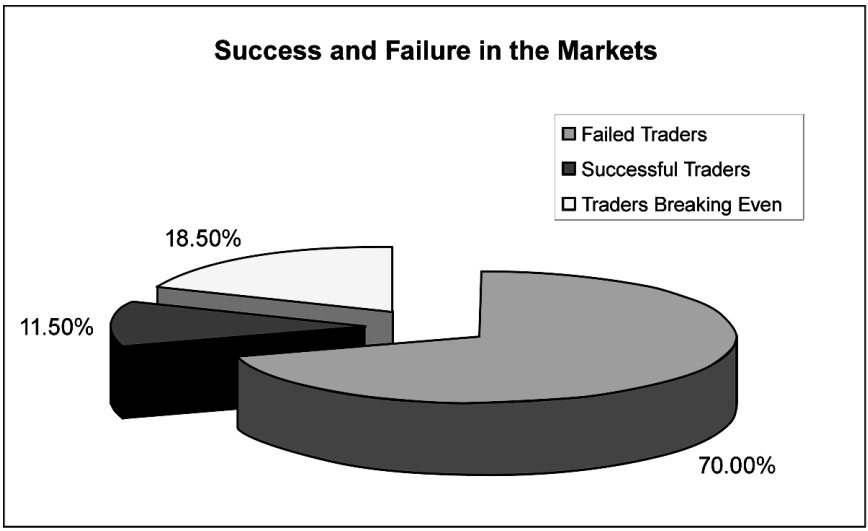
You understand that a good trading strategy is one of the single most im - portant factors when it comes to your trading.

With a proven, reliable strategy, you'll have a map for your trading future and a guideline for your success. You'll have a plan. Believe me, most traders out there just open a trading account and start trading, without a clue as to what they're getting themselves into. Only a few of them have a trading strategy, and because of that, many of them fail.

In fact, the vast majority of them fail. According to a report from the North American Securities Administrators Association (NASAA):

> *"Only 11.5% [of traders] might profitably trade [the markets]. At least 70% of traders lose money in the markets…70% of pub - lic traders will not only lose, but will almost certainly lose everything they invest."*

At least 70% will lose everything they invest. And only 11.5% of traders will actually succeed. That's just slightly over 1 in 10. Not great odds.



But, if you've followed the action items outlined throughout the previous chapters, then you should have a trading strategy mapped out. And, if you do, then that small step has dramatically increased your chances of belonging to the 11.5% of successful traders out there who are actually making money.

But here's the thing about trading strategies: they're a dime a dozen.

These days, you can find hundreds of books with different trading strategies, along with countless websites that offer trading strategies for free. In addition, you'll find "the trading strategy of the month" every couple of weeks in nearly every trading industry magazine out there.

So, if there are so many trading strategies available, why do only 11.5% of traders make money?

The problem is that strategies do NOT make a good trader. There's more to trading that just having a strategy. Only time, knowledge, experience, and guidance can make you the trader you want to be.

The Ralph Vince Experiment

Ralph Vince is a well-respected and well-known financial investor and educator. He's published a number of books on trading and the trading industry, and he also performed a very famous experiment known as the Ralph Vince Experiment.

Mr. Vince took 40 Ph.D.s and set them up to trade with a computer game. Now, these 40 people all had doctorates, but Mr. Vince made sure that none of their doctorates involved any sort of background in statistics or trading. In the game, each of them were given $1,000 and 100 trades, with a 60% winning percentage. When they won, they won the amount of money they risked. When they lost, they lost the amount of money they risked. Simple. As you can see, ALL of them had a profitable trading strategy.

So, after all 40 had completed their 100 trades, how many do you think made money?

2.

Only 2 doctorates out of 40 were able to make money. The other 38 failed to succeed.

Source: CSI News Journal, March 1992

Those are pretty convincing statistics. 95% of the candidates lost out. And why? Because they fell into the age-old traps: poor money management, gambler's fallacy, and lack of discipline, guidance, and experience.

Did they have a profitable trading strategy? Of course!

Remember, each one of the traders took 100 trades with a 60% winning percentage. Mr. Vince gave them a profitable trading strategy to use, but they still couldn't succeed.

So, it seems that there is definitely more to trading than just having a strategy. And that's exactly what you'll learn about in this section of the book:

The OTHER factors that are involved when it comes to your trading success.

The Seven Mistakes of Traders and How to Avoid Them

So, let's examine why traders fail. If you know the pitfalls of trading, then it becomes easier to avoid them. In this chapter, we'll talk about the mistakes that traders make and how you can avoid them.

First off, there are two types of mistakes that a trader can make:

- The small ones
- The big ones

Yes, you'll definitely make small mistakes along the way – I guarantee it. You might buy a security when you intended to sell it, simply because you pushed the wrong button. Or maybe you'll buy the wrong stock, just because there's a typo when you enter the symbol. Another possibility is placing the wrong order because you enter a buy order at $213.5 instead of $21.35. These types of things have happened to all of us.

They're small mistakes, and they're "forgivable." With a little bit of luck, you might even be able to profit from them.

However, there are big mistakes that you absolutely MUST avoid if you're going to be a successful trader.

For instance, one of the biggest trading mistakes that you could ever make is to try to learn and understand everything about trading…and then never actually START to trade.

I know many aspiring traders who have read countless books, have developed dozens of trading strategies, and who have analyzed a number of markets; but they've failed to pull the trigger when it comes to real trading. As you know, part of your education is your knowledge and your experience. If you want to make money with trading, then eventually you have to take the plunge and get started.

Yes, I know: there's a chance of losing some money. That's true. When you trade, you're taking a risk. (If you want to know how to start trading without risking any of your own money, please read the chapter "How to Start Trading Without Risking a Single Penny," on page 235).

What Exactly Is "Risk?"

Risk means "not having control."

Example: If you're driving a car on the highway, then you're at risk. It's as simple as that. But, thankfully, there are certain things we can do to control that risk:

- ✓ All motorists are required to have a formal education and successfully test their driving skills before they are allowed to drive a car. This qualification process is called getting a driver's license.
- ✓ Cars are equipped with certain security features, such as seat belts, airbags, anti-brake systems, and – let's not forget – a steering wheel, which enables you to navigate around obstacles in your path.
- ✓ When you're new to driving, you usually practice with another person (e.g. your parent) in an empty parking lot BEFORE hitting the road. You start driving at 10 mph, and then, as you grow more comfortable, you can slowly increase the speed. When you're confident in your abilities, you'll most likely leave the parking lot for the open road (but let's not move too fast – probably a country road, with no traffic!)

All of these things help you control the risk when it comes to driving. You'll never be able to eliminate the risk completely, but you can take appropriate action to reduce it.

The same principles apply in trading:

- ✓ You should have a formal education and prove your skills before you start to trade. Unfortunately, there are no tests required before you can open a brokerage account, but you should take the time to learn about the markets and develop a strategy before you "hit the open road."

- ✓ When trading, you can also apply certain "security features." Two of the most important are having a trading strategy and using stop losses.

- ✓ When you're new to trading, you should paper trade first (see page 235). Then, after you've built up some confidence, you can start trading with one lot/contract, or 100 shares. If you're comfortable and you achieve acceptable results, then you can increase the contract or share size.

And never trade with money you can't afford to lose. Get your current financial situation in order first, and THEN start trading.

Get your credit cleaned up, pay off high interest loans and credit cards, and put at least three months of living expenses in savings. Once this is done, you're ready to start letting your money work for you.

Don't trade to get rich quick.

That's the number one principle when it comes to controlling your risk.

If day trading was easy, everyone in the world would be doing the same thing: trading like crazy every day and becoming insanely rich by nightfall!

We both know it's NOT easy. So let's take a look at the seven "deadly" trading mistakes. These are the challenges that every trader faces, and they're the ones which usually cost traders a whole lot of money.

Being aware of these challenges is the first step in avoiding them. Think about the car driving example again: if you know that driving on icy roads is dangerous, you can try to avoid traveling in that particular weather condition. But, if you don't know about ice and the hazard it poses, you might just get into your car and drive like normal. You won't even realize the danger until you feel your vehicle slipping right off the road.

The same principle applies in trading: being aware of the possible mis - takes and pitfalls will help you to avoid them.

Mistake #1: Struggling To Identify the Direction of the Market

Traders use very complicated formulas, indicators, and systems to iden - tify a trend. They'll plot so many indicators on the screen that they can't even see the prices anymore.

They think that the more complicated a system is, the better it should "predict" the trends.

As a result, they completely lose sight of the basic principle: buy when the market is going up and sell when the market is going down.

About Indicators

These days, there are more than 150 indicators available, and you can even get indicators for indicators. Keep in mind that indicators are based on five variables: the open, the high, the low, the close, and the volume of a certain timeframe.

Indicators are simply collecting this data and displaying it differently, and they do this by setting certain variables up in relation to others, or in relation to previous data.

Examples:

- Williams %R displays the high and the low to the close.

- Moving Averages display the relationship between a series of closing prices over a period of time.

Remember, keep it simple:

One of the easiest ways to identify a trend is to use trendlines. In the section "Technical Indicators," you've been shown exactly how to construct and use trendlines.

Mistake #2: Not Taking Profits

By their very nature, traders are greedy. After all, you want to make money. A lot of money. And you want to make it fast. "Get rich quick," right? Every trader wants to get rich, and they want to do it in one trade. And that's when they lose.

Trading success comes from consistency, not from a trading "grand slam."

There are a lot of newbie traders out there who believe that their fortune will be made in just one amazing trade, and then they'll never have to work again for their entire life.

This is a dream, a dangerous one. Successful traders will realize that right away.

The best, and usually only, way to make a fortune in trading is consistency. And this fortune will probably be made in small amounts. Unfortunately, most traders go for the big wins, which result in big losses.

It makes sense that traders are more interested in larger profits per trade. What would you rather have – a fifty dollar bill or a five dollar bill? Well, that's obvious! But when it comes to trading, it's not that simple. If

you DON'T take the five dollar bill, you may lose fifty dollars of your OWN money, or more.

The main thing to keep in mind is this: even though you can't take the fifty dollar bill right away, you can take ten five dollar bills over a longer period of time. And the end result is the same – fifty dollars.

And that's the main point here: small, steady profits add up. This is not to say you'll never have a big winner. In options trading for example, it's pretty common to have profits of 100%, 200%, or even 1,000% in just one trade. So, it's not impossible to snag the big profits – it's just not something you should count on. If you expect numbers like this all the time and accept nothing less, you're setting yourself up for guaranteed disappointment.

The key to trading success: small but consistent profits. Consistency is the key, because if your profits are consistent and predictable, then you can simply use leverage to trade size.

Therefore, you MUST know when to exit with a profit. Resist the temptation to stay in "just a little longer, for just a little more."

Mistake #3: Not Limiting Your Losses

The only way you can make a fortune with trading is to actually stay in the game, and it's hard to stay in the game when you've already lost all of your dough.

Losses are a part of our business. The key to trading success is to limit your losses. Too many traders are giving a trade way too much "room," and they're taking big hits, which can shrink an account down by 20%, 30%, and sometimes even 40%. Set small losses.

As outlined in the chapter "Is It Really Possible to Make a Living As a Day Trader?", your average loss should be smaller than your average win, because then you'll be making profits even if your winning percentage is only 50%.

Always know when to exit a trade.

Mistake #4: Trading the Wrong Market

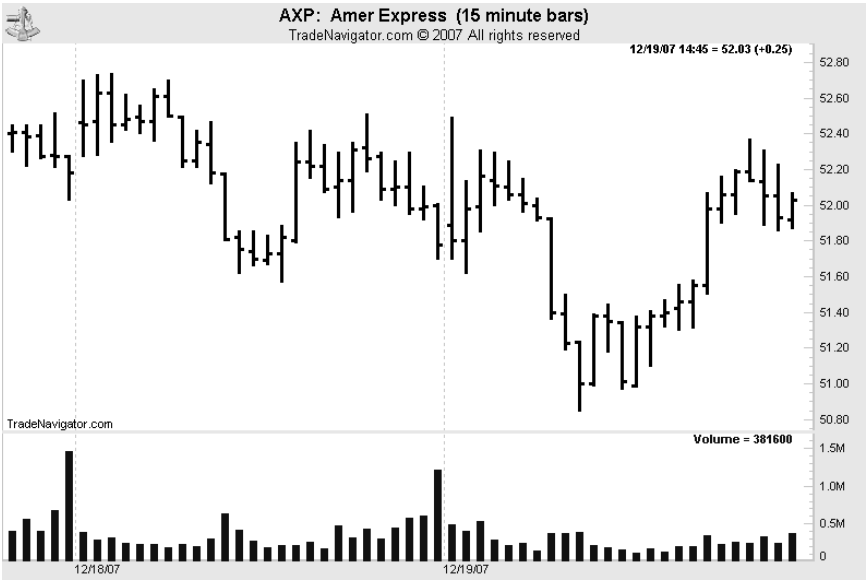
Too many traders are fixed on only one market; they trade ONLY the forex USD/EUR, or the E-mini Russell, or the E-mini DOW, or just certain stocks, etc.

Here's another key to trading success: trade a market that is MOVING, either up or down. You know you should buy when the market goes up and sell when the market goes down.

So stay away from a market that is choppy or just moving sideways, and start trading a market with nice trends.

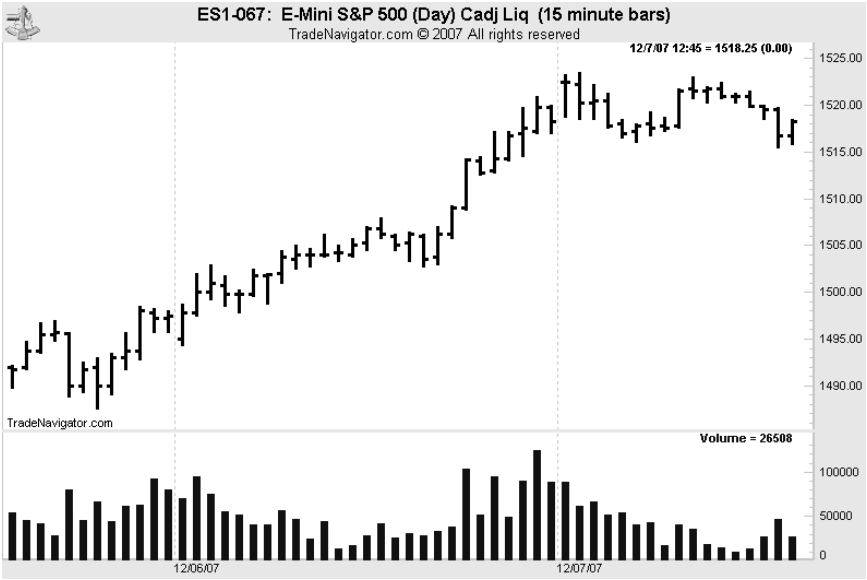
Take a look at the following examples:

Example 1: Choppy Market



Choppy Market

Example 2: Trending Market:



Trending Market

Stick with the trending market and you'll find the profits you're after.

Mistake #5: Lack of a Trading Strategy

You MUST have a solid trading strategy. Having a trading strategy is probably the single most important thing you can do in order to succeed with trading. Having a trading strategy means having a pre-defined set of rules that you have developed for your day trading.

It means knowing what you're doing instead of just gambling. Too many people start off day trading without a strategy, which means that they're completely unprepared.

With a day trading strategy, you're way ahead of the crowd, and you've dramatically increased your chances of making money with trading.

Mistake #6: Not Controlling Your Emotions

What are the main emotions of traders? There are many! Here's just a few:

- Greed – "I'm sure the market will continue rising, and I'll make millions!"
- Fear – "Please…. I don't want to experience another loss."
- Panic – "Oh no, the market is moving fast. Why? What should I do? The sky is falling…!"
- Indecision – "Should I enter this trade? Or should I wait? Ok, now I'm in a trade: should I take profits? Or not yet? Hmm, the trade goes against me: should I get out now, or should I give it a little bit more room?"
- Excitement (hopefully!) – "Hey, I made money!"

How many negative emotions are on this list? Too many!

In order to become a successful trader, you have to have control over your emotions. The best strategies and tools are useless if you lose your head while you're in a trade.

The Best Tools Are Useless

I recently saw the movie "The Guardian," with Kevin Costner and Ashton Kutcher. It's about the U.S. Coast Guard. Kevin Costner plays an instructor who trains young recruits to become rescue swimmers.

One day, they have a simple exercise in the pool: one of the instructors simulates a victim and one of the cadets has to rescue him. When the res - cue swimmer approaches the drowning victim, the victim grabs the swimmer and holds him tight, trying not to drown.

The rescue swimmer panics and can't escape the victim's grip. And both of them almost drown.

After the exercise, Kevin Costner's character explains this to the cadets; the only difference between THEM and the drowning victim out there in the ocean is that THEY have a strategy to rescue the victim and deal with the situation. But all of the tools and equipment that they have are absolutely useless if they panic, or have no idea what to do.

They need to remain calm and execute their strategy.

The same is true in trading: you can have the best trading strategy, superior software, the fastest computer, several 21" monitors, a $1,500 ergonomic chair, and an office with the most stunning view, but all of these things are absolutely useless if you're in a trade and you panic.

Remain calm, cool, and relaxed. Control your emotions – don't let them control you.

Mistake #7: Overtrading

Many traders think that "quantity" is better than "quality." They believe that if you just throw enough punches, one will eventually hit. They trade like maniacs and make their broker rich.

Traders are overtrading for the following three reasons, and none of them are good:

1.) **Greed**

You just closed a winning trade. You followed your plan and made the profits that you were looking for. But the market keeps going up. You think, "I should have stayed in this trade," so you jump right back in. And then you realize that YOU were the one who just bought the high of the day.

2.) **Revenge**

You lost money. The market has been mean to you. "They" just took out your stop and now the market keeps moving in your di - rection. So you want to get back at them. You keep trading, thinking, "The next trade will make back all the money I lost so far, and that will hurt them." Believe me: the market is AL WAYS stronger, and it will be YOU who gets the bloody nose.

3.) **Boredom**

There are some days when the ducks simply don't line up. You're watching the markets and it's like watching paint dry: nothing moves. You wait…and wait…and wait…and suddenly you just get that "itch" to trade. You think, "If I don't trade, I won't make any money!" and you jump into a trade immedi ately. Of course, the trade isn't according to your plan, and you end up with a loss.

I haves some news for you: if you don't trade when there's nothing to trade, then you won't lose any money – guaranteed!

If you want to succeed in trading, then you must understand the concept of taking only the "high-probability trades." Less is more.

Follow your plan!

The Trader's Psyche

You know that you need a strategy. And you know that there's more to trading than just having a strategy. In the previous chapter, you learned about the major mistakes that traders make, and you learned that your biggest enemy is not another trader, or market makers, or your broker – it's YOU.

And YOU are your biggest enemy because of your **emotions.**

In this chapter, you'll learn about the mindset and psyche of successful traders. Having a profitable trading strategy AND the right mindset will catapult you right into the 11.5% of successful traders we talked about earlier.

In order to develop the right mindset, you need to know what to expect when day trading.

Many traders mistakenly believe that trading will result in a consistently-rising account balance, like having an ATM in their front yard.

But you already know that losses are a part of our business as traders. There will be some days and weeks when your trading exceeds your expectations, and there will be periods when your trading results are far worse than you expected.

It's essential that you maintain a long-term perspective.

Day trading means playing a numbers game. You already know that you need to place at least 40 trades before you can look at the performance of the strategy. Most traders only evaluate their performance once a month,

trying to have as many profitable months as possible. Hedge funds evaluate their performances quarterly or yearly.

Long-term evaluations have their place, but if you look at your trading results daily, it will drive you crazy. That's why we define weekly goals.

Sure, nobody likes going through a drawdown. But when you're trading, it's inevitable. The key is in how you deal with it.

In an interview with Jack D. Schwager for his book, Market Wizards: Interviews With Top Traders, the famous Richard Dennis said:

> *"It is totally counterproductive to get wrapped up in the results. You have to maintain your perspective. Being emotionally deflated would mean lacking confidence in what I am doing. I avoid that because I have always felt that it is misleading to focus on short-term results."*

And way too many traders focus on short-term results and lose their perspective. That's why they fail: they experience a loss or a bad week, and so they start trading a different strategy. And while the trading strategy they just abandoned is recovering from the drawdown, the new trading strategy may result in yet more losses, so again, they start looking for another.

It's like a dog chasing too many rabbits: at the end of the day, he's totally exhausted and he has absolutely nothing to show for it, because he didn't catch a single thing.

Day trading necessitates selective, wise, and patient trading methods. Successful day traders are practical, and do not go overboard when trading the market. They focus on the quality of each trade, not the quantity.

Here are some important characteristics of successful traders:

- **Successful traders do not blame.** They accept the losses they have, and they don't dwell on them, or blame other people or conditions. They learn from their mistakes and move on with their trading.

- **Successful traders have a system.** They stick to their system of trading religiously.

- **Successful traders have patience.** They know that most positions will not be profitable the minute they are opened.

- **Successful traders do not overtrade.** They realize that overtrading puts their account at risk, and they know that not every day is a day for trading. They wait for high probability opportunities.

- **Successful traders realize that nothing is 100% foolproof.** They trust in their indicators, but they are aware of other factors that may influence their trades.

- **Successful traders do not stay in a losing trade.** They honor the stop losses that they set, and they do not hold their position in the hopes that the market will eventually "go their way."

- **Successful traders do not rush into trades.** They take their time while selecting trades, and they are picky about which trades to jump on. They don't place orders just for the sake of having a position in the market every second.

- **Successful traders stick to a successful strategy.** They have one to three techniques that really work, and they use them over, and over, and over again.

- **Successful traders have the ability to adapt.** They adjust their trading methods and decisions to changing market conditions.

- **Successful traders know what type of trader they are.** They don't force themselves to trade with methods or strategies that do not fit their personality.

- **Successful traders bank on consistent profits.** They know that ignoring the small-profit trades and angling for a "grand slam" is a sure way to lose money.

- **Successful traders take action.** They don't let their fear control their decisions or interfere with their trading.

- **Successful traders use successful systems.** Their trading methods and indicators focus on high probability trades, sound money management, keeping their strategies free of curve-fitting, and working their system into their business plans for successful implementation.

- **Successful traders recognize a "good" trade.** They don't base their evaluation on profits or losses; they base it on whether or not they followed their trading plan to the letter. Even if they DID lose money, as long as they stuck to their plan, it is a "good" trade.

- **Successful traders take time off.** They realize the importance of taking breaks from trading and the markets to clear their heads.

- **Successful traders do not fear losses.** They realize that losses are a part of their business, and they expect them.

If you can adopt the right psychological mindset, then you'll gain a significant edge in the market.

I can't stress this enough:

The right mindset is one of the keys to investment success, and most traders fail to understand this.

Greed and Fear

When day trading, two emotions are constantly present: greed and fear. If your trade goes well, your natural inclination will be to trade even more, opening yourself up to significant loss. And if your trade goes wrong, fear will torture you. Fear of loss or fear of a further loss makes traders scared.

Greed and fear are destructive emotions, and all traders are influenced by them; they're a natural part of every trader's psychology. Greed and fear can make traders act irrationally: they may know what they should do, but they simply can't do it.

The bottom line: if you're scared or greedy, and you can't control your emotions when day trading, then you'll have a very difficult time being profitable.

But, when you trade well, in accordance with your trading plan, you will have a fantastic chance of success. Feel proud of yourself for good trades and decisions, but don't dwell on them, or allow arrogance to set in. Keep your head up and continue to apply a sound trading strategy, even when you suffer losses – remember, they are just a part of the business.

Do not allow yourself to get caught up in positive or negative emotions – understand the psychology behind trading and know that no trade is guaranteed.

Work on your mental state. If a trade goes wrong, try and work out why it did, and learn from it. Executing a trading method with discipline is the only way to overcome destructive emotions. Whether you're a day trader or an investor, and whether you trade in commodities, stocks, or currencies, the fact is that your trading psychology WILL influence your results.

You should never trade without a solid reason. Don't chase the market. If a market moves sharply, but you don't participate in this move because your entry criteria weren't met, don't worry about it. If you miss a trade, another one will be just around the corner. Practice patience and discipline.

You need to control your emotions by having a specific plan to follow. Having the correct trading psychology is just as important as having a reliable trading strategy.

The more you are prepared mentally for trading, the better you will trade. Note my emphasis on better trading, not better winning. A good day in day trading is not defined by profits. Successful day traders define a good day as one that is researched and planned and follows their overall trading strategy.

Action Items:

- ✓ The "Law of Attraction" says that "you get what you think about." Here's how to avoid negative emotions and to have a positive attitude:

  Write down 10 "I Am" statements. These statements should reflect who you WANT to be, not necessarily who you are now.

  Here are some examples of "I Am" statements:

  - I am a disciplined trader who follows his trading plan.
  - I am cool and relaxed when I am trading.
  - I am in control of my emotions.
  - I am a profitable trader.

- ✓ Read these "I Am" statements every morning before you start trading. Read them aloud and read them like you mean it. Do it for two weeks, and I promise, you WILL notice a difference.

The Three "Secrets" to Day Trading Success

Trading can be simple, but it's not easy. And trading is definitely more difficult if you complicate it. Remember the saying: " A Confused Mind Takes No Action." As a trader, you MUST take action, every single day; therefore, you must avoid confusion.

So keep it simple. Very simple.

Here are the three "Secrets" to Day Trading Success

- **Secret 1: Trading In the Right Direction**

  You must buy when the market is going up and sell when the market is going down. That's how money is made.

- **Secret 2: Always Know When To Exit A Trade**

  It is essential that you know when it's the right time to exit with a profit AND when it's the right time to exit with a loss.

- **Secret 3: Trade the Right Market**

  The right market is a trending market. As you know, money is made in trends – either up or down – so you dramatically increase your chances of making money if you trade a trending market.

Now you know why I put the word “secrets” in quotation marks. These are not “secrets” at all. Unfortunately, though, most traders don’t realize the importance of these facts and tend to forget them.

Losing traders focus on finding a “magic method” of trading, visiting countless websites and spending hundreds and thousands of dollars on books, courses, and software packages.

Don’t make the same mistake. Keep your trading simple.

Remember, the “secrets” to day trading success are universal. They apply to every market, whether you’re trading stocks, futures, options, or forex. And they apply to every timeframe, which is why they’re so powerful.

Focus on the “secrets:”

1.) Learn how to determine whether the market is going up or going down.

2.) Learn when to exit a trade, when to take a profit, and when to bail if the market is not moving in your favor.

3.) And learn how to find the right market.

Don’t make your trading overly complicated. Stick to the basics. As you already know, if you can’t drive a Ford, you won’t be able to drive a Ferrari. And if you can’t drive a car at 10mph, you shouldn’t try to drive it at 80mph.

Remember Power Principle #1: Use Few Rules – Make It Easy to Understand (page 192). That’s how your trading plan should be.

Action Items:

- ✓ Take a look at your trading plan right now and answer the following questions:
    - Have you found an easy way to identify the direction of the market?
    - What tools or indicators are you using?
    - Are you using more than two indicators? Are they complementing each other or contradicting each other?
    - Can you describe your entry rules in two lines or less?
    - Do you know exactly when to exit a trade?
    - Do you know when to exit a trade even before you enter it?
    - Are you sure you're trading the right market? Did you select a market based on your goals or based on a "friend's" recommendation?
    - Did you evaluate other markets to see if there's an alternative market which may support your goals and your trading strategy BETTER than the one you're trading now?

The Tenets of Day Trading

Throughout the course of this book, you've learned a lot, and you should be well on your way to becoming a successful day trader. In this chapter, you'll find a summary of the most important tenets of trading success.

Online day trading requires both patience and practicality. To be successful, you need to focus on your trading technique, not the frequency of your trades. Remember, quality over quantity! There are many factors that play a vital role in online trading.

First, people don't begin with specific objectives. Most people approach the markets and they don't have a clue what they're trying to do. The first rule is to decide what you're trying to accomplish. That's your business plan.

Take a look at the following – my list of basic tenets for day trading.

1.) **Understand the Risk**

The online trading market can be volatile, which creates risk. To be successful, you must be aware of factors that can influence prices, such as economic releases, earning reports, and statements by government officials.

Staying updated with new developments will allow you to make sounder trading decisions.

2.) Choose a Trading Time

Before entering the online trading market, be sure to choose a block of time that suits your lifestyle. There is no point in trying to trade if you can't find a suitable time to do it.

Everyone has commitments in their lives which cannot be ignored, so you have to decide for yourself which regularly scheduled block of time you are most comfortable with.

3.) Develop a Strategy For Your Day Trading

Every online day trader should have an online trading strategy which he follows religiously. Most of these strategies will have common elements, including guidelines for signals, indicators, and rules regarding entry and exit. It's important to determine your strategy before you begin to trade.

4.) Trade the Right Market

Different markets have different trading profiles, which vary in volatility (the online currency market is considered the most volatile of them all). Some are ideal for intraday trading while others are favorable for long-term action.

Determine the market you want to invest in based on factors such as your account size, trading timeframe, personal knowledge, and risk tolerance.

5.) Be Open to Learning

If you're a first-time day trader in the market, there are a number of risk-free ways for you to gain experience. For example, with a demo account, you can practice your order execution and trading systems to check their viability before putting your actual money at stake.

Take advantage of the ample resources available to learn and practice the craft of online day trading.

6.) Don't Trade Too Often

Overtrading is one of the most common mistakes of traders. It occurs mainly when traders try to compensate for their previous losses with 'just a few more trades.'

Wise traders will allow themselves a pause from trading activity after a loss, instead of trading frantically in an attempt to recoup their money.

7.) Start Small

Starting small is a wise choice, especially if you're fairly new to online day trading. Being conservative in your trading decisions will help protect you from possible mistakes and failures. Remember, if you trade big, you're risking big money and setting yourself up for big failure.

Also, consider a few of these effective day trading strategies to stick to:

- **Believe in the day trading system you follow.** Do not question the effectiveness of its rules and methods unless, and until, you have successfully explored all of its trading options.

- **Trade only twice a day – once in the morning and once in the afternoon.** Continue trading this way for at least the first 2 to 3 months. A conservative schedule will save you from the temptation of overtrading.

- **Make a weekly goal of $250 or $300 profit per contract.** When you get a successful trade and achieve the weekly target of $250 or more, you should switch off your trading screen and take a break until the following Monday. This will be good for your health – and it'll also help prevent overtrading. Trust me, when the discipline you have practiced with a small weekly goal is applied to a larger weekly goal (where you will be trading 10-20

contracts), you'll be very glad that you took the time to focus on the smaller goal first.

If, for some reason, you're not able to meet your set profit goal in a particular week, don't worry. It's happened to everyone. Just focus on consistency in your trading results and you WILL find success.

How to Start Trading Without Risking a Single Penny

That's it! Now you KNOW what to do. The next step is putting it into practice.

If you completed the action items at the end of each chapter, you now have a trading strategy. You have tested it against the power principles. You back-tested it, and everything looks good. You have prepared yourself for the mental challenges of trading.

In short: **you are ready.**

Now, you NEED to begin trading. It's time for the rubber to meet the road!

You can have the best trading plan ever, but you'll never make any money if you don't take action and actually start. Of course, it always helps to have a little risk-free practice first, right?

After all, you might still be pretty new to trading, even after having read this book and completing the action items. You don't want to lose thousands of dollars because you made a small mistake in your trading plan, do you?

But how can you get started without risking a single penny of your own money?

The best thing you can do is to get a "paper trading account." And the best news you'll hear today: you can get a paper trading account for FREE from your broker. Or, just contact Rockwell Trading®, and we'll get you set up with a free paper trading account ourselves.

So what is a paper trading account?

A paper trading account let's you trade your strategy with "virtual money." You will get live quotes, and you can enter the trades according to your plan. The system will simulate fills, and you'll find yourself in a trading position. Paper trading accounts show the profit and loss in real-time, and you can see LIVE how much money you are making or losing. Keep in mind that we're talking about "virtual money," so you are not actually making money yet.

If you're serious about your trading success, you MUST trade your strategy on a paper trading account first.

Here's why:

The biggest enemy of a trader is discipline. Traders lose money because of a lack of discipline. Your trading plan might be excellent, but if you don't have the discipline to follow it, then you're doomed. Trading your strategy on a paper trading account will help you to gain confidence in your strategy AND develop the much-needed discipline to actually make money with it.

An Example for Trading the E-mini S&P:

Your system establishes a long position at 1190.00, and the profit target order was placed at 1192.25 ($112.50 profit per contract). Prices move up to 1192.00 and then reverse. One hour later, the system tries to reverse at 1191.00. Again, prices move up to 1190.75 and reverse. Two times, the system missed the profit target by one tick.

Should you change the strategy?

Or should you manually override the strategy when something like this happens?

Doing any of this is like opening Pandora's Box. Let's say you start by lowering your profit goal one tick. Of course, you would be instantly rewarded, because the number of winners would increase.

Next week, though, you might experience the following situation: your stop is hit and you are taken out of the trade, but then the market turns and takes off and you are missing a nice winner. What now? Well, you start moving your stop a little bit further away, and again, you're instantly rewarded: the number of losses decrease.

One week later, you experience a similar situation and you continue "fine-tuning" your system by slightly moving down your profit goal and minimally increasing your stop loss. And very soon, the winning system that you once had turns into a losing one, because your losses are much bigger than your profits.

I've seen it so many times: a trader will back-test his system with over 700 or maybe even 1,000 trades, and then he "fine-tunes" it after the first 5 trades. This doesn't make sense! If you have a sound logic to why your system should work, then you shouldn't "fine-tune" it after just 5 trades. It doesn't NEED fine-tuning.

You should evaluate your system periodically, but instead of curve-fitting your system's parameters, you should ask yourself: "Does the logic of the system still apply?"

If you have a trend-following strategy and markets are trading sideways, then "optimizing" the strategy parameters won't even help – it's the wrong market condition, and the market is just not right for your strat egy.

So, again, exercise discipline: if your strategy worked well for over 1,000 trades, and you have sound logic, and you haven't curve-fitted the strategy, then you should not override the plan or "fine-tune" it after only a few trades!

By watching your trades on a paper trading account, you'll learn a lot about yourself and how to deal with emotions.

- Can you "pull the trigger" when your entry signal appears?
- How do you feel when you see the trade moving against you? Do you feel the urge to move your stop loss?
- How do you feel when the trade makes a profit? Do you want to get out? Or do you want to stay in a little bit longer?
- Do you have the discipline to trade your system according to your rules?

Trading a system on a paper trading account will also help you:

- Watch yourself and your feelings.
- Deal with your feelings.
- Develop the discipline you need to become a successful trader.

And, of course, it'll help you test your trading system under "realistic" market conditions.

By utilizing a paper trading account to test your strategy BEFORE you begin live trading, you will gain confidence in your strategy and your decisions as a trader.

And confidence is your most important characteristic.
Trade your strategy for at least 40 trades on a paper trading account be - fore you even think about putting real money on the line.

Stick to the successful things you know, follow your plan, and control your emotions.

All the best in your trading!

Action Items:

- ✓ Get a paper trading account for the markets you've selected NOW, and get familiar with the trading platform.

Bonus Materials

There's so much more info that I wanted to include in this book, but unfortunately, I've got to stop here. However, I would like to give you a few more materials to help with your trading. These include:

- An electronic downloadable version of the **Trading Plan Template** which you can use for your trading right away.
- A downloadable **Trading Log Template** that will automatically calculate your performance report based on your trades.
- A downloadable PDF version of the **Broker Checklist** in Appendix B, which you can print and use at your convenience.
- An electronic downloadable eBook entitled **'The Practical Guide to Swing Trading.'**
- An eBook containing a **fully disclosed trading strategy**.

All of these resources, along with much more reader-only content, are available to you today.

Just visit our website at: www.thecompleteguidetodaytrading.com.

Appendices

Appendix A – Trading Plan Template

Financial Goal
(see the chapter "Is It Really Possible to Make a Living As a Day Trader?" page 9)

I Want to Make: $_____ per year

$_____ per month

$_____ per week

My Account Size: $_____
(see the chapter "How Much Money Do You Need to Get Started?" page 23)

I am Willing to Risk: $_____
(see the chapter "Determining Your Risk Tolerance," page 27)

Selecting a Market
(see the chapter "Step 1: Selecting a Market," page 51)

I will trade the following market(s): _____

Selecting a Timeframe
(see the chapter "Step 2: Selecting a Timeframe," page 85)

I will trade the following timeframe(s): _____

Selecting a Trading Style
(see the chapter "Step 3: Selecting a Trading Approach," page 87)

I will use the following approach:

☒ trend-following ☒ trend-fading ☒ other:

The underlying assumption / idea is:

_____

_____

_____

Entry Signals
(see the chapter "Step 4: Defining Entry Points," page 149)

Long Entry: _____

_____

Short Entry: _____

_____

Exit Signals
(see the chapter "Step 5: Defining Exit Points," page 151)

Profit Target: _____

_____

Stop Loss: _____

_____

Other Rules
(see the chapter "Step 7: Improving Your Strategy," page 183)

_____

_____

_____

Expectations
(see the chapter "Step 6: Evaluating Your Strategy," page 171)

	Expected	Realized (after 40 Trades)
# of Trades per Day		
Winning Percentage		
Average Winning Trade		
Average Losing Trade		
Total Profit		
Average Profit per Trade		

Appendix B – Broker Checklist

(see the chapter "What You Need to Begin Trading," on page 39)

Below is a list of questions that you can use when interviewing a broker. It will help you tremendously when it comes to finding the right broker.

- How long has your firm been registered with the NFA? *(Only applicable to futures and forex brokers)*
- How long have you been a broker?
- Do you charge any account maintenance or inactivity fees?
- Does your online platform have a cost?
- What is my total cost per transaction, and are there any other monthly costs?
- Do you have a 24-hour trading desk?
- Can I contact you directly during market hours if I have an emergency?
- What happens if I get a margin call: do you automatically close my position, or do I have the chance to send additional funds?
- What kind of leverage do you offer for intraday trading?

Appendix C – Additional Resources

Useful Websites:

http://www.rockwelltrading.com

- Coaching programs for stock traders and day traders alike – includes a success guarantee. Free coaching sessions available.

http://www.candlecharts.com/

- Steve Nison's official website – CDs, books, DVDs, and courses about candlestick charts.

http://www.genesisft.com/

- Official website of the charting software "Genesis Financial Trade Navigator."

http://www.ireallytrade.com/

- Larry Williams' official website – commodities and futures trad - ing courses, seminars and newsletters for short- and long-term traders.

http://www.stockweblog.com

- Daily market commentary for stock and options traders through blog writing; market timing information through newsletters.

http://www.superstockpicker.com

- Innovative stock market research software which picks the best Canadian stocks from the Toronto Stock Exchange to build high-performance stock profiles for those investing in the Canadian markets.

http://www.traderslog.com/

- An excellent online resource for stock, futures, and forex traders. Hundreds of free articles from trading experts, and an extensive glossary of trading terms and technical indicators.

Appendix D – Reading Resources

Trade Like a Hedge Fund: 20 Successful Uncorrelated Strategies & Techniques to Winning Profits (Wiley Trading)
by James Altucher

Hedge Fund Manager James Altucher reveals 20 trading strategies. Use these strategies as idea generators when developing your own trading strategy. Learn about gap-trading, intraday trading using the NYSE tick indicator (an interesting short-term trading idea using Bollinger Bands) and much more. Use these strategies as they're described here, or incorporate them into your own trading.

The Tax Guide for Traders
by Robert A. Green

In this hands-on book, C.P.A. Robert Green provides traders with practical material on how to minimize the impact that taxes have on hard-won profits, along with how to get immediate refunds from losses. Written in a clear concise style that appeals to traders as opposed to accountants, this book discusses the best ways to set up a trading business, key tax forms and how to use them, tax treatment for specific types of securities, commodities, futures, and currencies, what to do in case of an audit, how to deal with the IRS, ways to lower your taxes legally, and more.

The Trading Game: Playing by the Numbers to Make Millions
by Ryan Jones

This book contains virtually all information on money management methods. Ryan Jones details the various methods of money management, exposes their flaws, and then presents you with his own solution for money management. Money management can make or break a trader, and this book is a must-read.

Reminiscences of a Stock Operator (Illustrated Marketplace Book)
by Edwin Lefèvre

A classic. Originally written in the early 1920s, this novel tells the story of Larry Livingston, a pseudonym for Jesse Livermore, one of history's most famous traders. You have probably heard many of the famous rules that are introduced in this book, like: "The trend is your friend," "History repeats itself," "No stock is too high to buy or too low to sell," and "Let your winners run and cut your losses quickly." This book is a must-read for beginners and a must re-read for all others.

Options as a Strategic Investment
by Lawrence G. McMillan

THE options bible. In 896 pages, Lawrence McMillan describes dozens of strategies in detail for option traders. He starts with the basic strategies like buying calls, covered call writing, and naked call writing. He then introduces bull and bear spreads, calendar and butterfly spreads, and other call option strategies. The next chapters explain put option strategies in detail. He explains index options, futures, and futures options, and concludes the book with advanced option strategies like volatility trading. This book is the most complete book on options I have ever seen. A must-have for options traders.

The Candlestick Course
By Steve Nison

The Candlestick Course is a hands-on course book that will help you master Steve Nison's landmark techniques for Japanese Candlestick Charting. Each chapter gives you specific learning objectives, key terms, clear instruction, and real-world applications of the concepts. Plus, each chapter ends with a review quiz, allowing you to perfect your charting abilities before moving on to the next phase.

Market Wizards: Interviews with Top Traders
by Jack D. Schwager

This book is another classic. Jack Schwager interviewed 17 superstar money-makers including Richard Dennis, Paul Tudor Jones, Ed Seykota, Marty Schwartz, Tom Baldwin and others to answer the question "How do the world's top traders make millions of dollars in the markets?" After reading this best-selling book, you'll know what ingredients enable these top traders to consistently work their financial magic in the markets while so many others walk away losers. One of the top-selling trading books of all-time.

Trade Your Way to Financial Freedom
by Van K. Tharp

While *Reminiscences of a Stock Operator* will teach you the basic rules, Van K. Tharp demonstrates in this book exactly how to "let your winners run and cut your losses quickly." In the first part of the book, Van Tharp describes how the trader himself is a major factor in successful trading. The second part conceptualizes the creation of one's trading system, and the third part helps you to understand the key parts of a trading system. In covering these topics, Tharp brings in several outstanding traders, each of whom contributes his own expertise.

Long-Term Secrets to Short-Term Trading
By Larry Williams

The public thinks speculation is a game of knowing the future, of knowing that which cannot be known. They're wrong. It's a game of developing strategies with winning advantages, of getting the odds on your side, and then working those odds. Short-term trading is how most traders and would-be traders play the markets. While it offers the greatest financial payoffs, it also presents the greatest challenge, requiring constant attention and vigilance, as well as a very strict plan. This book provides the blueprint necessary for sound and profitable short-term trading, highlighting the advantages and disadvantages of what can be a fruitful, yet potentially dangerous venture.

Appendix E – Glossary

(Thanks to www.traderslog.com for glossary definitions)

Average True Range (ATR) – A volatility measurement indicator developed by Welles Wilder. True Range is defined as the largest difference of:

- The current high minus the current low
- The absolute value of the current high minus the previous close
- The absolute value of the current low minus the previous close

Back-Testing – A method commonly used in developing a trading system. A trading strategy is tested and optimized based on historical data. It is then applied to current data to determine predictive value. Back-testing is based on the notion that a strategy that worked in the past will continue to work in the future.

Bear Market – A market in which prices generally decline over a period of months or years. Sellers are often referred to as 'bears.' A bear market is the opposite of a bull market.

Bollinger Bands – An indicator developed by John Bollinger which consists of a moving average and two standard deviations, one above the moving average and one below.

Broker – An individual paid a fee or commission for executing buy and sell orders for a customer.

- ***Full-service brokers*** – usually offer more types of investments, may provide you with investment advice, and are typically paid in commissions.

- ***Discount brokers*** – do not usually offer any advice or research; they just execute the trades that you request, without all of the bells and whistles.

Bull Market – A market in which prices generally rise faster than their historical average over a period of months or years. Some analysts require a market to rise 20% from a major low for a sustained period of time before using the term 'bull market.' Buyers are often referred to as 'bulls.' A bull market is the opposite of a bear market.

Chart – The graphical expression of a financial market's behavior over a period of time.

- ***Bar Charts*** – charts that consist of rectangular bars whose lengths are proportional to the value they represent. Bar charts are used for comparing two or more values – they consist of an opening foot, a vertical line, and a closing foot. Each bar includes the open, high, low, and close of the timeframe, and also shows the direction (upward or downward), and the range of the timeframe.

- ***Candlestick Charts*** – charts that consist of a wide vertical line, and a narrow vertical line. Each "candlestick" graphically illustrates the open, high, low, and close of the timeframe, the direction (upward or downward) of the timeframe, and the range of the timeframe.

- ***Line Charts*** – charts that consist of closing prices connected with straight lines.

Charting Software – A software or package that takes the market data and displays that data in a variety of charts. Typically, the user can modify the appearance and layout of the charts and add features such as indicators, trendlines, support and resistance levels, etc.

Chicago Board of Trade (CBOT) – A leading futures and options exchange. The CBOT was established in 1848; it's the world's oldest derivatives exchange.

Chicago Mercantile Exchange (CME) – A marketplace for financial futures, foreign currency futures, commodity futures, and futures options. The CME is the world's second-largest exchange for futures and options on futures, and it's the largest exchange in the United States. (Sometimes called the Merc.)

Closing Price (C) – The last trade of the day, as expressed in charts.

Commission – The set percentage of a trading transaction or the flat fee per trading transaction that is paid to a broker.

Commodity Exchange Act – The Commodity Exchange Act, 7 U.S.C. § 1, et seq., provides for the federal regulation of commodity futures and options trading.

Commodity Futures Trading Commission (CFTC) – The Federal regulatory agency established by the Commodity Futures Trading Act of 1974 to administer the Commodity Exchange Act.

Contract – The term used to reference a unit of trading for a future or options commodity. The contract specifies which commodity is being traded, detailing the amount and grade of the product and the date on which the contract will mature and become deliverable.

Currency Pairs – Two currencies which are simultaneously bought and sold in Forex trading. (Examples: EUR/USD, USD/JPY, GBP/USD.)

Day Trader – See 'Day Trading.'

Day Trading – The buying and selling of financial instruments throughout the day. As the day progresses, prices will rise and fall in value, which creates both the opportunity for gain and the possibility of loss for day traders.

Dow Jones Industrial Average – An index of 30 "blue chip" stocks (Dow 30 Stocks) of U.S. companies. The Index includes substantial in - dustrial companies with a history of successful growth and wide investor interest.

E-Mini – An electronically traded futures contract; E-mini contracts are traded on the CME and represent a small measure of normal futures con - tracts. They're available on several indices, including the Russell 2000, the S&P 500, and the NASDAQ 100.

Entry/Exit Signals – Signals that define when to open and close trading positions; these signals are derived from a trading strategy's entry and exit rules.

Equity – Ownership of a share in a company; can also refer to the resid - ual dollar value of a futures or option trading account.

Exchange – A central marketplace with established rules and regulations where buyers and sellers meet to trade futures and options contracts or securities.

Exchange Traded Fund (ETF) – A security that tracks an index and represents a basket of stocks, like an index fund, but trades like a stock on an exchange, with daily price fluctuations. ETFs provide the diversifi - cation of an index fund as well as the ability to sell short and buy on margin, and they have lower expense ratios than the average mutual fund, too. The commissions on ETFs are the same as for regular stocks. (Examples: SPDR, or SPYDER Contract, QQQ, or Qubes Contract.)

Exponential Moving Average – The most popular of all versions of the moving average. The exponentially smoothed moving average gives greater weight to recent price data and also includes all the data in the life of the security. The user is able to adjust the weighting for the most recent price data by assigning a percentage value to the last day's price.

Federal Reserve Board (FRB) – The governing body of the Federal Reserve System. The seven members of the board of governors are ap - pointed by the president, subject to confirmation by the Senate. The board sets Fed policy regarding the discount rate and reserve require - ments (among other key economic decisions).

Fill – The execution of an order.

Financial Industry Regulatory Authority (FINRA) – An industry organization representing persons and companies involved in the securities industry in the United States. Formerly known as the National Association of Securities Dealers (NASD).

Foreign Exchange (Forex) – The trading market which deals in the buying and selling of foreign currencies. Forex is the largest of the trading markets, encompassing all of the world's currencies; it is also the most liquid. It is important to note that there is not actually a central marketplace for Foreign Exchange. Trading is done over the counter.

Forex Trading – The buying and selling of currencies. The word "forex" comes from Foreign Exchange, and forex is often abbreviated to FX (see the chapter 'Trading Forex').

Fundamental Analysis – The study of basic, underlying factors that affect the supply and demand of the markets which are being traded. Fundamental analysis looks at the cause of market movement.

Futures Commission Merchant (FCM) – Individuals, associations, partnerships, corporations, or trusts that solicit or accept orders for the purchase or sale of any commodity for future delivery. The FCM also accepts payment from or extends credit to those whose orders are accepted.

Futures Trading – The buying and selling of exchange-traded derivatives, or futures contracts (see the chapter 'Trading Futures').

Initial Capital – The amount of financial resources or money that a trader starts trading with; initial capital is the total sum of money available for investment before any losses are accrued or profits are gained.

Initial Margin – The sum of money that the customer must deposit with the brokerage firm for each futures contract to be bought or sold; initial margin is paid by both buyer and seller. (Sometimes called original margin or initial deposit.)

Leverage – The ability to control large dollar amounts of a commodity or security with a comparatively small amount of capital.

Maintenance Margin – The minimum amount which an investor must keep on deposit in a margin account at all times for each open contract.

Margin Account – A type of customer account through a broker. When customers open a margin account, they can trade stocks on margin. (See 'Margin Trading.')

Margin Call – A call issued by a broker if the equity in a customer's account drops to or below the level of the maintenance margin; the margin call is issued to bring the customer's equity back up to the required level.

Margin Trading – The buying and selling of goods on collateral; basically, margin trading is borrowing money from a broker to purchase stock. It can be thought of it as a loan from the brokerage.

Market – A system which allows people to easily buy and sell (trade) financial securities (such as stocks and bonds), commodities (such as precious metals or agricultural goods), and other items of value. There are always two roles in markets – buyers and sellers.

Market Analyst – An individual who specializes in investment research and analyzes the stock or futures market, predicting what it will or will not do and how specific stocks or commodities might perform based on past data.

Martingale Trading System – A trading strategy which requires traders to double their position after every loss; the theory of this system is that the first win will recover all previous losses, plus win a profit equal to the original stake.

Mini Contract – Refers to a futures contract that has a smaller contract size than an otherwise identical futures contract. (See 'E-Mini.')

Minimum Margin – The amount of money that traders are required to place in their margin account before they are allowed to trade on margin or sell short.

Minimum Tick Movement – The smallest increment of price movement possible when trading a given contract.

Moving Average Convergence Divergence (MACD) – A trend-following indicator developed by Gerald Apple which shows the relationship between two moving averages of prices.

Moving Averages – A trend-following indicator which shows the average price in a given point of time over a defined period of time. They're called 'moving' averages because they reflect the latest average, while adhering to the same time measure. This indicator works very well in trending markets.

NASDAQ – An acronym for the National Association of Securities Dealers Automated Quotation System. Unlike the New York Stock Exchange, where trades take place on an exchange, NASDAQ is an electronic stock market that uses a computerized system to provide brokers and dealers with price quotes.

NASDAQ Composite Index – A market capitalization-weighted index of over 3,000 securities. The index was launched in 1971, and it includes many leading technology stocks, such as Dell, Intel, and Microsoft.

National Association of Securities Dealers (NASD) – An industry organization representing persons and companies involved in the securities industry in the United States. Currently known as the Financial Industry Regulatory Authority (FINRA).

National Futures Association (NFA) – A self-regulatory organization whose members include Futures Commission Merchants, Commodity Pool Operators, Commodity Trading Advisors, Introducing Brokers, commodity exchanges, commercial firms, and also banks. The NFA is responsible—under CFTC oversight—for certain aspects of the regulation of FCMs, CPOs, CTAs, IBs, and their Associated Persons, focusing primarily on the qualifications and proficiency, financial condition, retail sales practices, and business conduct of these futures professionals. The NFA also performs arbitration and dispute resolution functions for industry participants.

Net Profit – A trader's total earnings (or profit). Often referred to as the bottom line, net profit is calculated by subtracting a trader's total expenses from his total revenue, showing what that trader has earned (or lost) in a given period of time. (Sometimes called net earnings or net income.)

New York Mercantile Exchange (NYMEX) – The world's largest physical commodity futures exchange; the preeminent trading forum for energies and precious metals. Transactions executed on the Exchange avoid the risk of counterparty default because the Exchange clearinghouse acts as the counterparty to every trade. Trading is conducted through two divisions, the NYMEX Division – home to the energy, platinum, and palladium markets – and the COMEX Division, on which all other metals trade.

New York Stock Exchange (NYSE) – The world's oldest and largest stock exchange; the NYSE is operated as an unincorporated association with a governing board of directors and a full-time chairman. More than 1,600 companies are listed, representing some 60% of the total shares traded in the United States.

North American Securities Administrators Association (NASAA) – The oldest international investor protection organization (founded in 1919). The NASAA was created to protect consumers who purchase securities or investment advice, and its jurisdiction extends to a variety of issuers and intermediaries who offer and sell securities to the public.

One-Cancel-Other Order (OCO) – A pair of orders; if one order is filled, the other order will automatically be cancelled.

Opening Price (O) – The first trade of the day, as expressed in charts.

Options Trading – The buying and selling of contracts which give the buyers the right, but not the obligation, to buy or sell a specified quantity of a commodity or other instrument at a specific price within a specified period of time, regardless of the market price of that instrument (see the chapter 'Trading Stock Options').

Over-Optimizing – A term which refers to the optimization of a trading strategy to the extent that the rules of the strategy only produce positive results for the historical data that was used during the design of the strat - egy. Over-optimized trading strategies are usually ineffective in real-time trading.

Parabolics – A trend-following indicator developed by Welles Wilder which is designed to create a trailing stop.

Pattern Day Trading Rule – A rule established by the NYSE and NASD in August and September of 2001. The rule states: "If a trader executes four or more day trades within a five-day period, then he must maintain a minimum equity of $25,000 in his margin account at all times."

Performance Report – A report which details the effectiveness of a trading strategy; performance reports generally include such information as records of wins, losses, total profit, maximum drawdown, average winning percentage, average losing percentage, etc.

Pip – The smallest price change that a given exchange rate can make. The term 'pip' is most common in the Forex market, where prices are quoted to the fourth decimal point.

Pivot Points – Technical levels calculated using the high, low, and closing prices of a given security.

Profit Factor – A percentage amount often included in a performance report which shows a strategy's gross profit divided by the gross loss. This figure will tell you how many dollars you will win for every dollar you lose. Typically, a trading strategy should have a profit factor of 1.5 or higher.

Profit Target – The amount of money that traders hope to achieve in a particular trade. Once a profit target is determined, traders place an order at that price; if the contract price reaches the profit target, the order will automatically take the profits and remove the trader from his position in the market. A profit target is the opposite of a stop loss.

Range – The difference between the high price of the day and the low price of the day, as expressed in charts.

Rate of Return – The profit or loss on an investment over a certain period of time; the rate of return is expressed as a percentage increase over the initial investment.

Real Estate Investment Trust (REIT) – A security which is bought and sold on major exchanges - much like stocks. REIT companies hold portfolios of properties, or real estate-related assets. There are about 200 publicly traded REITs. Many mutual funds contain REIT in their portfolios and there are also several Exchange Traded Funds that include multiple REITs.

Relative Strength Index (RSI) – A trend-fading indicator developed by Welles Wilder which compares the magnitude of a stock's recent gains to the magnitude of its recent losses and turns that information into a number which ranges from 0 to 100. This indicator works best in sideways-moving markets.

Resistance Level – Usually the high or the peak point in any charting pattern (hourly, weekly, or annually). In technical analysis, resistance is defined as a price area where new selling will emerge to dampen a continued rise. Resistance is the opposite of support.

Risk Tolerance – The amount of uncertainty that a trader feels comfortable with in situations where there is a possibility of loss. Risk tolerance is not based on how traders feel about risk. There are a number of factors in determining risk tolerance, including financial goals, desire for financial security, account size, emotions, etc.

Share – See 'Stock.'

Single Stock Futures (SSF) – A futures contract on a single stock. It's an agreement to deliver 100 shares of a specific stock at a set date in the future (the expiration date).

SMART Goal – A goal that meets all of the criteria referenced in the acronym SMART: specific, measurable, attractive, realistic, timeframe.

Spread – The difference between the bidding price and the asking price of a financial instrument. The bidding price is the amount at which a market participant is willing to buy a security; the asking price is the amount at which a market participant is willing to sell a security.

SPYDER Contract – An artificial stock that mirrors the S&P 500 Index. (Sometimes called the SPY Contract or SPDR.)

Stochastics – A momentum indicator developed by Dr. George Lane in the 1950s which compares the closing price of a commodity to its price range over a given time span; used in technical analysis. (Sometimes called the Stochastics Oscillator.)

Stock – An instrument that signifies ownership (equity) in a corporation and represents a claim on part of the corporation's assets and earnings.

Stock Market – A private or public market for the trading of company stock at an agreed price. Companies are given a value by investors. The value of the company is divided into many shares. These shares can be bought or sold (raising or lowering the value of the company).

Stock Trading – The buying and selling of instruments which signify ownership (equity) in a corporation and represent a claim on part of the corporation's assets and earnings (see the chapter 'Trading Stocks').

Stop Loss – The amount of money that traders are willing to lose in a trade. Once a stop loss is determined, traders set a stop order at that price; if the contract price falls to the level of the stop loss, the stop order will automatically remove the trader from his position in the market so that he does not lose more money. A stop loss is the opposite of a profit target.

Support Level – Usually the low point in any chart pattern (hourly, weekly, or annually). In technical analysis, support is defined as a price area where new buying is likely to come in and stem any decline. Support is the opposite of resistance.

Swing Trading – Buying and selling financial securities in a timeframe of one to four days. Swing traders attempt to exploit short-term price momentum.

Technical Analysis – The study of a stock's trading patterns through the use of charts, trendlines, support and resistance levels, and many other mathematical analysis tools, in order to predict future movements in a stock's price, and to help identify trading opportunities.

Tick Size – The minimum legal change in the price of a contract, either up or down.

Timeframe – A predefined time interval which is used to draw trading charts. Charts are constructed with the opening, closing, high, and low prices of the interval. The most commonly used intervals are 1-, 3-, 5-, 10-, 15-, 30-, and 60-minute, along with daily and weekly.

Time Stop – An exit strategy that closes a position after a predefined time if there has not been sufficient movement or direction towards achieving a profit target; typically used in conjunction with stop loss exits and profit-taking exits.

Trading Plan – The complete outline of a trader's approach to trading. A trading plan should encompass trading strategies, markets, rules, indicators, methods, profit targets, stop losses, entry/exit signals, account size, money management, and much more.

Trading Platform – A software package that traders use to place, modify, cancel, and monitor orders to buy and sell a security; it's the interface between a trader and his broker. Trading platforms can also be web-based, allowing them to be accessed from any computer without installing software.

Trading Strategy – A predefined set of trading rules that a trader develops prior to trading. A trading strategy is a subset of a trading plan and specifies when to enter and exit a trade, along with how much money should be risked.

Trends – The general direction, either upward or downward, in which prices have been moving.

- ***Confirmed Trend*** – a price trend that is already confirmed by past market movement.

- ***Downtrend*** – present when prices make a series of lower highs and lower lows. If a trend points down, it is called 'bearish.' A downtrend is the opposite of an uptrend.

- ***Projected Trend*** – a price trend that is predicted based on past market movement.

- ***Trend Channel*** – the price path drawn by two parallel trend-lines.

- ***Trendline*** – in charting, a line drawn across the top or bottom of a price chart indicating the direction or trend of price movement.

    - ***Downtrend Line*** – a straight line on the chart of a contract drawn above successive price peaks, illustrating a downtrend. The longer the downtrend line has held without violation and the more times it has been tested, the more important it becomes. A violation of the downtrend line can signal a trend reversal. A downtrend line is the opposite of an uptrend line.

    - ***Uptrend Line*** – a straight line on the chart of a contract drawn below successive price troughs, illustrating an uptrend. The longer the uptrend line has held without violation and the more times it has been tested, the more important it becomes. A violation of the uptrend line can signal a trend reversal. An uptrend line is the opposite of a downtrend line.

- ***Trend Reversal*** – a change of direction in the price of a contract. (Sometimes called a reversal, rally, or correction.)

- ***Uptrend*** – present when prices make a series of higher highs and higher lows. If a trend points up, it is called 'bullish.' An uptrend is the opposite of a downtrend.

Trend-Fading – A trading approach which requires traders to sell when prices are trading at an extreme (e.g. upper band of a channel), and then try to catch the small move while prices are shifting back into "normalcy." The same applies for buying. (Examples: Bollinger Bands, RSI, Williams %R.)

Trend-Following – A trading approach which requires traders to buy when prices are going up and sell when prices are going down. (Examples: Moving Averages, Turtle Trading, MACD.)

Turtle Trading – A trend-following method developed by Richard Dennis to prove that anybody can learn how to trade. It's a simple breakout system, buying the high or selling the low of the last twenty bars.

Volatility – A statistical measurement of the rate of price change in futures contracts, securities, or other instruments.

Volume – A measurement specifying the number of shares, lots, or contracts traded during the time period between the open of the market and the close of the market, as expressed in charts.

Williams%R – A trend-fading indicator developed in 1966 by Larry Williams which helps traders identify overbought and oversold positions in the market. Williams %R shows the relationship of the close relative to the high-low range over a set period of time. This indicator works best in sideways-moving markets. (Sometimes called %R.)

Winning Percentage – The percentage of a trader's wins. Winning percentage is calculated by dividing the number of winning trades by the total number of trades.

Zero Sum Game – A situation in which one participant can gain only at the expense of another participant's equivalent loss.

Appendix F – About Markus Heitkoetter

As CEO of Rockwell Trading®, Markus Heitkoetter has taught hundreds of investors how to make consistent profits in the U.S. and European markets.

Markus started trading 19 years ago, using point and figure charts from published numbers in the morning newspaper, mainly with stocks. In 1996, he began developing a number of trading systems by using Super-Charts (which is now TradeStation), MetaStock, OmniTrader, and other software.

In 2002, Markus decided to quit his regular day job as a director at IBM to become a professional trader. He moved from Germany to the United States to get started.

Throughout his career, Markus has traded EVERYTHING: stocks, options, futures, commodities, spreads, forex, foreign markets, interest rates, etc. If it's out there, he's probably traded it. In addition, he's traded on a wide variety of different timeframes: ticks, 1-, 3-, and 5-minute, hourly, daily, and weekly.

In 2005, Markus launched Rockwell Trading® to fill the void of quality education that he saw in the trading industry. He has since coached hundreds of traders and investors to success through his strategies and methods.

Markus regularly offers educational webinars for the CME (Chicago Mercantile Exchange), Eurex, FXstreet, Strategy Runner, and other financial companies; he's also written articles on over 500 websites, and he's become an expert contributor on ezinearticles.com, Yahoo Answers, and FAQTs.com.

Markus currently resides with his wife and two children in Austin, Texas.

Appendix G – Coaching Programs

Success in anything is based on **instruction**, **practice,** and **guidance.**

Trading is no different. Simply learning something from a seminar or a textbook is not enough. And it's not smart to dive in head-first without practice either. It's important to take the time and make sure your educa - tion covers all the essentials.

At Rockwell Trading®, we offer education programs for both day traders and investors, and our courses are based on the three key principles above.

Rest assured that when you sign up with Rockwell, you're not getting a run-of-the-mill trading course. You're getting something special. Our personalized coaching is what sets us apart from our competitors.

It doesn't matter how skilled, or unskilled, of a trader you are - a coach is essential to your success. Think about it. All of the best professionals out there have coaches, regardless of their innate talents.

Look at Tiger Woods. He's a phenomenal golfer, a real natural. But he's still got a coach. And do you remember what happened to Tiger Woods when he fired his coaches? It wasn't pretty. Everyone needs guidance and constructive criticism to be successful. Even the athletes, geniuses, and superstars.

The same applies for all of us traders.

Rockwell's coaching programs are not just about listening and note-taking - though these are important factors, too – they are about the con - structive guidance, input, and feedback from your coach, and the hands-on application of your new trading habits.

We TEACH our students ABOUT success.
We TRAIN our students IN success.
We COACH our students TO success.

Simply put, there is no better way to learn. Practical experience is the most valuable thing you can gain in this industry, and that's exactly what we provide you with here at Rockwell.

Rockwell's Day Trading Coach™

Our Day Trading Coach program is perfect for active day traders who are interested in trading the futures and currency markets. If you can spend at least two hours per day following the markets, then this is the right program for you.

Our Day Trading Coach Consists Of:

- Four-Week Intensive Training (Coaching Sessions & Practical Application)
- Easy-To-Use Trading Software (Genesis Trade Navigator)
- Lifelong Trading Software Updates
- Unlimited Lifelong Customer Support
- Five Proven Trading Strategies That Work In Any Market
- Unlimited MasterMind Forum Access
- The Strongest Performance Guarantee In The Industry

Rockwell's Stock Trading Coach™

Our Stock Trading Coach program is perfect for busy professionals who can't follow the markets during regular trading hours. You'll be using end-of-day data and weekly charts to make your trading decisions in the evenings or on the weekend. If you're looking to start trading part-time, then this is the right program for you.

Our Stock Trading Coach Consists Of:

- Four-Week Intensive Training (Coaching Sessions & Practical Application)
- Easy-To-Use Trading Software (Genesis Trade Navigator)
- Lifelong Trading Software Updates
- Unlimited Lifelong Customer Support
- Proven Stock Lists Automatically Updated Weekly
- Up To 100 Demo Accounts For Use Throughout The Program
- Unlimited MasterMind Forum Access
- The Strongest Performance Guarantee In The Industry

Our Day Trading Coach and Stock Trading Coach programs cater to both novice and experienced traders alike. As a Rockwell student, you will develop and streamline your trading skills and approaches at your own pace through one-on-one coaching sessions and hands-on practice in the markets.

For more information, please visit our website at:

www.rockwelltrading.com