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Dedication to Mom, Dad, Lisa and Lauren. Thank you for your love, support, and understanding. You keep me focused, driven, and happy.
INTRODUCTION

Success as a day trader will only come to 10% of those who try. It’s important to understand why most traders fail so that you can avoid those mistakes. The day traders who lose money in the market are losing because of a failure to either choose the right stocks, manage risk, find proper entries, or follow the rules of a proven strategy. In this book I will teach you trading techniques that I personally use to profit from the market. Before diving into the trading strategies we will first build your foundation for success as a trader by discussing the two most important skills you can possess. I like to say that a day trader is two things, a hunter of volatility and a manager of risk. I’ll explain how to find predictable volatility and how to manage your risk so you can make money and be right only 50% of the time. We turn the tables by putting the odds for success in your favor. By picking up this book you show dedication to improve your trading. This by itself sets you apart from the majority of beginner traders.

The act of day trading is simply buying shares of a stock with the intention of selling those shares for a profit, within minutes or hours. In order to profit in such a short window of time, we trade shares of companies that have just released breaking news, made a big earnings announcement or have any type of fundamental catalyst that results in above average interest from retail traders and investors. The type of stocks a day trader will focus on are typically much different from what a long term investor would look for. Day traders acknowledge the high levels of risk associated with trading volatile markets, and they mitigate those risks by holding positions for very short periods of time.

While investors typically look for 5-10% annual returns, day traders look for trades that have the potential to make 5-10% intraday returns. However, in order to profit from intraday moves, most day traders will take large positions which can result in a high level of single stock exposure. Some will even engage in the high risk practice of trading on margin (money borrowed from your broker). For example, a day trader with a $25k trading account may use margin (buying power is 4x the cash balance) and trade as if he had $100k in equity. This is considered leveraging your account. By aggressively trading on margin, if the trader can produce 5% daily returns on the $100k buying power, the trader will grow the $25k initial equity at a rate of 20% per day. The risk of course is that the trader will make a mistake that can cost him everything. Unfortunately, this is the fate for 9 out of 10 traders. The cause of these career ending mistakes result from a failure to manage risk.

Imagine a trader who has just taken 9 successful trades. In each trade there was a $50 risk and $100 profit potential. This means each trade had the potential to double the risk for a 2:1 profit loss ratio. The first 9 successful trades produce $900 in profit. On the 10th trade, when the position is down $50, instead of accepting the loss, the untrained trader purchases more shares at a lower price to reduce his cost basis. Once he is down $100, he continues to hold and is unsure of whether to hold or sell. The trader finally takes the loss when he is down $1k. This is a trader who has a 90% success rate, but is still a losing trader because he
failed to manage his risk. We will discuss in detail how to identify stocks and find good trade opportunities, but first we will focus on developing your understanding of risk management. Traders that don’t utilize risk management techniques stand a good chance of being among the 90% of retail traders who lose money in the market.

Over my years as a trader and as a trading coach, I have worked with thousands of students. The majority of those students experienced a devastating loss at some point due to avoidable mistakes. It is easy to understand how a trader can fall into the position of a margin call (a debt to your broker). The money to trade on margin is easily available, and the allure of quick profits can lead both new and seasoned traders to ignore commonly accepted rules of risk management. The 10% of traders who consistently profit from the market share one common skill. They cap their losses. They accept that each trade has a predetermined level of risk and they adhere to the rules they set for that trade. This is part of a well-defined trading strategy. It’s common for an untrained trader to adjust their risk parameters mid-trade to accommodate a losing position. For instance, if they said their stop loss is at -$50, and the trade goes down to -$60, they might say they’ll hold for just a few more minutes to see if it comes back up. Before you know it, they are looking at an $80-100 loss, or worse, and they are wondering how it happened. I’ll admit that it’s extremely difficult to achieve the level of discipline to sell when you hit your max loss on a trade. Nobody wants to lose, but the best traders are great losers. They accept their losses with grace and move on to the next trade. They never allow one trade the ability to destroy their account or their career. This characteristic will keep them in business as a day trader for a long time.

The skill to take losses and not allow them to cause you to lose focus is an act of mindfulness. Our human emotions often work against us while we are in trades. The emotions of fear and greed are present in every trader. The successful traders are able to experience those emotions without acting on them. When you allow emotions to overtake your rational thought process, you run the risk of over trading, exposing yourself to unnecessary risk, and unplanned losses. It takes years of emotional conditioning to be able to sit for eight hours watching the computer screens while maintaining composure the whole time. For new traders, we encourage starting with shorter blocks of time and maintaining a constant focus on the idea of thinking like a risk manager.

**Buying Long or Selling Short**

If you are new to trading you may not be familiar with the concept of selling short. Traders who sell short are borrowing shares from their broker to sell those shares at a high price, with the intention of buying the shares back at a lower price, and profiting from the drop. When you sell short, your account will show in your open positions window, a negative position (e.g. -1000 shares). You have borrowed 1000 shares from your broker and sold them. The broker expects that you will buy back those shares. When you buy back those shares, it is called covering your position. Some traders have a short bias and prefer to trade as stocks drop. One of the risks with short selling is that if the stock goes up, you will eventually be
forced to cover your position. Since theoretically prices can climb infinitely, a trader could experience an infinite loss if they do not cover their open short position.

Conversely, when you buy stock to the long side, your maximum loss is capped to the amount of shares you purchased. The worst case scenario is the stock goes to $0. With a short position, if you short 1000 shares of a stock at $5.00, and it goes up to $100.00, your $5k position becomes a $95k loss. Throughout this book, we will discuss examples of momentum trades that involve buying stock to the long side, but these patterns could be equally applied to the inverse pattern in order to short stocks.

Whether you are a short seller or a long biased trader, it is important to know about the Short Sale Restriction (SSR). This was designed to reduce downward volatility and help prevent potential stock crashes. When Short Sale Restriction has been activated on a stock, you can only short the stock when the price is moving up. This prevents people fueling a crash by shorting as the price is dropping. SSR is turned on when a stock drops more than 10% in price versus the previous day’s close. The SSR is an example of an indicator that tells us the markets have a built-in bias for trading to the long side. There is no such thing as a long buy restriction. A stock can surge up 100% and you can continue to buy as it surges. This is one of the reasons I prefer to be a long biased trader.

It’s also important to note that shorting is not available for all stocks. The ability to short a stock requires your broker to have shares available to borrow. If they have a small inventory, you may not be able to short that stock.

What you will learn

If you have tried day trading or watched somebody else day trade, you already know the concepts are simple, but being successful at day trading is like walking a tightrope. If you watch somebody doing it they make it look easy, but when you try it, it seems nearly impossible. This is the experience most new day traders will go through. In fact, it’s the same experience I went through when I was learning to trade. I have found that the best trades are the ones that have the most obvious setups and start to work in our favor almost immediately. If I find myself in the position of holding trades that aren’t performing or I start trying to force trades to work under less than ideal setups, I usually get into trouble. I’d encourage traders to focus on the obvious setups we teach rather than overcomplicating things.

In this book we will teach you the fundamental concepts required for day trading. You will learn how to manage risk, how to choose stocks worth trading, how to identify potential setups, how to enter and exit trades, and how to manage your emotions while you are trading. By taking the time to educate yourself, you are already proving a willingness to learn, and that puts you ahead of the majority of new traders. Most new traders will trade unproven strategies and then wonder why they are losing money. While you are in training, it is important that you only trade in a simulated account. You have to practice the strategies we teach and work on building your skills before ever trading in a live account. In our live trading courses, we review the performance of all our students to ensure they are meeting the
metrics and statistics of a profitable trader. This means we evaluate accuracy rates, average losses versus average winners, how much risk they take in their trades and how they behave under stress of difficult markets or losing positions. Once students have proven they can be profitable in a simulated environment, they will be ready to switch to live trading with strict size and risk restrictions. Students in our live day trading chat room benefit from being able to trade side by side with me, and hundreds of other professional traders. We have trained the students in our community to be the best possible traders, thus increasing the overall skill of our trading group.
CHAPTER 1

WHY DO MOST TRADERS FAIL?

If you are considering a career as a day trader, you cannot ignore the statistics that show only 1 in 10 traders will be able to make a living at it. I am not saying this to discourage you from trading. We are going to talk about the reasons why most traders fail so you can avoid making those same mistakes. I believe failure is an option, one that is often chosen without the trader realizing it. Just as failure is an option, so is success, if you make the right decisions. Most traders that I have seen fail were unable to follow simple rules of risk management. We will be discussing the rules of risk management in the next chapter, but let us first talk about the reason why it is so difficult to follow the rules. Trading becomes extremely emotional when we are faced with losses and even wins. Being a day trader puts you in the unique position of having to experience a financial loss every single day. On a good day, you will win more than you lose and end the day with a net profit. But, even on the best days there will still typically be at least a few losing trades. There is no such thing as a strategy or a trader who is 100% successful on every trade they take. The best traders may be profitable every month out of the year, but it would be unreasonable and statistically improbable to expect 100% accuracy. Even investors who make billions of dollars have losing investments. This means you will have to face loss and become comfortable with it. The traders I have known who have failed were never able to cope with loss. They allowed the fear of loss to guide their trading decisions.

The hunt for the Holy Grail

If you are a trader who is constantly jumping from strategy to strategy or technical indicator to technical indicator, you may be suffering from the Holy Grail syndrome. These traders will spend tremendous amounts of time and energy searching for the perfect combination of indicators and strategies that will always give them winning trades. On the surface, it makes sense to search for the best strategy, but that’s not the motivation of these traders. Just below the surface is a deep fear of loss. It is a fear so strong that it motivates these traders to search endlessly for that perfect strategy in hopes of preventing them from having to experience any more losses. These traders sometimes work to create automated trading systems, search out other traders they can mirror trade (following trade for trade), or simply jump from strategy to strategy until they have exhausted their financial resources and give up. If you are in the group of traders hunting for the Holy Grail, I would encourage you to read this carefully: you can lose 50% of the time and still make money just as easily as you can be right 90% of the time and still lose money. You have to focus not on your percentage of success, but on your profit loss ratios.
Profit Loss Ratios

Profit loss ratios are often overlooked by novice traders. We have our students trading with a minimum of a 2:1 profit loss ratio (every trade has the profit potential of 2x the risk). With a 2:1 profit loss ratio, our students can make money and be profitable with only 50% success rate. When I work with students, the first thing I look at is their trade history. I want to know their profit loss ratios and their average percentage of success. These numbers will tell me if they have a sustainable strategy. If you can trade with a 2:1 profit loss ratio, it becomes much easier for you to succeed. Most traders who fail will be trading with negative profit loss ratios. Meaning they lose more on average than they win. Regardless of their percentage of success, they will have set the bar so high, it becomes almost impossible to succeed. The odds are stacked against them. From a purely statistical standpoint, a negative profit loss ratio of 1:2 (you lose 2x what you win on average) is an unsustainable strategy unless you maintain 75% success rate. After years of trading, I can assure you that maintaining a 75% success is not easy. Often times the failed traders will exit the market having never realized they were destined for failure because they did not learn about the profit loss ratios required in order to be profitable.

Profit Loss Ratio Statistics

- 2:1 Profit Loss Ratio = 33% is your Break Even before commissions
- 1:1 Profit Loss Ratio = 50% is your Break Even before commissions
- 1:2 Profit Loss Ratio = 66% is your Break Even before commissions

Fear of Loss in Trading

Fear is a natural emotion, but it’s difficult when your job requires you to experience fear on a regular basis. Many traders will experience fear in a number of ways. The most obvious is the fear of financial loss. We acknowledge that investing in the market and day trading in particular is high risk, but when we are faced with the decision to take a trade and expose ourselves to a potential loss, fear can begin to guide our decisions. A less obvious form of fear is the fear of missing a big move in the markets. If you suddenly see a stock start to jump up on what might appear to be breaking news, or you see a reversal begin to take shape, you may feel inclined to jump into the market out of fear of missing a potential winner. The fear has guided your decision and led you into an unplanned trade. You may have purchased at a price too far away from your stop or taken more shares than your risk tolerance allows. In a split second you made a decision and broke your rules. The result when these trades go badly will be a larger loss than your strategy and rules allow for. When I speak with a trader about a massive loss, they often say “it happened so fast.” They made a quick decision and it was the wrong decision. In reviewing my own trading performance, my biggest losses were spontaneous trades I jumped into on an impulse. I see the markets starting to move and jump into a stock without fully analyzing my risk. Unfortunately, when emotions are guiding a trader’s decisions, big mistakes are common.
We will discuss techniques for managing emotions while trading, but first let's review a few other examples of erratic trading brought on by emotions.

**Holding Losers Too Long**

As you can see, our fear of loss in trading can manifest itself in some unusual and outright counterproductive ways. Many beginner traders and most failed traders will experience the tendency to hold their losers too long and sell their winners too soon. The driving emotion that leads to this behavior is a fear of loss. Why does a trader hold losers too long? It is because a trade is not a loss until you have hit the sell button. There is always the chance that the price could pop back up until you hit the sell button. The fear of making the loss real keeps you in the trade because it makes you think about finding a way to turn the trade around instead of just taking the loss and moving on to a different trade. The reality is that small losses are not a big deal, but a trader in an emotional state does not think that way. Sometimes traders will make a bad trade worse by averaging down, adding shares at a lower price to reduce their cost basis. This typically results in bigger losses when it is not part of a proven strategy that involves scaling in and out of trades by averaging. I have worked with traders who set $200 max losses, and on a trade when they were down $200, instead of simply cutting the loss, they decided to add more shares so they could trade out of the loss. These trades would often end in losses of -$1000 or more. In hindsight, it is easy to say the right thing to do was simply cut the loss at -$200 and follow the rules you made for yourself. Unfortunately, in the heat of the moment, emotions take control and your rational thought processes get thrown out the window. In those cases, the fear of loss actually resulted in the trader taking bigger losses than the rules of trading would allow for. This is the exact opposite of what you want! The most important skill for a new trader to understand and adopt is the ability to cap their losses.

**Selling Winners Too Soon**

If you enter a trade that had a good profit potential and it fit into your trading strategy, the last thing you want to do is sell the trade before it has had a chance to work. If you are up 10 cents on a trade that has the potential to make 50 cents, there is no reason to sell it. Why do so many traders sell their winners too soon? It is because the fear of loss has guided their decisions. It is the fear of the small winner turning into a loser that convinces us to sell the trade too soon. Just as a loser isn't real until you hit the sell button, a winner isn’t real until you’ve hit the sell button and locked it up. In the short term we feel happy to have locked up some profit, even if only a small one, but the big picture is that you are forming a habit of capping your winners. To be a successful trader you have to cap your losers and let your winners run. You will want that occasional big winner, because those will tide you over during periods of slow trading. A trader that sells winners too soon and holds losers too long has the habits of a failing trader. To avoid failure these traders must address how their emotions are influencing their trading. Instead of selling the full position when sitting on a small profit, I combat that urge by selling a partial position and adjusting my stop. This means I will walk away with a small profit (not a loss), but still have a position in the trade to let it realize its full potential. This is called scaling out. Scaling out is a great trade management method of keeping partial positions with a good
cost average. To maintain discipline, I refuse to sell my final position until I get stopped out by a valid exit indicator.

**Embrace Loss as a Part of the Business**

Instead trying to search for the Holy Grail, or give in to the urge to hold losers and sell winners, we must simply accept loss as part of the business of day trading. We cannot fight it. Every day trader will experience losses. Becoming a good day trader means being a good loser. The trick to being a good loser is learning to cap your losses at a set dollar amount and sticking with it. The hard part is holding yourself to the rules. Day trading requires a tremendous amount of discipline and self-control. It is a job that will challenge you in more ways than you would imagine. In the example of the trader with a 90% success rate that was still losing money, he failed to cap his losses. Being that type of trader is a choice. By teaching you about profit loss ratios and the importance of capping your loses, we are empowering you to make the choice to be a successful trader.

**Discipline as a Practice**

In our trading courses, we spend a great deal of time working with students to help them improve their discipline. Many of our students found us after taking other trading courses and finding themselves still stuck in a cycle of poor trading habits, trading losses, and disappointment. We realized that textbook concepts of trading, which are important and will be covered later on, are not enough. Understanding fundamental concepts of trading on their own are not enough to be a successful trader. You must also think and act like a successful trader. This means selling losers quickly and holding partial positions in your winners as long as possible. In order to help our students improve their ability to be disciplined, we require a min of 30 minutes of exercise and 15 minutes of meditation every day. I use exercise and meditation to help train my mind to cope with stress. By forcing myself to do these two things every day, I am practicing discipline. In the moment when I am in a trade and need to make a hard decision, I need to be able to fight the urge to sell the winners too soon and hold the losers too long. By practicing discipline in others areas of our life, we strengthen that muscle memory and improve our ability to maintain composure while trading. Practicing discipline is a way of conditioning our minds to become accustomed to a feeling of discomfort. Rather than taking steps to alleviate the feeling, we can train ourselves to withstand it. When we sell a winner too soon or hold a loser too long, we are allowing the uncomfortable emotion of fear to guide our decision. Most of the successful traders I know have strict exercise regimens because it helps improve their trading performance. We know it is impossible to block out the emotions such as fear, they will still surface within every trader. However, the difference between winning traders and losing traders is that winning traders will not subject their strategy to the emotion. They recognize the emotion and allow it to exist without acting on those feelings. This is a critical step in the emotional development of any trader. I would encourage you to begin journaling your emotions while trading. The first step to changing your behavior is becoming aware of your emotional patterns and their impact on your trading performance. As we discussed earlier, you can have a deep understanding of all the textbook concepts of trading, but still fail to succeed because you have not achieved
the emotional training to be a trader. We focus on providing our students with a well-rounded education that includes both textbook and emotional development.

It is important to remember that discipline is not like learning to ride a bike or learning to swim. Discipline is very much like a muscle that can be strengthened when exercised or atrophy when ignored. Even after years of trading, I still find myself occasionally giving in to my instinct to chase a stock for fear of missing the move, to sell a winner too soon, or hold a loser a little too long. Every day when I trade I have to fight against my natural instincts. Unfortunately many of our natural human instincts do not encourage healthy trading patterns. If I had to guess I would say almost all successful traders have spent thousands of hours training their minds to fight against counterproductive impulses. I am sure there are some traders that have a natural aptitude for the mindset required to be profitable, but I believe the majority of us have to really work at it. It took me years to become successful, and looking back I have realized it was because of the emotional obstacles that stood in my way. I had a great concept of stocks, chart patterns, basic strategies, but I kept falling into the cycle of big losers and small winners. It took a long time before I developed the self-awareness to realize what was causing those actions. My hope is that by reading this, you will avoid the years of trial and error it took me to learn these important lessons.
One of the first things I told you was that day traders are hunters of volume and managers of risk. In this chapter we are going to discuss risk management. As an aspiring day trader, you already understand that day trading is one of the riskiest investment techniques. The reason traders choose to day trade instead of make more traditional, longer term investments is because day trading can produce much larger gains in a faster time frame. Day trading is one of the fastest ways to grow a small account, when it is done properly. The problem is most people will not trade properly. Successful traders can utilize $25k accounts to produce over $50k per year, or 200% in returns. It would not be realistic, however, for a trader to utilize a $250 million account to produce $500 million per year. The markets typically do not have the liquidity to support a trader entering or exiting a multi-million dollar position within minutes, but positions of tens of thousands or even hundreds of thousands of dollars can be executed almost immediately. This allows day traders with accounts under $1 million and as low as $25,000, to utilize leverage and high speed trading techniques to produce large percentage gains. When a trader reaches a point where they are managing more money than they can efficiently day trade, they would typically begin to branch out by adding longer term investments to diversify the portfolio.

While understanding that day trading is one of the highest risk trading techniques, the potential for a big reward captures our interest. We can acknowledge that within the realm of day trading, there will be relatively higher risk day trading strategies and relatively lower risk day trading strategies. Our goal is to develop a trading strategy to maximize profit potential while taking steps to minimize risk. Every time you take a trade, you must evaluate the risk of the trade and weigh that against the reward. Often times our judgment can be clouded by our emotional state or previous trading experiences. If we recently experienced a loss, we may decide to take more risk on the next trade to compensate for the previous loss. Or a more conservative trader may decide to reduce position sizes or even skip good trade opportunities because the last time they traded that setup they lost money. It takes a heightened level of self-awareness to recognize when we are making clear risk reward decisions and when our judgment is clouded. This is a skill that is learned over time. You can develop a sense of mindfulness by journaling while you trade and then reviewing your notes after the market closes.

Different Types of Risk

When we talk about risk there are a few different types of risk you need to understand. As day traders we are primarily concerned about the distance between our entry and our stop (the price where we will sell for a loss). Your stop loss should be based on a recent support or resistance area on the chart and should always fall within your maximum dollar loss amount. The majority of losses we experience will be when a trade drops down and hits the stop price.
The second type of risk we have to be mindful of is the volatility in the market. As day traders we love volatility, but it also presents a risk because extremely volatile markets can result in larger losses than we may have originally planned for. Since we know that there is a spectrum of risk in day trading, we choose to avoid day trading during moments of unpredictable volatility, such as breaking news. When news is realized, individual stocks or the market at large can trade in a very wide and volatile range. Instead of jumping into the market during that peak in volatility, we wait for the dust to settle before determining a potential trade opportunity.

The third type of risk is your exposure risk. Exposure is calculated by multiplying the share price by the number of shares you are holding. As an investor, you have to factor in exposure risk since positions are held for a long time. An investor typically will not allocate more than 10% of the portfolio to any single stock. In contrast, day traders who use leverage may experience particularly high levels of exposure risk. While this level of risk has to be carefully monitored, most day traders are able to mitigate that risk by holding shares for short periods of time.

**Stock Halts**

A type of risk that can be a nightmare for day traders using large positions are stock halts. Trading can be halted by the exchanges at any time. There are a number of different types of stock halts. There are market wide stock halts which only occur when there is a technical glitch or some type of computer errors in the exchange. These halts can last for a few minutes, hours or potentially longer. These are rare. The more common stock halts are volatility halts and halts pending the release of material news. Anytime a stock is halted, it can reopen at a much different price. The risk is that a stock could reopen far below your maximum loss amount. We can take certain steps to avoid halts by understanding what causes halts. The market has created what are called circuit breaker halts. If a stock rises or falls more than 10% in a 5min period, the stock can be halted for five minutes. This is a volatility pause to give traders a chance to get their bearings, analyze news, and slow down. This is a measure to prevent flash crash situations. In volatile markets, these types of halts can be fairly common. Often times if some type of news about the company is leaked it can result in a rapid move and then a volatility halt. When stocks are halted going up, they often open higher. Conversely, when they are halted going down, they often open lower. When stocks are halted pending news, it means the company is releasing significant, material news. Once the news has been released, the stock will be scheduled to reopen. If the news is bad, the stock can open significantly lower. This is one of the greatest risks in trading. Stocks susceptible to being halted pending news include stocks surging up rapidly for no apparent reason. In these cases it is not uncommon for the company to issue a statement regarding the price action, or to address the rumors that may be causing the price action. Although stocks can be halted at any time pending news, news is typically released when the market is closed.

Another type of stock halt which is common with penny stocks, but not as common with higher priced stocks is a halt pending government investigation. This is typically the result of a stock being used for market manipulation and fraud. Stocks halted pending an investigation can remain halted for weeks or even months.
As day traders, we have to be mindful of the potential for stock halts and limit our positions on stocks that are at risk for being halted. High risk stocks include penny stock companies and stocks trading on unconfirmed news that has not been released by the company itself. Despite our best efforts to avoid being caught in a halt, it can happen. This is one of the reasons trading on margin can be so dangerous. In the event you are caught in a halt and the stock reopens down 20%, if you were trading on margin, it could result in a massive loss or even a margin call from your broker.

**A Day Traders Statistical Advantage (2:1 Profit Loss Ratios)**

When I was a new trader, I would take extremely large positions without any real understanding of the level of risk I was taking. I would enter trades without a predetermined max loss, and if the trade went against me, I would become paralyzed by fear. I would be unable to think or make a decision as I would watch the loss get bigger and bigger. The first mistake was entering a trade without first outlining the risk versus the reward. As an example, I would often buy stocks as they approached whole dollar levels. So I might buy 1000 shares of a stock at $8.90 with the target of selling it at $9.10 for 20 cents profit. Unfortunately, when the stock would pullback, I would often hold until it broke below the nearest half dollar of $8.50. In this example, I would be risking 40 cents to make 20 cents. This is a negative profit loss ratio which requires a 66% accuracy rate in order to break even before commissions. This is not a sustainable ratio, especially for a new trader. When I was a new trader I did not know anything about profit loss ratios, and I continued to make these uneducated trades and then wonder why I was losing money. Using a 2:1 profit loss ratio, my proper stop on that trade should have been $8.80 instead of $8.50. With a 10 cent stop and a 20 cent profit target, I could justify taking that trade. That means my proper stop was only 25% of the loss I was taking as an untrained trader. That’s a huge difference! This meant that by using proper risk management, I could potentially reduce my losses on those types of trades by over 75%. It is extremely important to understand, regardless of your strategy or the setups you trade, that every trade has the potential to double what you are risking. If you do not have the potential to win twice as much you risk, you should not be taking the trade. By simply understanding profit loss ratios and the huge statistical advantage of a 2:1 profit loss ratio, you have set yourself ahead of the majority of new traders.

**Data Mine Your Trade History**

If you are not already tracking all of your trades in an excel document, I suggest you start doing this now. The information you want to track is the type of setup, time, symbol, price, entry, exit, amount made, amount lost and notes. I have been tracking all of my trades for years and have the benefit of thousands and thousands of trades available for review. I can sort my data based on the strategy, the profits or losses, or the time of day. I dig into the analytics of my trading performance to get a deeper understanding of where I have strengths and where I need to make adjustments. If for example you recognize that the majority of your profits are in the morning, and your biggest losses are in the afternoon, you can begin to become more mindful during afternoon trading. You can also keep track of your profit loss ratios on a monthly basis and always work to improve your statistics. If you trade 500,000 shares per month and you can improve your
average profits by 1 cent per share, it will increase your profits by $5,000 per month. This shows you that very small adjustments in your statistics can result in huge differences at the end of the month. This also highlights the tightrope traders must walk. The difference between success and failure can be the matter of a slight adjustment in your ratios. The part of your profit loss ratio that is easiest to control is your max loss.

**Capping your Losses - Be good at being wrong**

When I speak with a trader who recently experienced a large loss, I like to spend time reviewing the trade that resulted in the loss. I always begin by asking the trader what their risk was when they entered the trade. Rarely does a beginner trader enter a position intending to risk as much as they ultimately lose. That is the first mistake. Every time we take a trade, we must know how much we are risking. This means understanding the logical place to sell the stock for a loss if the trend or the setup fails. Before getting into the chart patterns and the definitions of exit indicators, we will first say that we stop out of all trades when they hit our max loss. Unfortunately, many traders enter position without a max loss in mind.

Every trading plan should have a max loss per trade and a max loss per day. We recommend students set their daily max loss at their daily profit target. When they have a $200 daily profit target, if they are down $200 on the day they shut down their computer and walk away. Although it is difficult to accept defeat, it is far more important to realize that once you have exceeded your max loss, your judgment is almost guaranteed to become compromised. It is always best to walk away instead of attempting to trade in a compromised emotional state. Just as we have a max loss per day, we also have a max loss per trade. I typically set my max loss at about 25% of my daily goal. If I take a trade and the market suddenly turns against me, I take the loss. Over the years of working with students, I have found that some students are very good at taking their losses, while others struggle to press the sell button. Some even turn short term day trades into long swing trades. If you are in the group of traders who frequently find themselves down beyond your pre-determined max loss, I would consider setting automatic stop orders with your broker. If the price falls below the stop price, your order will automatically execute and you avoid having to press the sell button yourself. Even though it can be difficult to hand over this aspect of trade management to the computer, it is sometimes the best technique for students who struggle to take the losses early. When you are trading, it is important to remind yourself that regardless of how you traded last week or last month, today is your opportunity to prove to yourself that you can follow rules and stick to your trading plan. If you want to succeed as a trader, it is paramount that you are able to hold yourself to the rules of max loss per trade and max loss per day. Ultimately, this means walking away from the computer when you hit your max loss for the day, even if it is difficult.

Day trading is a career where you can make a catastrophic mistake, and then keep trading moments later. You could take a 30,000 share position, lose $15,000, and then do it again five more times in a row. In just one day and a handful of trades, you could easily blow up your entire account. This type of event is the result of emotionally fueled trading. By forcing yourself to walk away after hitting your max loss, you can avoid the temptation to fall into a cycle of increasing
your risk and trying to make back your losses. In other careers, race car driving for instance, if you crash your car into the wall you are done with the race and have to wait until the next race. The very nature of that type of job gives you a period of time to reflect on the mistakes you made that resulted in the accident. Day trading does not come with these built-in time out periods after we make a mistake. We have to build them into our trading plan because they are extremely important for our emotional development as a trader. They are what prevent us from making mistakes when we are in a heightened emotional state.

Balancing your Risk

If you take 10 trades in a day, and you risk $100 on the first nine trades and then risk $1,000 on the 10th trade, it doesn’t matter if you have a 90% success rate when you lose on the last trade. You will be a losing trader. This is an element of risk management called balancing risk. You never want to have one trade weighted so heavily with risk that it has the power to erase previous winners. Even if the final trade had the 2:1 profit loss potential (risking $1,000 to make $2,000), it is a poor decision because the risk of that one trade far outweighs your average risk per trade. Many traders, including myself, will adjust our risk per trade throughout the day based on our performance and to adapt to greater market conditions. This is a common practice used to increase profits on days when trading is good and reduce losses on days when trading is difficult. The difference is that I am adjusting risk in smaller increments, so the impacts of winners or losers will not have a strong effect on my overall performance. If I risk $100 on the first six trades, I may decide to increase risk to $150 or decrease risk to $75 on seventh, but I would not make a drastic change to my risk parameters in the middle of a trading day. Many beginner traders will have a great day until they decide to swing for the fences and take a high risk position on what they think is a perfect setup. If they lose on that high risk trade, they will give back their entire profits from the day and potentially go into the red. This is a disappointing financial loss, but what is even worse is the loss of confidence and the impact that it has on your emotions. This is the type of behavior that can quickly cause a trader to fall into a cycle of emotionally fueled trading known as revenge trading. Trying to quickly make back the losses by taking increasingly risky trades. To avoid this situation entirely, a trader must balance their risk across all trades, so if that final trade is a loser, it does not ruin their day or their psychological control over future trades.

Gamblers think about Profits, Traders think about Risk

The stock market is a place where all different personalities come together to trade. You will find long term investors, institutional investors, activist investors, retail traders, and you will also find gamblers. Unfortunately, day trading has a negative connotation to some who consider it the equivalent to gambling. Any full-time trader understands that that is far from reality. A trader makes decisions based on a strategy that has historical data to support it. The only way to make a career out of trading is to understand your risk on every trade and to follow the rules of your trading plan. But, there will always be those who simply gamble with their trading accounts by taking reckless positions in the search of huge profits. If you want to gamble, you might as well go to a casino. The odds of having a lucky trade and making a fortune in the stock market are extremely slim. You cannot base your strategy or your career on luck. Greed is a powerful
emotion that, a lot like fear, can allow you to throw out your rational thought processes. If you ever find yourself feeling that emotion of greed kicking in, it is a good time to turn off your platform and walk away. Since we are trading with and against the best traders in the world, if we are not able to trade at our peak performance levels, we should not be trading.

**Add to Winners not to Losers**

Although there are many traders and investors that utilize a strategy of scaling in, adding shares at various prices to get a good cost basis, I avoid adding to stocks that are below my entry price for day trades. If I purchase a stock at $10.00 and it drops to $9.50, I could double my position and adjust my cost basis to $9.75, but then I am adding to a losing position. If it drops to $9.25, I will experience a loss double than the initial loss if I had simply sold at $9.50. In all my years of trading, I have found the best trades work almost immediately. Occasionally, I will get into a trade and it will nearly touch my stop and then turn around and end up being a winner, but more often, those trades turn into losers. Instead of adding to a losing trade, I prefer to cut the loss and move on to the next opportunity. When you focus on adding to losers, you risk making the loss bigger and you miss the opportunity to find a better setup.

In contrast, if I buy a stock at $10.00 and it goes up to $10.50, I may double my position and have a new cost basis of $10.25. If the stock surges up to $10.75 or $11.00 I’ll make more with the increased position, and if it the stock drops back down to $10.25 or $10.00, I can sell for breakeven or for a small loss. Adding to winning trades gives you the potential to have big winners, while adding to losers gives you the potential for big losses. Since we want to focus on capping our losses, we need to avoid adding to losers.

**Stock Picking versus Risk Management**

This is a good time to remind you that you can be a profitable trader with an accuracy rate of 50% or less, as long as you have a good profit loss ratio. Being profitable is not about being right on every trade, it’s about capping your losses and taking trades that provide the opportunity for winners that will exceed the losers. Early on I made the example of the trader who loses money despite a 90% success rate. This trader may be a great stock picker, but his lack of risk management results in a losing strategy. Picking good stocks is important, but clearly it is not as important as managing your risk on every trade. I say this to remind you to focus first and foremost on your risk and your max loss on each trade. In the next chapter, we will discuss stock selection as an extension of risk management. By trading the right stocks, we can improve our likelihood for success especially when we combine risk management techniques.
CHAPTER 3

STOCK SELECTION - CHOOSING THE RIGHT STOCKS TO TRADE

In the last chapter we talked about the importance of risk management. We will continue to touch back on the theme of risk management and emotional conditioning throughout this chapter. By trading only the strongest stocks and applying the principles of good risk management, we can give ourselves a huge statistical advantage for success. There are thousands of stocks available to trade each day, but only a few that are actually good candidates for day trading. There are so many that a new trader can quickly become overwhelmed. Often, new traders refer to a watch list of companies they are familiar with. While this may be suitable for some longer term investment strategies, it is not appropriate for day trading. For day trading, there are usually only a small handful of stocks each day that I would consider the right stocks to trade. We have a very specific list of requirements for what makes a stock worth trading on any given day. Most day traders will trade hundreds of different stocks each month, rarely trading the same stocks for more than a few days at a time. The reason we trade so many different stocks is because we are only interested in stocks with volatility and heavy trading volume. Stocks trade on heavy volume because they have a high level of retail interest. High levels of retail interest are typically driven by news, but are sometimes driven by stocks trading at extreme highs or lows. If you look at almost any chart, you will see a few days where the stock traded on extremely high relative volume. Those days are often accompanied by a big gap on the chart. Those are the days we would be most interested in trading that stock. I often remind our students that on any given day, there is a stock having a once in a year event. As a day trader, we have to be willing to jump from stock to stock in order to find the type of price action that can result in at least 5-10% intraday moves.
Chart of a stock showing the days with big volume. Those were the days this was a stock in play for day traders.

**Stocks must have Volume**

As day traders, we look for stocks that are trading on above average volume. On any given day, algorithmic trading computers account for more than half of the volume in the market. If we see a stock that is trading on below average volume, it is safe to assume that day traders have very little interest in that stock and that the majority of the volume is controlled by high frequency trading computers. These trading computers will buy and sell shares which will result
in volume and chart patterns. The problem for day traders is, that when we look at these charts and recognize a familiar pattern, we can be fooled into thinking it is a good buying opportunity. A good looking setup is never complete without above average volume. We need above average volume to confirm that thousands of other traders are watching this same chart. When we are watching a setup forming and we expect a breakout to the upside, that breakout is the result of thousands of traders all buying up shares. In fact, we are one of those buyers! That means as day traders we should only trade stocks other people are trading.

There are a few techniques for making sure we are trading the right stocks. The most obvious technique is to simply look at the daily volume. If a stock trades an average of 500k shares per day and has already traded 2 million shares, there is above average interest. The other option is to use stock scanning software to scan for stocks with high relative volume. The relative volume for the day is translated into a number, a ratio. ‘1’ is average and ‘2’ being 2x average. Stocks can trade on any multiple of relative volume, so anything above a ‘2’ is interesting.

The Hunt for a Catalyst

Every morning starts the same way for me. I look at the stocks trading on heavy volume in the pre-market session. This is often an indicator of early retail interest that will carry over into the trading day. I review each of the stocks trading on high volume to see if there is a catalyst. A biotech or pharmaceutical stock that has just released results from a clinical study could be interesting, or a stock that just reported a big earnings release would be worth watching. I don’t put a tremendous amount of energy into researching the catalyst beyond confirming there is a reason that the stock is moving up or down. Even the best news releases sometimes result in poor price action, so I remind myself to always follow the chart and not the fundamentals of the catalyst. Investors focus on fundamentals, but traders focus on chart patterns and technical analysis. We have to remember that we are traders and keep our attention on the chart patterns at all times.

When I’m reviewing pre-market leaders, it is important to check for buy outs. When a stock has been bought out overnight it will trade the next morning at the new price, and typically there will be a huge amount of volume as people buy and sell shares they have been holding. The problem is that since the stock has been bought out, the value of the stock has been determined. If a buyout is priced at 4.00 for example, the stock will trade almost exactly at 4.00 all day long. There is no reason to short the stock or buy the stock knowing the value of the company has become fixed at 4.00. The reason these stocks trade on high relative volume is because long term investors sell their positions at the buyout price. Anytime we see a buy out on the gap scanner we disregard it and move on to the next stock.
When we are reviewing the news for a stock, it is important to think about the quality of the source. News released directly from the company, a competing company, majority shareholders, top tier analyst firms or government agencies will typically be the strongest. This will include earnings results, sales contracts, buyout offers, stock buyback programs, FDA approvals, government investigations, patent approvals, etc. News released from unknown analysts or unconfirmed sources should always be considered suspect.
It is important to be familiar with former runners. A former runner is a stock that has made huge intraday moves in the past, or has made parabolic moves on the daily chart. These are stocks that made moves in excess of 100% over a few days. If we notice a former runner reporting news, it is worth keeping a close eye on it. We already know the stock has the potential for home run type breakouts, so it is possible we could see that type of move again under the right conditions. Former runners will typically have all the characteristics of a good stock. They will have that perfect combination of a low float and strong breaking news.
Chart of Low Float Stock moving 10,000% in 3 weeks.

Low Float Stocks

All stocks have a float. The float is the number of outstanding shares available to trade on the open market, not including shares held by insiders and the company. The float is the supply. When a stock makes its initial public offering (IPO), they release a set number of shares into the market. This becomes the float. At any time, a company can begin a stock buyback program to repurchase the shares on the open market. The result of a buyback program will be a decrease
in float and typically, an increase in share price. Alternatively, a company can increase their float by selling more shares on the open market through offerings. Selling more shares will increase the float and decrease the value of the shares. Secondary offerings are a form of dilution used for the purpose of raising more capital for the company. This is where the concept of supply and demand in the markets comes from.

Day traders will always want to be aware of the float size of the stocks they trade. If a stock has a great catalyst and a very low float, the supply and demand effect can cause 100% intraday moves. In contrast, a stock that has a very large float is unlikely to result in more than a 10% intraday move, even with the best news. By understanding the float, we can recognize the potential of a stock. Whether we are looking at a pre-market runner or reviewing a stock that just popped up on a scanner mid-day, the float is always going to be one of the first things we check. As day traders, we hunt for volatility, which means we prefer to trade lower float stocks. Investors looking for less volatility and less risk may look for companies with a larger float. This again highlights the unique skill set required for different market participants.

I prefer to trade momentum stocks with a float of under 50 million shares. Stocks with a float of under 10 million shares will produce some of the biggest percentage gainers. There are days when a stock with a 5 million share float will trade more than 20 million shares. That means the entire number of outstanding shares has changed hands four different times. When stocks trade the entire float of available shares, it is commonly known as float rotation. When we see stocks that move 100%-200% intraday, they will almost always experience at least one full float rotation.

When I trade reversals, I will trade any float. A reversal setup that has a great 5min chart with a strong daily chart can be a good candidate regardless of the float. The target on these types of trades will typically be a move back towards the open price. Stocks with a float of more than 500 million shares will typically be less volatile and less interesting for most day traders.
Chart of a several follow through days. This is when momentum continues over several days. A follow through day is when a candle breaks the previous days high.

**Follow Through Days / Continuation**

When I review the stocks gapping up each morning, I also take note of stocks that were extremely active in the previous trading day. Sometimes these stocks will have the potential to carry over momentum from the previous day. Multi-day runners are common among stocks that have released really good news and also have strong daily charts. The important price level to watch is the previous days high and low. I only trade when the prices make a fresh breakout versus the previous days high. Typically, the fresh breakout will bring in a new set of buyers and
force short sellers to cover their open positions. For this reason, I keep follow through stocks on close watch for a potential breakout.

Chart of an inside day. The inside day was the small green candle after the large red candle.
Inside Days

In contrast to follow through days where we look for continued momentum and a fresh breakout, an inside day is when a stock trades completely inside the previous days high and low. I avoid trading a stock on an inside day because there is no reason to expect significant momentum or price action. Inside days will often follow days of big volatility. Sometimes, stocks are able to break out over the previous days range and form a follow through, but until that happens, I stay on the sidelines.

A stock chart showing the power of breaking mid-day news that created a 20 point move. The stock retraces to its moving averages before finding support and moving back up.
Breaking News & Intraday Extremes

In addition to extreme stocks that are former runners or have low floats, there are also going to be stocks that become irrationally weak or strong in the middle of the day. The midday strength or weakness can sometimes be attributed to breaking news. When news breaks in the middle of the day, it can cause a stock to spike up so rapidly that shares will be halted by a volatility halt. A stock spiking 10% in five minute can trigger these halts. It is not uncommon to see a stock spike up and get halted after a press release. These stocks are experiencing an intraday extreme, and if they are also trading on high relative volume, they become a stock worth watching for a trade. We will apply one of our trading strategies, covered later in this book, to these breaking news setups. In addition to stocks surging on breaking news, we also have stocks that will begin to trade at intraday extremes for no apparent reason. As long as these stocks are trading on high relative volume, they become a stock in play, even if we do not have an obvious catalyst. We would prefer to trade stocks with a clear catalyst, but since we know the market can be irrational, we do not want to discount any stock that is moving with sufficient volume.

Stocks Selection as Risk Management

Trading the right stocks can help reduce your risk as a trader. The majority of stocks in the market are not suitable for day trading on any given day. As day traders, we are only interested in the highly active stocks each day. This means we must be quick to adapt to changing markets. Some months we trade pharmaceutical stocks while other months we trade technology stocks. The market is constantly changing, but we can rest assured that every day there will be a stock trading on heavy volume due to news. Regardless of bearish markets or bullish markets, there will always be volatility in the market and that will keep day traders in business. As hunters of volatility, we begin each day with a review of the pre-market movers and continue through the day with a sharp eye for stocks coming in and out of play. As you continue reading, you will begin to learn about trading chart patterns on the right stocks while applying good risk management principles.
CHAPTER 4

INTRODUCTION TO CANDLESTICKS

As day traders, we spend the majority of our time looking at intraday stock charts, but it’s important to remember that every stock is trading in the context of its daily chart. This means that although we will take trades based on intraday chart patterns, we will always keep an eye on potential support and resistance levels on the daily chart. In this chapter, we will work through setting up your basic stock charts and teach the basic chart patterns we look for on daily charts, with an emphasis on support and resistance levels. Later, we will dive into the intraday patterns.

A stock chart is a visual representation of the price history of a stock. Stock charts provide us with a context so we can understand the current price of a stock relative to previous prices. The most commonly used charts for day traders are candlestick charts. If you are looking at a daily chart that includes the last 90 days, you will see 90 candlesticks. On a daily chart, each candlestick represents one day of trading, while on a 1min chart, each candlestick represents one minute of trading. Charts can be set in almost any time frame a trader desires, but the most common time frames are daily charts, 60min charts, 15min charts, 5min charts, and 1min charts. I personally use a daily chart, 5min, and 1min chart to find my entries.
A single candlestick provides us with four pieces of information about the price action of a stock within that time frame. The four pieces of information we learn from a candle stick are the high of the period, the low of the period, the open of the period, and the close of the period. The center of the candle is called the real body, and the lines that go up to the high and down to the low are called the upper and lower candle wicks, or shadows. In addition to the four data points, we can also draw conclusions about the market sentiment based on the shape of the candle. Multiple candlesticks lined up together can begin to form familiar chart patterns, including flags and wedges.

Doji Candlesticks

A doji candlestick has a very small candle body, meaning the open price and the close price are nearly the same. We can infer from this candlestick shape that there is a momentary standoff between buyers and sellers. If the candle occurs on heavy volume it tells us there is a battle at that price. Sometimes a doji will also have a long upper or lower candle wick. This tells us the price suddenly moved up or down, but quickly returned to the same price as the open. The means the move was not sustained. In general, doji candles represent some degree of indecision in the market. When a doji candle occurs at the top of a very strong move of 5-10 green candles, the indecision reflected in the candle shape can signify a potential reversal. Doji's that occur during a period of sideways consolidation are less important to us because sideways price action already reflects indecision.
Bottoming Tails and Topping Tails

Candles at the top or bottom of a long trend that have long upper or long lower wicks are considered topping tail or bottoming tail candles. They can signify a potential reversal. The shape of the candle indicates a continuation of the trend, followed by a quick reversal with a close around the middle or low of the candle’s range. A doji candle that has long upper or lower wicks is one of my favorite indicators of a potential reversal. I rely on these candlestick patterns for timing my counter trend entries.
Hammers and Inverted Hammers

Like bottoming tails and dojis, a hammer candle really only has significance when it occurs in the context of a long downtrend. Hammer candles will always have small bodies and long lower wicks that are larger than the bodies. It is often said that a hammer candle at the bottom of a downtrend is hammering out a new base. The long bottom wick indicates a selloff in that period where the buyers quickly took the opportunity to jump in and push prices back up. This does not always mean the trend will reverse, confirmation of the reversal will come when the next candle breaks the high of the hammer. This is called a candle over candle confirmation. We will discuss the entry and exit indicators in detail a bit later.

An inverted hammer only carries significance when it occurs at the end of a long uptrend. The inverted hammer will have a long topping tail and a small real body. The long topping tail indicates a surge of buying that was quickly reversed. This suggests indecision and a battle between buyers and sellers that was won by the sellers. When we are watching stocks trading in real-time, we can see the formation of the candle wicks. They often appear as a final burst of volume and then a quick and powerful snap back up as the reversal begins.
Long Body Candles

The final candle stick shape we will discuss are long body candles. A long body candle that is green, opens and surges up without ever going down. These candles close at the high and are indicative of extreme bullish sentiment. As day traders, we always want to be holding a stock while a long body candle is forming, but we never want to buy after a long body candle. If we buy at the top of a long body candle we are chasing a large move. Instead, we need to wait for a pullback opportunity if we want to trade with the trend, or wait for a reversal indicator if we want to short the stock.

A red long body candle shows extreme bearish sentiment as the candle opens and sells off for the entire candlestick period. If we are in a short position during the formation of a long body candle, we may want to consider covering part of our position into the flush to the downside. After a series of several long body candles in a row, there is a high likelihood of a bounce. Anytime I miss a move, whether to the upside or the downside, I wait for a good reversal indicator. We will discuss the counter trend trading strategies later in this book, but if you can picture three red long body candles in a row that end with a bottoming tail candle, that is the type of reversal pattern we are going to be hunting for. If that bottoming tail also coincides with a daily support level, we may feel confident taking a candle over candle entry on the first candle to make a new high following the selloff.
Image of Long Body Candles (these candles can be either red or green).
As we setup your charts we are going to focus on keeping things simple and clean. Adding complexity to your charts will create unnecessary confusion. There are thousands of technical indicators available to download and install on your chart, but I think they are predominantly overrated and unnecessary. Technical indicators are almost always lagging indicators. They are a middleman between you and the price action. A technical indicator is a formula that calculates current price action and then tries to place the price in a context in order to help predict future price action. The problem is, that by the time a technical indicator is confirming a reversal, the reversal is already well underway. Like with price action, a trader has to learn to anticipate the move before it actually happens. We can either learn to read the subtle cues of an indicator or focus on the candle sticks. I decided I would prefer to become an expert at reading candlestick shapes and patterns than the moves of a technical indicator. We are cutting out the middleman and going straight to the price action. The hunt for the perfect combination of indicators that will give you that added measure of confidence can become dangerously close to the hunt for the Holy Grail. I would encourage you to avoid going down that path and instead, focus on candlestick patterns as your primary source for finding setups. In this chapter, I will introduce you to the technical indicators I use on a daily basis. We will discuss the detailed application of these indicators later in the book.
When I am looking at a stock, I always have three charts that I am watching. The 1min, 5min, and daily charts. The 1min and 5min charts are zoomed in to show just today's price action, but the daily chart will usually show the last 3-6 months depending on what I am looking for. On the daily chart, I will draw out my horizontal trend lines to mark out windows and triggers. On the 1min and 5min chart, I will draw support and resistance lines throughout the day. I find the visual presence of the lines helps me make decisions about whether a trade is worth taking and how much room for profit it might have.

You will notice that my charts are very clean. I use a few of the most common technical indicators, but I try to keep it really simple.
Chart of Moving Averages (Gray is 9 EMA, Blue is 20 EMA, Red is 50 EMA, Purple is 200 EMA).
Moving Averages

Moving averages are one of the most important indicators I use as a day trader. They represent well respected levels of support and resistance for most stocks on both an intraday and a daily level. While using moving averages alone are not enough to be a profitable trader, they are an important indicator on our charts because they show the direction of the trend. Stocks trading above their moving averages are considered in an uptrend while stocks below their moving averages are in a downtrend. Therefore, when price crosses a moving average there will be a lot of traders that take notice and adjust their positions.
There are two types of moving averages. Simple moving averages (SMA) and exponential moving averages (EMA). All moving averages are calculated as the average price of a stock over a set period of time. A 9 period moving average is based on the last 9 candles. A 9 period moving average on a 5min chart will be different from the 9 period moving average on a 15min, 60min, or daily chart, since the last 9 periods will be different for those time frames. A simple moving average is the average price over the set number of periods. An exponential moving average takes the average over the set number of periods, but will weigh the most recent price action more heavily, so that the moving average moves quickly in response to more recent moves. As a day trader, we are making quick decisions and therefore need an indicator that responds quickly. I use exponential moving averages. The moving averages I have on each of my charts are the 9 EMA, the 20 EMA, the 50 EMA and the 200 EMA.

Chart of a stock respecting the 9 EMA (in gray). Each moving average pullback is a buying opportunity. Additionally, the moment the price crosses below the moving average marks a potential change in the trend.
Chart of a trend reversal. The stock was trading below the 9 and 20 EMA, but near the red arrow the price crossed over the moving averages. The first pullback after the price crossed the moving average (labeled #1) took the form of a bull flag and was a great entry. The 2nd, 3rd, and 4th moving average pullbacks were also potential entries.

Trending stocks usually respect either the 9 EMA or the 20 EMA. I prefer to trade stocks trending along the 9 EMA because that shows more strength. Trending stocks will have a pattern of making quick moves up and then consolidate sideways until they tap the 9 EMA, then move back up again. This means if I am in a trending stock, I can set a conservative stop loss slightly below the 9 EMA support level and adjust it as the price moves. Alternatively, if I see a trending stock following this pattern and I want to jump in, I will recognize the moving average as a good potential entry point since it is being respected as support. By entering near the support of the moving average I will typically have a tight stop with good profit potential. When a trending stock makes moving average pullbacks I will typically buy the first and second pullback most
aggressively and be a bit cautious on later pullbacks. When stocks are trending, we want to buy as close to moving average support as possible to reduce risk. In contrast, if I am looking to take a reversal trade, I will usually look to take a position when the price is extremely extended and has moved away from the 9 EMA. The plan is to take profits on part of the trade when price comes back to the 9 EMA to test that support or resistance level.

![Chart of a stock respecting the 200 EMA (dark purple trend line).](image)

**Importance of the 200 moving average**

While I primarily use the 9 EMA on my 5min and 1min charts, the 200 EMA is also a very well respected moving average. It is not uncommon to find support or resistance at the 200 EMA on
the 5min chart, and especially on the daily chart. I often trade cautiously around the 200 moving average because I recognize stocks may consolidate before breaking away from that level. If I am looking for a reversal trade and the price is running into resistance at the 200 EMA I would consider that to be a stronger setup. Most of the momentum trades I take will be well above the 200 EMA. I rarely take trades to the long side that are below the 200 EMA or take trades to the short side that are above the 200 EMA.

Chart of the VWAP indicator.
Volume Weighted Average Price (VWAP)

In addition to the standard moving averages, I use the Volume Weighted Average Price (VWAP). Just as the exponential moving averages give weight to recent price action, the VWAP weighs the amount of volume that traded at each price more heavily. The VWAP gives us a really good understanding of the average price of the stock over the course of the day, because it factors in how many shares were traded. The VWAP is the equilibrium point of a stock on any given day. If we are looking for countertrend setups, we would want to find a stock that is extremely extended.
away from its equilibrium point. For trend based trading, I generally look to find entries close to the VWAP. This is not always possible if a stock has made a really strong intraday move. In cases where the price is extended from the VWAP, but I still want to take a trend based trade, I will refer back to the price relative to the 9 EMA.
I use Bollinger Bands exclusively for timing reversal trades. I use a standard 20 period moving average with a 2.0 standard deviation for my Bollinger Bands. This is the default setting for the indicator. As a counter trend trader, we have to be very careful not to enter a reversal trade too soon. We want to enter stocks as close to the maximum extension point, and then ride the momentum when the trend reverses. In order to get good entries, I wait for candles to trade outside the Bollinger Bands. You will notice that almost all of the price action on any given day
will take place inside the Bollinger Bands. Therefore, anytime the price is outside the Bollinger Bands, it’s an extreme situation. It is important to remember that prices can stay outside the Bollinger Bands during a parabolic move, so we still have to be cautious about entering too soon. The reason we trade intraday extremes, like candles outside Bollinger Bands, is because we know this is where we will find above average volume. In order to make sure any reversal is trading at extremes, I keep the Bollinger Bands on my 5min charts. I do not use them on the daily charts or the 1min charts.

Chart with Relative Strength Index.
I use the Relative Strength Index (RSI) exclusively for reversal trades. Like a candle fully outside the Bollinger Bands, when RSI is below 20 or above 80, it indicates an intraday extreme. Many of the best reversal trades will have an RSI below 5 or above 95. RSI is measured on a scale of 0-100, and it represents the strength of the stock. A reading of 90 or 95, indicates an extremely overbought condition while 5-10, represents an oversold condition. Many traders jump to the conclusion that when RSI is at extremes, the trend cannot possibly get any more extended and could change.
directions. It is important to note that since RSI can remain at extremes for a long period of time, it is not a reliable buy or sell indicator without additional confirmation. Stocks that are trending slowly, up or down, generally don’t always show RSI extremes. The RSI extremes are more often combined with parabolic moves or long trends that finally peak with one last surge. Instead of keeping RSI on my charts, I have created a filter in my stock scanners to only show me reversal stock ideas when the RSI is below 20 or above 80.

Image of Volume Bars.

Volume Bars

The final technical indicator that I use on a daily basis are simple volume bars. These bars tell us how many shares of volume were traded during a candlestick period. Volume is a critical piece of information for my trading strategies. It would be very difficult for me to trade without the volume bars. I need to have a sense of the increasing and decreasing volume as momentum builds and then fades. When I see decreasing volume during a trend, it can be an indicator that the trend is about to change directions. Additionally, during periods of consolidation, seeing an increase in volume can suggest a potential break back into a trend.