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SEC Statement

Day traders rapidly buy and sell stocks throughout the day in the hope that their stocks will continue climbing or falling in value for the seconds to minutes they own the stock, allowing them to lock in quick profits. Day trading is extremely risky and can result in substantial financial losses in a very short period of time. If you are a day trader, or are thinking about day trading, read our publication. We also have warnings and tips about online trading and day trading. For more information on day trading and the related FINRA margin rules, please read FINRA's investor bulletin “Margin Rules for Day Trading.”
Introduction:

So you want to be a day trader? You are about to enter a fascinating world of fast money, huge highs, crushing lows, and non-stop action.

It’s a mental game like chess that takes physical endurance and incredible self control. It’s a business but it is unlike any traditional business you may have participated in.

You will learn a tremendous amount about yourself. You will face your demons directly without anyone to blame for your failures but yourself. This makes your victories all the sweeter knowing that you are solely responsible.

If your background is from the 9 to 5 corporate world, the freedom day trading provides will be a breath of fresh air. If you ran your own business, never having to deal with customers or clients again can lift a huge weight from your shoulders.

No matter what your background, day trading is a noble profession that offers tremendous financial rewards as well as numerous other benefits.

Welcome to the world of the day trader!
Chapter One: Winners and Losers

As you can imagine the success rate in the day trading business is very low. It’s said that less than 5% of those who try day trading are successful at it. The following will explain two primary reasons why so many lose and provide you with actionable ideas to be among the winners.

1. The Trader’s Psychology

This is most likely the number one reason most traders fail at day trading. Self control, following rules, and the ability to accept losses are the psychological aspects that differentiates winners from losers.

These three things seem easy when you just think about it. When real money is on the line, following these edicts is much more difficult.

The key to controlling your psychology is to realize that any single trade is meaningless while day trading. Every trade is simply part of a process that when successfully implemented will shift the winning odds in your favor.

This works to remove the mental pressure of believing you have to be right on every trade.

This may be the hardest thing for traders to learn but is critical to realizing success at day trading.

Many traders will have a major type A personality with a burning desire to win at everything they do. Realizing that losing is part of winning could be the revelation that helps shift a trader’s fortune to being a winning day trader.

2. Relying on Misinformation

Not that many years ago, traders faced the dilemma of not being able to quickly access enough information to make profitable day trading decisions. Many traders remember waiting for The Wall Street Journal and Investor’s Business Daily to be delivered so they could devour these papers for ideas. While an excellent education, newspapers just were not fast enough to provide actionable day trading ideas. The information traders had access to was always too late or too little.

Today, with the advent of the internet, the opposite is true. We are awash in information. The problem is most of this information is irrelevant and some is even designed to deliberately mislead you.

The key today is to know how to filter this deluge of information to find actionable nuggets, as well as, know how to identify misinformation.
Here Are A Few Tricks to Finding Profitable Information

1. Find an experienced, successful trader to follow

There is no better mentor than a personal friend who is a successful day trader who will take the time to show you what is working now in the market. Many successful traders were fortunate to have this advantage when they started in the markets.

However not everyone has a successful day trading friend or even knows of anyone else who day trades.

In this case, an internet-based educational service like those offered at TradingTips.com can provide the right ideas at the right time to supply you with actionable, timely ideas that have passed the muster of experienced and successful traders.

2. Pay no attention to stock market message boards

While entertaining and fun reading, don’t place much credence in stock market message boards. These places can be full of disinformation, misinformation and outright lies. They sometimes seem to be virtual cess pools of angry, losing traders trying to bring you down to their level. If it’s not angry traders, it can be people talking up their own stocks in the hope of attracting buyers to push the price higher. No matter what, the amount of decent, real information on stock market message boards is usually miniscule. It generally isn’t worthwhile to dig through the garbage to find a few information gems.

3. Never Trade Pink Sheet Stocks

This is another place that is nothing but misinformation. The pink sheet or OTCBB stocks are companies that can’t qualify for a regular listing on a real exchange. This adds another layer of risk onto an already risky endeavor.

Notice I didn’t say you shouldn’t trade low-priced or even penny stocks. There are many opportunities to profit from low-priced penny stocks that are traded on more regulated exchanges.
It just doesn’t make sense to take the ridiculously higher risk of pink sheet stocks. Penny Stock Guru can guide you to profitable low priced stocks that are traded on real stock exchanges.

Now, there is an exception to the rule of never trading pink sheet stocks.

This exception is for stocks that were forced onto the OTCBB or pink sheets due to a low trading price. Stocks that were once on the regular exchanges but are now trading on these dubious exchanges can be considered for day trading. Fannie Mae (FNMA) comes to mind as an example of one of these companies.
Chapter Two: How To Find Profitable Day Trading Stocks

This is the dilemma of most start up day traders, how to find the right stocks for day trading.

Let’s first look at the characteristics of good day trading stocks. Good day trading stocks generally have the following characteristics.

1. Solid Volume

Volume is the number of shares traded. Good day trading candidates generally have at least an average 3-month daily volume of 100,000 shares. Solid volume is what provides the liquidity to allow you to buy and sell quickly. You see, if the stock is thinly traded with low volume, it makes it difficult to sell or buy shares at your chosen, ideal price.

2. Wide intraday moves

One of the only constant facts in day trading is the stock needs to move enough for you to make a profit. The wider the intraday moves are, the better for the day trader. The only stocks that a directional day trader can’t make money on are those stocks that don’t move.

You will find out later in this report how to make money from sharp moves even if you don’t know the direction!

Financial professionals refer to a measure of a stock’s movement as the average true range or ATR for short. The standard setting for the ATR is the average daily range over 14 trading sessions. Here’s the basic calculation.

\[
\text{Current ATR} = \left( \frac{(\text{Prior ATR} \times 13) + \text{Current TR}}{14} \right)
\]

- Multiply the previous 14-day ATR by 13.
- Add the most recent day’s TR value.
- Divide the total by 14.

Fortunately, for many of us, most brokers’ trading platforms have the ATR formula already built in. You can see from the chart below how the ATR is often displayed in real-time on your trading platform:
An even easier way to make sure that the stock you have chosen to day trade has enough of an ATR to successfully day trade is to just look at the daily bars or candlesticks on a chart. The longer the bar or candle, the wider the intraday range.

*Remember, you only want to day trade stocks that are on the move.*

3. A Price Catalyst

Knowing a pending price catalyst will occur during the day is another key to narrowing down the stock universe. These known price catalysts can be an earnings release, both bad or good news, company announcements and a host of other price moving events.

**How To Find Stocks to Day Trade**

Now that we know the characteristics of a good day trading stock, how are these stocks located? There are a variety of ways to locate profitable day trading stocks. Here are a few of my favorite ways:

1. **Watch CNBC or Bloomberg TV**

Watching these business news channels during the day will tip you off to the latest stock market moving news.

Take note of the stocks mentioned and in what context they are mentioned on the different shows. Remember, 1000’s of other traders are watching the same information and will often act upon it causing the stock to climb higher or plunge lower.

Some trading platforms like TDAmeritrade’s Think or Swim trading platform have live CNBC built into the software. The best part of watching CNBC via the trading platform might be that the annoying commercials are eliminated.
2. Use Stock Screeners

There are multiple stock screeners available that can be set for a multitude of criteria. Some trading platforms have screeners already built in. Take a close look at the screen shot above of a Think or Swim trading platform. You can see on the left the largest percentage gainers in the Nasdaq. This screener can be set for different criteria to keep you appraised as to what is happening during the day. Knowing these on the move stocks can be a great way to narrow down the day trading stock universe! Another excellent free screener is this one from www.stockcharts.com.

3. Find a Trustworthy and Proven Successful Service for Alerts

While listening to random tips is a sure-fire way to fail in the day trading game, following a proven, successful service to help locate day trading candidates can make good sense. Remember, a premium service like those offered at TradingTips.com are operated by professional traders who share their knowledge and stock picks with you. These services can be helpful. In other words, someone else does the heavy lifting of identifying stocks likely to take off.
Chapter Three: Techniques For Day Trading

Now that we know strategies for locating the best stocks for day trading, how do successful day traders trade these stocks?

Day trading is like riding a runaway bull! Prices can and do go everywhere, even when least expected. Fortunately, day traders have tools and techniques to time their entries onto the wild and crazy bull.

There are two primary techniques day traders use to time their entries and exits. They are tape reading and technical analysis. Let’s take a closer look at each of these techniques.

1. Tape Reading

In the early days of trading, tape reading was the preferred method of timing entries and exits. As far back as the great speculator Jesse Livermore, tape reading was the most popular day trading technique. This tactic has morphed since the advent of the PC to interpreting the time and sales screen along with Level 2.

The time and sales or TS screen shows the time and size of each transaction. Here’s an example of what a TS screen looks like:
The green prints are buys and the red prints are sales. The right-hand side indicates the time of the transaction, the middle shows the price and the left indicates the number of shares in the trade.

**Level 2**

Level 2 was once the key to successful day trading. It allows traders to see the depth of the order book, what firms are active, and how fast the trading action, among other things. Here’s an example of a Level 2 screen:

Direct access day trading platforms allow you to place orders directly onto the Level 2 screen. This means you can target bids and asks based on a variety of factors with your orders.

Level 2 has recently fallen out of favor with today’s day traders. High frequency trading and other tape spoofer have been filling the screen with orders that are not intended to be executed. This has dramatically hurt the effectiveness of tape reading techniques.

**2. Technical Analysis**

Technical analysis or basing day trading decisions on a price chart is the technique used by most day traders today. It isn’t as fast or accurate as tape reading. However, using charts helps filter out the fake orders and other chicanery that the high frequency trading crew may be up to.

There are two primary technical analysis techniques for using charts to time day trades. These are breakout trades and break down trades.

Let’s take a closer look at each of these:

**Breakout Trade Entries**

Breakout entries are exactly what the name says. The trader enters the trade when a predetermined level on the chart is broken on the upside by a price bar. This level is usually placed at what is considered technical resistance on the particular time frame being traded. Some traders use the five-minute time frame when using charts for day trading.
You can see the line drawn at the high of the day on the five-minute chart below. The day trade would wait for this line to be pierced by a price bar prior to entering the stock for a long trade.

Break out entries depend on price momentum to profit. This means that the trader is betting that price will continue in the same direction as the break out.

**Breakdown Entries**

A breakdown entry waits for price to pullback to support before entering. The idea here is that price will bounce higher from the support level. You can see from this five-minute chart that the price hits support and then bounces. Savvy day traders would wait until the bounce higher appears to be solid before they start buying shares. Watching the volume increase, as you can see on the example, is a smart way to determine if the bounce from resistance will be profitable.
Chapter Four: Using Options for Day Trading

Stock options have opened up the stock market to almost everyone. Even if your trading account isn’t very large, options allow you to benefit from intraday moves on stocks that you couldn’t otherwise afford. For example, Google trades for more than $700 a share as this report is being prepared. It would take more than $70,000.00 to buy 1000 shares of Google. However, ten call options which control 1,000 shares of Google and participate in the price movement might cost only $9,250.00.

The issue with options is they have a definitive life span. Standard options expire on a monthly basis. The more time and more volatile the underlying stock, the higher the price of the option.

Buying call or put options can make sense when you know there is a big announcement coming on your particular stock. For instance, when blowout positive earnings are released, the subsequent sharp upward movement in the share price makes earnings day a great time to buy calls. Remember, generally the closer the expiration date and the strike price, the more the option will move in relation to the stocks movement. Should you bet that the earnings will send shares higher, but the opposite occurs and share prices slump, your calls will quickly lose money.

The day trader would buy puts in anticipation of bad news. Puts increase in value as the share price drops.

One of the more intriguing features of options is that you can be both a buyer and a seller.

Call sellers are betting that prices will drop so that they can keep the profits made from selling the call when it expires worthless.

The opposite is true for put sellers. Put sellers hope the stock price climbs higher so they can keep the premium when the put expires worthless.

Another great way to use options is when you don’t have a strong opinion about the likely direction of a pending move, but you believe there will be a large and fast, perhaps related to an earnings announcement.

For example, you know the company is about to make a big announcement on a certain date. However, no one knows if it’s going to be good or bad news. There is a day trading option strategy that is custom made for this situation. It’s called a straddle. Here’s how it works.

How to Use Option Straddles for Day Trading

Straddles are a trade that will profit if a large move occurs regardless of direction. A straddle is buying both a put and a call at the same strike price and the same expiration month on the same stock. The goal is that a sharp move in either direction will profit enough to absorb the losses in the opposite direction and still create an overall profit.

Here’s a simple example:
You know that XYZ Company will announce earnings on December 10th. Based on the past price movements of the company during earnings announcements, you think that the share price will either soar or collapse after the announcement. Let’s say the stock is trading at $10 and you buy one $10 December put for $2 and one $10 December call for $2. *Earnings are released and it’s a surprise to the downside.* The stock price plunges and the $2 call quickly become worthless. However, the $2 put soars to $6 creating $4 of profit. Remember, you need to subtract your losses of $2 from the call side of the trade but you are left with a $2 profit overall.

Here’s a diagram so you can visualize how straddles work:

Another popular way to use options for day trading is the selling of puts.

Selling a put has the same risk and profit characteristics as the popular swing trading strategy of covered calls.

In option talk, selling a naked put is simply a way to create a synthetic covered call. The good thing for day traders is that you don’t have to own to underlying stock to sell a naked put. Yet you can obtain the same benefits!

Selling puts on the day of an announcement or near expiration is a strategy that can be used by day traders to collect the premium paid for the puts by other investors.

Here’s an excellent diagram originally published in Futures Magazine that illustrates how a covered call is exactly the same as selling a naked put.
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Chapter Five: Avoiding Bull Traps

Many day traders believe the market is full of deceit, treachery and danger. It is these risks that allow the process of day trading to be so profitable. One of the most insidious tricks the stock market plays on day traders is called the bull trap.

The bull trap occurs when everything looks great for a break out trade, but things go terribly wrong. The trader enters the trade long on the break out and within seconds the stock gets slammed lower, almost on cue, taking the traders money.

Bull traps seem to happen all the time. The reason bull traps occur is simple -- many professional traders and institutions sell into strength. This is because the big money needs the strength of an up move to dump their shares. The high volume is a must for large orders to be executed. This selling into strength can overwhelm the break out, pushing shares quickly and sharply lower.

Here’s an example of what a bull trap looks like on a price chart. You can see the break out above resistance but quickly reverses and in the process creates losing trades for break out traders.

The facts of the market are that most retail day traders and at home speculators are break out traders. This buying strength seems to make sense in hindsight when looking at charts. It can and does work on many occasions. However, overall, most retail day traders lose money over time. This is due to being on the wrong side of a move more often than not.
However, truth be told, professional big money traders sell break outs for the reasons mentioned earlier. Day traders would be well advised to “think like a professional” when it comes to break out trading.

It isn’t easy psychologically to sell into a break out, but it is often the hardest trades to take that are the most profitable.

The best way to deal with bull traps is to wait for the break out to drop back below the resistance line, then short the stock.

If you are buying the break out, be sure to use stops, maybe just a few ticks below the break out line on the chart.

An interesting strategy for breakouts is to be ready to go short should the break out not work out.

Here’s how it works.

You can go long on the break out in anticipation that it will continue higher. If it doesn’t and starts to fall back, wait for the stop to be triggered, and then short the same stock. Day traders can place certain order types that will reverse positions automatically. Check your particular day trading platform for how to use these stop-and-reverse order types.