

LEARNING MADE EASY



2nd Edition

Day Trading For Canadians

for **dummies**[®]
A Wiley Brand



Position yourself for day trading success

Manage risk as you buy and sell

Day trade stocks in today's market

Bryan Borzykowski

Founder, ALLCAPS CONTENT,
CNBC contributor

Annie Logue, MBA



Day Trading For Canadians

2nd Edition

**by Bryan Borzykowski
and Annie Logue, MBA**

for
dummies[®]
A Wiley Brand

Day Trading For Canadians For Dummies®, 2nd Edition

Published by: **John Wiley & Sons, Inc.**, 111 River Street, Hoboken, NJ 07030-5774, www.wiley.com

Copyright © 2021 by John Wiley & Sons, Inc., Hoboken, New Jersey

Published simultaneously in Canada

No part of this publication may be reproduced, stored in a retrieval system or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, scanning or otherwise, except as permitted under Sections 107 or 108 of the 1976 United States Copyright Act, without the prior written permission of the Publisher. Requests to the Publisher for permission should be addressed to the Permissions Department, John Wiley & Sons, Inc., 111 River Street, Hoboken, NJ 07030, (201) 748-6011, fax (201) 748-6008, or online at <http://www.wiley.com/go/permissions>.

Trademarks: Wiley, For Dummies, the Dummies Man logo, Dummies.com, Making Everything Easier, and related trade dress are trademarks or registered trademarks of John Wiley & Sons, Inc., and may not be used without written permission. All other trademarks are the property of their respective owners. John Wiley & Sons, Inc., is not associated with any product or vendor mentioned in this book.

LIMIT OF LIABILITY/DISCLAIMER OF WARRANTY: WHILE THE PUBLISHER AND AUTHOR HAVE USED THEIR BEST EFFORTS IN PREPARING THIS BOOK, THEY MAKE NO REPRESENTATIONS OR WARRANTIES WITH RESPECT TO THE ACCURACY OR COMPLETENESS OF THE CONTENTS OF THIS BOOK AND SPECIFICALLY DISCLAIM ANY IMPLIED WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE. NO WARRANTY MAY BE CREATED OR EXTENDED BY SALES REPRESENTATIVES OR WRITTEN SALES MATERIALS. THE ADVICE AND STRATEGIES CONTAINED HEREIN MAY NOT BE SUITABLE FOR YOUR SITUATION. YOU SHOULD CONSULT WITH A PROFESSIONAL WHERE APPROPRIATE. NEITHER THE PUBLISHER NOR THE AUTHOR SHALL BE LIABLE FOR DAMAGES ARISING HEREFROM.

For general information on our other products and services, please contact our Customer Care Department within the U.S. at 877-762-2974, outside the U.S. at 317-572-3993, or fax 317-572-4002. For technical support, please visit <https://hub.wiley.com/community/support/dummies>.

Wiley publishes in a variety of print and electronic formats and by print-on-demand. Some material included with standard print versions of this book may not be included in e-books or in print-on-demand. If this book refers to media such as a CD or DVD that is not included in the version you purchased, you may download this material at <http://booksupport.wiley.com>. For more information about Wiley products, visit www.wiley.com.

Library of Congress Control Number: 2020948814

ISBN 978-1-119-73671-4 (pbk); ISBN 978-1-119-73672-1 (ebk); ISBN 978-1-119-73674-5 (ebk)

Manufactured in the United States of America

10 9 8 7 6 5 4 3 2 1

Contents at a Glance

Introduction	1
Part 1: Day Trading Fundamentals	5
CHAPTER 1: All You Need to know about Day Trading	7
CHAPTER 2: The Business of Day Trading	25
CHAPTER 3: Introducing the Financial Markets	45
CHAPTER 4: Assets 101: Stocks, Bonds, Currency, and Commodities	61
CHAPTER 5: Assets 102: ETFs, Cryptocurrency, Options, and Derivatives	81
CHAPTER 6: Increasing Risk and Potential Return with Short Selling and Leverage	101
CHAPTER 7: Managing Your Money and Positions	117
CHAPTER 8: Planning Your Trades and Trading Your Plans	135
Part 2: Developing Your Strategy	153
CHAPTER 9: Picture This: Technical Analysis	155
CHAPTER 10: Following Market Indicators and Tried-and-True Day Trading Strategies	177
CHAPTER 11: Eliminating Emotion with Program Trading	197
CHAPTER 12: Day Trading for Investors	217
CHAPTER 13: Researching Research Services	229
CHAPTER 14: Testing, Tracking, and Evaluating Performance	247
Part 3: Day Trading, Incorporated	267
CHAPTER 15: Your Key Vendor: Your Broker	269
CHAPTER 16: Regulation Right Now	281
CHAPTER 17: Choosing the Right Accounts	291
CHAPTER 18: Taxes for Traders	297
Part 4: The Part of Tens	311
CHAPTER 19: Ten Good Reasons to Day Trade	313
CHAPTER 20: Ten Common Day Trading Mistakes	319
CHAPTER 21: Almost Ten Alternatives to Day Trading	325
CHAPTER 22: Ten Tested Money-Management Techniques	331
Appendix: Additional Resources for Day Traders	337
Index	345

Table of Contents

INTRODUCTION	1
About This Book	2
Foolish Assumptions	2
Icons Used in This Book	3
Beyond the Book	3
Where to Go from Here	4
PART 1: DAY TRADING FUNDAMENTALS	5
CHAPTER 1: All You Need to know about Day Trading	7
It's All in a Day's Work	8
Speculating, not hedging	9
Understanding zero-sum markets	9
Keeping the discipline: Closing out each night	10
Committing to Trading as a Business	11
Trading part-time: An okay idea if done right	11
Trading as a hobby: A bad idea	12
Working with a Small Number of Assets	13
Managing your positions	14
Focusing your attention	14
Working with risk capital	15
Personality Traits of Successful Day Traders	15
Independence	16
Quick-wittedness	17
Decisiveness	17
The Difference between Trading, Investing, and Gambling	18
Investing is slow and steady	18
Trading works fast	19
Gambling is nothing more than luck	19
Busting Some Day Trading Myths	20
Myth #1: I can make millions	20
Myth #2: Profits are guaranteed	21
Myth #3: Day trading is dangerous	21
Myth #4: It's easy	21
A lot of other worthwhile activities are stressful too	22
CHAPTER 2: The Business of Day Trading	25
A Day in the Life of a Trader	26
Setting Up Your Trading Laboratory	29
Where to sit, where to work	30
Count on your computer	30
See it on the big screen	30

Connect to the Internet	31
Fix hours, vacation, and sick leave	31
Stay virus- and hacker-free	32
The department of redundancy department: Back up your systems	33
Planning Your Trading Business	33
Setting your goals	34
Finding volatility	34
Investing in your business	36
Evaluating and revising your plan	36
Getting Mobile with the Markets	37
Controlling Your Emotions	37
Dealing with destructive emotions	38
Having an outlet	41
Setting up support systems	42
Watching your walk-away money	43
Managing the Risks of Day Trading	44
It's your business	44
It's your life	44
CHAPTER 3: Introducing the Financial Markets	45
Having a Firm Grasp How Markets Work	46
Supply and demand	46
Exchanges versus over the counter	47
Commissions, fees, and spreads	48
Understanding zero-sum games	49
Opening an Account and Placing an Order	50
Opening a brokerage account	50
Placing your initial order	50
Closing out your order	50
Taking your cash	50
Defining the Principles of Successful Day Trading	51
Working with a small number of assets	51
Managing your positions	52
Focusing your attention	53
Understanding Risk and Return	53
Recognizing what risk is	54
Getting rewarded for the risk you take	57
Market efficiency in the real world	58
CHAPTER 4: Assets 101: Stocks, Bonds, Currency, and Commodities	61
Grasping the Different Things to Trade	61
Defining a Good Day Trading Asset	62
Looking for liquidity	62
Homing in on high volatility	64

Staying within your budget	65
Making sure you can use margin	65
Taking a Closer Look at Stocks	67
How Canadian and U.S. stocks trade	68
Where Canadian stocks trade	69
Where U.S. stocks trade	72
The high-risk over-the-counter exchanges	74
Dark pools	75
Examining Bonds	75
How bonds trade	76
Listed bonds	77
Over-the-counter trading	77
Treasury dealers	77
Cashing In with Currency	78
How currency trades	78
How the Canadian dollar is traded	79
Where currency trades	79
Considering Commodities and How They Trade	80
CHAPTER 5: Assets 102: ETFs, Cryptocurrency, Options, and Derivatives	81
Explaining Exchange-Traded Funds (ETFs) in Plain English	82
Traditional ETFs	83
Strategy ETFs	84
How ETFs trade	85
ETF risks	86
Getting Familiar with Cryptocurrency	86
Bitcoin and blockchain	87
Other cryptocurrencies	88
Understanding how cryptocurrencies trade	89
Avoiding the risks of cryptocurrencies	91
Dealing in Derivatives	91
Getting to know types of derivatives	92
Buying and selling derivatives	94
Comprehending Arbitrage and the Law of One Price	96
Understanding how arbitrage and market efficiency interact	96
Creating synthetic securities	97
Taking advantage of price discrepancies	98
Reducing arbitrage opportunities: High-frequency trading	99
CHAPTER 6: Increasing Risk and Potential Return with Short Selling and Leverage	101
Understanding the Magic of Margin	102
Making margin agreements	103
Understanding the costs and fees of margin	104

Managing margin calls	105
Enjoying margin bargains for day traders	105
The Switch-Up of Short Selling	105
Selling short	106
Short selling in Canada	107
Choosing shorts	108
Losing your shorts?	108
Leveraging All Kinds of Accounts	109
In stock and bond markets	109
In options markets	110
In futures trading	111
In foreign exchange	112
Borrowing in Your Trading Business	113
Taking margin loans for cash flow	113
Borrowing for trading capital	114
Assessing Risks and Returns from Short Selling and Leverage	115
Losing your money	115
Losing your nerve	115
CHAPTER 7: Managing Your Money and Positions	117
Setting Your Earnings Expectations	118
Finding your expected return	118
Determining your probability of ruin	119
Gaining Advantage with a Money-Management Plan	121
Minimizing damage while increasing opportunity	121
Staying in the market longer	122
Getting out before you lose everything	123
Accounting for opportunity costs	123
Examining Styles of Money Management	124
Limiting portions: Fixed fractional	124
Protecting profits: Fixed ratio	125
Sticking to 10 percent: Gann	126
Finding the ideal percentage: Kelly criterion	126
Doubling down: Martingale	127
Letting a program guide you: Monte Carlo simulation	127
Considering past performance: Optimal F	128
How Money Management Affects Your Return	129
Planning for Your Profits	130
Compounding interest	131
Pyramiding power	131
Making regular withdrawals	133

CHAPTER 8: Planning Your Trades and Trading Your Plans	135
Starting to Plan Your Trades: Just the Basics, Please	136
What do you want to trade?	136
When will you be trading?	137
How do you want to trade?	137
Figuring out when to buy and when to sell	139
Setting profit goals	139
Setting limits on your trades	141
What if the trade goes wrong?	144
Closing Out Your Position	146
Swing trading: Holding for days	146
Position trading: Holding for weeks	147
Investing: Holding for months or years	147
Maxims and Clichés That Guide and Mislead Traders	147
Pigs get fat, hogs get slaughtered	148
In a bear market, the money returns to its rightful owners	148
The trend is your friend	149
Buy the rumour, sell the news	149
Cut your losses and ride your winners	150
You're only as good as your last trade	150
If you don't know who you are, Wall Street is an expensive place to find out	151
There are old traders and bold traders, but no old, bold traders	151
 PART 2: DEVELOPING YOUR STRATEGY	 153
CHAPTER 9: Picture This: Technical Analysis	155
Comparing Research Techniques Used in Day Trading	156
Knowing what direction your research is	156
Examining fundamental research	157
Looking closer at technical analysis	158
Using Technical Analysis	160
First things first: Should you follow a trend or deviate from it?	160
Finding trends	161
Those ever-changing trends	165
Reading the Charts	167
Wave your pennants and flags	167
Not just for the shower: Head and shoulders	169
Drink from a cup and handle	169
Mind the gap	170
Grab your pitchforks!	171

Considering Different Approaches to Technical Analysis	172
Dow Theory	172
Fibonacci numbers and the Elliott Wave	172
Japanese candlestick charting	173
The Gann system.	174
Avoiding Technical Analysis Pitfalls.	174
If it's obvious, there's no opportunity.	175
Overanalyzing the data.	175
Success may be the result of an upward bias.	175
CHAPTER 10: Following Market Indicators and Tried-and-True Day Trading Strategies	177
Psyching Out the Markets	178
Betting on the buy side.	179
Avoiding the projection trap	179
Taking the Temperature of the Market	180
Pinpointing with price indicators.	180
Volume	183
Volatility, crisis, and opportunity.	185
Measuring Money Flows.	187
Accumulation/distribution index.	188
Money-flow ratio and money-flow index.	189
Short interest ratios	189
Considering Information That Crops Up during the Trading Day	190
Price, time, and sales	191
Order book.	191
Quote stuffing	192
News flows	192
Identifying Anomalies and Traps.	193
Bear traps and bull traps	194
Calendar effects.	195
CHAPTER 11: Eliminating Emotion with Program Trading	197
Creating Your Own Trading Program	198
Recognizing what you want to automate.	198
Knowing the limitations of robots.	199
Programming, the Day Trading Way.	199
Looking at basic brokerage offerings	200
Adding a trading platform	200
Finding trading modules.	200
Backtesting Once, Backtesting Twice	201
Building on Some Standard Strategies.	201
Range trading.	202
Contrarian trading.	202

News trading	203
Pairs trading	203
Arbitraging for Fun . . . and Profit	203
Understanding how arbitrage and market efficiency interact	204
Taking advantages of price discrepancies	205
Scalping, the Dangerous Game	206
Understanding Risk Arbitrage and Its Tools	207
Arbitrating derivatives	208
Levering with leverage	209
Short selling	209
Creating synthetic securities	209
Examining Arbitrage Strategies	210
Convertible arbitrage	211
ETF arbitrage	211
Fixed income and interest-rate arbitrage	212
Index arbitrage	213
Merger arbitrage	213
Option arbitrage	215
Watching Out for Those Pesky Transaction Costs	215
CHAPTER 12: Day Trading for Investors	217
Recognizing What Investors Can Glean from Traders	217
Being disciplined	218
Dealing with breaking news and breaking markets	219
Setting targets and limits	220
Judging execution quality	221
Applying Momentum	223
Earnings momentum	224
Price momentum	224
For investors only: Momentum-research systems	225
When an Investor Considers Trading	227
The idea has a short shelf life	227
Your research shows you some trading opportunities	227
You see some great short opportunities	228
CHAPTER 13: Researching Research Services	229
Understanding the Trade of Trading	230
Enjoying freebies from the exchanges and the regulators	230
Hitting the (virtual) road for conferences	233
Taking training classes	234
Getting the Research You Need	236
(Price) Quote me on that	237
Charting your strategy	238
News, newsletters, gurus, and strategic advice	240

Doing Your Due Diligence	243
Where to start your research.	243
Questions to ask	244
CHAPTER 14: Testing, Tracking, and Evaluating Performance.	247
Before You Trade: Testing Your System.	247
Backtesting.	248
Simulation trading.	250
Backtesting and simulation software	251
During the Day: Tracking Your Trades	254
Setting up your spreadsheet	254
Pulling everything into a profit and loss statement	255
Keeping a trading diary.	256
After You Trade: Calculating Overall Performance.	257
Reviewing types of return	258
Calculating returns	258
Determining the risk to your return	263
Using benchmarks to evaluate your performance.	265
 PART 3: DAY TRADING, INCORPORATED	 267
CHAPTER 15: Your Key Vendor: Your Broker	269
Choosing a Brokerage.	270
Getting proper pricing	270
Evaluating types of platform	272
Opening an account	274
Exploring Brokers for Day Traders	275
Brokers for stocks and a bit of the rest	275
Brokers for foreign exchange	278
Watching Out for Brokerage Scams	279
 CHAPTER 16: Regulation Right Now.	 281
How Regulations Created Day Trading	282
Who Regulates What?	283
Provincial securities commissions	284
Investment Industry Regulatory Organization of Canada (IIROC).	285
Mutual Fund Dealers Association of Canada (MFDA).	286
The exchanges	286
Brokerage Basics for Firm and Customer	286
Are you suitable for day trading?	286
Staying out of the money laundromat	287
Rules for day traders.	288
Tax reporting	289

	Hot Tips and Insider Trading	289
	Taking on Partners	290
CHAPTER 17:	Choosing the Right Accounts	291
	Understanding Investment Accounts	292
	RRSP	292
	TFSA	293
	RRIF	294
	Non-registered accounts	295
	Deciding on an Account to Use for Day Trading	295
CHAPTER 18:	Taxes for Traders	297
	Are You a Trader or an Investor?	298
	Claiming Business Expenses	298
	Hiring a Tax Adviser	299
	The many flavours of tax experts	299
	Questions to ask a prospective adviser	300
	You still want to do it yourself?	301
	What Is Income, Anyway?	302
	Earned income	302
	Capital gains and losses	303
	Tracking Your Investment Expenses	305
	Qualified and deductible expenses	306
	Paying Taxes All Year	308
	Using Your RRSP	308
	Trading within a Tax-Free Savings Account	309
	PART 4: THE PART OF TENS	311
CHAPTER 19:	Ten Good Reasons to Day Trade	313
	You Love Being Independent	313
	You Want to Work Anywhere You Like	314
	You're Comfortable with Technology	314
	You Want to Eat What You Kill	315
	You Love the Markets	315
	You Have Market Experience	315
	You've Studied Trading Systems and Know What Works for You	316
	You're Decisive and Persistent	316
	You Can Afford to Lose Money	317
	You Have a Support System	318
CHAPTER 20:	Ten Common Day Trading Mistakes	319
	Starting with Unrealistic Expectations	319
	Beginning without a Business and Trading Plan	320

Ignoring Cash Management	321
Failing to Manage Risk	321
Not Committing the Time and Money to Do It Right	322
Chasing the Herd	322
Switching between Research Systems	323
Overtrading	323
Sticking Too Long with Losing Trades	324
Getting Too Emotionally Involved	324
CHAPTER 21: Almost Ten Alternatives to Day Trading	325
Proprietary Trading for an Investment Company or Hedge Fund	325
Trading for an Agricultural, Energy, or Commodities Company	326
Joining a Market Making Firm	326
Traditional Investing for Your Own Account	327
Taking a Swing at Swing Trading	327
Gambling for the Fun of It	327
Playing Day Trading Video Games	328
Trading in Demo Accounts	328
Participating in a Trading Contest	329
CHAPTER 22: Ten Tested Money-Management Techniques	331
Taking Money off the Table	332
Using Stops	332
Applying Gann's 10 Percent Rule	332
Limiting Your Losses with the Fixed Fractional System	333
Increasing Returns with the Fixed-Ratio System	333
Following the Kelly Criterion Formula	334
Figuring the Amount to Trade with Optimal F	334
Measuring Risk and Sizing Trades with Monte Carlo Simulation	335
Taking a Risk with the Martingale System	335
Throwing It to the Fates	336
APPENDIX: ADDITIONAL RESOURCES FOR DAY TRADERS	337
INDEX	345

Introduction

A lot has happened since the first edition of *Day Trading For Canadians For Dummies* came out a decade ago. Mobile apps, tax law changes, new investments accounts and an entirely new asset class — cryptocurrency — have changed the work of day trading. The world also feels more uncertain than ever before, in part because, as we're writing this, in the summer of 2020, COVID-19 is wreaking havoc on the world. Stock market volatility is higher than it's been in years, and while that's not great for the average investor, it's good news for day traders, who love market ups and downs.

There will always be people who try to make money off daily stock price movements, but whenever there's market uncertainty (like the tech bubble and burst in 2001, the Great Recession in 2008, and now the novel coronavirus crisis in 2020) more people want to try their hand at day trading. So if you're looking to learn more about how all of this works, you've come to the right place. Our second Canadian edition will help steer you straight.

It may be obvious, but it's worth saying out loud: Day trading is a business in which you use real money to take on the markets. If you love the thrill of market ups and downs and have the patience to sit and stare at a screen for hours, waiting for the right moment to get in and get out of securities, then day trading may be a great career option. But it has many risks too. Any day can be your best day, but it can also put you out of business forever. For that reason, day trading requires the right psychological makeup. Good day traders are patient and decisive, confident but not arrogant. They most certainly are not gamblers, although day trading attracts gamblers who discover it's a great way to *lose* money from home.

Day Trading For Canadians For Dummies, 2nd Edition, is for people who are looking to get into the trading business or who simply want to supplement their investment returns with new techniques. In this book, you can find all the information you need to determine whether you're cut out for day trading, from laying out your home office, to researching and planning trades, and more. (And even if you decide day trading isn't for you, you can still find lots of sound general advice about markets, trading, and investing strategies that you can benefit from. Plus, you'll have saved all the money you would have otherwise invested on research and training, not to mention the trading losses!)

A lot of people make a lot of money selling services to neophyte day traders, claiming to be the best thing going. And maybe so — for some people. In this book, we give you a wider perspective. Instead of telling you to use a particular trading strategy, for example, we help you research and evaluate the different day trading methods available so that you can find one that works for you. Still, as comprehensive as this book may be, it shouldn't be your only guide.

About This Book

First, let us tell you what this book is not: It's not a textbook, and it's not a guide for professional investors. Several of those are on the market already, and they are fabulous — but often dry and assume underlying knowledge.

This book assumes you don't know much about day trading, but that you are a smart person who is thinking about doing it. It contains straightforward explanations of how day trading works and how to get started. Of course, we also talk about the pitfalls and cover some of the alternatives for your portfolio and for your career. If you really want to read some textbooks, we list a few in the appendix.

Foolish Assumptions

In writing this book, we made some assumptions about you, the reader:

- » You're someone who needs to know a lot about day trading in a short period of time.
- » You may be considering a career change, looking for a productive part-time retirement activity, or bored and looking for a challenge. Maybe you just want to know if day trading is a good way to supplement your current investment program. Whatever your reason for considering day trading, you want to know how to decide whether it's the right option for you.
- » If you already know that day trading is right for you, you want to know how to get started, from opening an account to setting up your computer monitors. (And yep, that's plural.)

- » You have extra money to trade (whether it's yours or not) and you want to try day trading techniques to enhance your portfolio returns.
- » You have some understanding of the basics of investing, so you know about mutual funds and brokerage accounts, for example. If you don't feel comfortable with that much, you may want to peruse some personal finance books first. It's okay. We'll be here when you're done.

Icons Used in This Book

As you read this book, you'll see icons scattered around the margins of the text. Each icon points out a certain type of information, most of which you should know or may find interesting about day trading. Here's what they mean:



REMEMBER

This icon notes something you should keep in mind about day trading. It may refer to something we covered earlier in the book, or it may highlight something you need to remember for future investing decisions.



TIP

Tip information tells you how to invest a little better, a little smarter, and a little more efficiently. The information can help you make better day trades or ask better questions of people who want to supply you with research, training, and trading systems.



WARNING

We've included nothing in this book that can cause death or bodily harm, as far as we can figure out, but plenty of things in the world of day trading can cause you to lose big money or, worse, your sanity. These points help you avoid big problems.



TECHNICAL
STUFF

We put the nonessential (but often helpful) academic stuff here. By reading material marked by this icon, you get the detailed information behind the investment theories or, sometimes, some interesting trivia or background information.

Beyond the Book

Along with the material in this book, there is also a free Cheat Sheet that you can access on the web. The Cheat Sheet includes additional day trading information that you should find useful. To view the Cheat Sheet, go to www.dummies.com and type "Day Trading For Canadians For Dummies Cheat Sheet" in the Search box.

Where to Go from Here

Well, open up the book and get going! It's a good idea to read it from front to back, but if you know nothing about day trading, then certainly start with Chapter 1 so that you can get a good sense of what we're talking about. If you want to know more about getting started — like how to set up your office — then read Chapter 2. You'll definitely need to learn how to read charts and why technical analysis is important for day traders, which you can find in Chapter 9.

If you have a particular area of interest, use the index and table of contents to go to the topic you want. If you're not sure, you may as well turn the page and start at the beginning.

1

Day Trading Fundamentals

IN THIS PART . . .

Get comfortable with the basic idea of day trading: the process of making a large number of short-term trades during a single day.

Understand the different things that you can trade to help you find those that suit your personal style and risk profile.

Find out the basics of markets, trades, and strategies to help you get started — if day trading is right for you.

Discover how to plan your trades so you can trade your plan and increase your chances for success.

IN THIS CHAPTER

- » Figuring out just what day traders do anyway
- » Setting up a trading business
- » Concentrating on a few assets, a few dollars at a time
- » Knowing what it takes to be a successful trader
- » Dispelling some of the myths of trading

Chapter **1**

All You Need to Know about Day Trading

Make money from the comfort of your home! Be your own boss! Beat the market with your own smarts! Build real wealth! Tempting, isn't it? Day trading can be a great way to make money all on your own. It's also a great way to lose a ton of money, all on your own. Are you cut out to take the risk?

Day trading is a crazy business. Traders work in front of their computer screens, reacting to blips, each of which represent real dollars. They make quick decisions, because their ability to make money depends on successfully executing a large number of trades that generate small profits. Because they close out their positions in the stocks, options, and futures contracts they own at the end of the day, some of the risks are limited. Each day is a new day, and nothing can happen overnight to disturb an existing profit position.

But those limits on risk can limit profits. After all, a lot can happen in a year, increasing the likelihood that your trade idea will work out. But in a day? You have to be patient and work fast. Some days nothing seems good to buy. Other days it feels like every trade loses money. Do you have the fortitude to face the market every morning?



REMEMBER

There are also other forces at play that can mess with your day trading abilities, namely high-frequency algorithms programmed by hedge funds and brokerage firms that have no emotions and can make trades faster than even the speediest human can.

In this chapter, we give you an overview of day trading. We cover what exactly day traders do all day, go through the advantages and disadvantages of day trading, cover some of the personality traits of successful day traders, and give you some information on your likelihood of success.

You may find that day trading takes advantage of your street smarts and clear thinking — or that the risk outweighs the potential benefits. That's okay: The more you know before you make the decision to trade, the greater the chance of being successful. If it turns out that day trading isn't right for you, you can apply strategies and techniques that day traders use to improve the performance of your investment portfolio.

It's All in a Day's Work

The definition of day trading is that day traders hold their securities for only one day. They close out their positions at the end of every day and then start all over again the next day. By contrast, *swing traders* hold securities for days and sometimes even months, whereas *investors* sometimes hold for years.

The short-term nature of day trading reduces some risks, because no chance exists of something happening overnight to cause big losses. Meanwhile, many investors have gone to bed thinking their position is in great shape, then woken up to find that the company has announced terrible earnings or that its CEO is being indicted on fraud charges.

But there's a flip side (there's always a flip side, isn't there?): The day trader's choice of securities and positions has to work out in a day, or it's gone. There's no tomorrow for any specific position. Meanwhile, the swing trader or the investor has the luxury of time, as it sometimes takes a while for a position to work out the way your research shows it should. In the long run, markets are efficient, and prices reflect all information about a security. Unfortunately, it can take a few days of short runs for this efficiency to kick in.



REMEMBER

Day traders are speculators working in zero-sum markets one day at a time. That makes the dynamics different from other types of financial activities you may have been involved in. When you take up day trading, the rules that may have helped you pick good stocks or find great mutual funds over the years will no longer apply. This is a different game with different rules.

Speculating, not hedging

Professional traders fall into two categories: speculators and hedgers. Speculators look to make a profit from price changes. Hedgers want to protect against a price change. They're making their buy and sell choices as insurance, not as a way to make a profit, so they choose positions that offset their exposure in another market. For example, a food-processing company might look to hedge against the risks of the prices of key ingredients — like corn, cooking oil, or meat — going up by buying futures contracts on those ingredients. That way, if prices do go up, the company's profits on the contracts help fund the higher prices that it has to pay to make its products. If the prices stay the same or go down, it loses only the price of the contract, which may be a fair tradeoff to the company.

The farmer raising corn, soybeans, or cattle, on the other hand, would benefit if prices went up and would suffer if they went down. To protect against a price decline, the farmer would sell futures on those commodities. Then, his futures position would make money if the price went down, offsetting the decline on his products. And if the prices went up, he'd lose money on the contracts, but that would be offset by his gain on his harvest.



REMEMBER

The commodity markets were intended to help agricultural producers manage risk and find buyers for their products. The stock and bond markets were intended to create an incentive for investors to finance companies. Speculation emerged in all of these markets almost immediately, but it was not their primary purpose.

Day traders are all speculators. They look to make money from the market as they see it now. They manage their risks by carefully allocating their money, using stop and limit orders (which close out positions as soon as predetermined price levels are reached) and close out at the end of the night. Day traders don't manage risk with offsetting positions the way a hedger does. They use other techniques to limit losses, like careful money management and stop and limit orders (all of which you can read about in Chapter 2).

Knowing that different participants have different profit and loss expectations can help a day trader navigate the turmoil of each day's trading. And that's important, because in a zero-sum market you only make money if someone else loses.

Understanding zero-sum markets

A zero-sum game has exactly as many winners as losers. No net gain exists, which makes it hard to eke out a profit. And here's the thing: Options and futures markets, which are popular with day traders, are zero-sum markets. If the person who holds an option makes a profit, then the person who *wrote* (which is option-speak for *sold*) that option loses the same amount. No net gain or net loss exists in the market as a whole.

Now, some of those buying and selling in zero-sum markets are hedgers who are content to take small losses in order to prevent big ones. Speculators may have the profit advantage in certain market conditions. But they can't count on having that advantage all the time.

So who wins and loses in a zero-sum market? Some days, it all depends on luck, but over the long run, the winners are the people who are the most disciplined. They have a trading plan, set limits and stick to them, and can trade based on the data on the screen — not based on emotions like hope, fear, and greed.

Unlike the options and futures markets, the stock market is not a zero-sum game. As long as company profits will grow, share prices will grow. Over the long run, there are more winners than losers; otherwise no one would put their retirement money into stocks. However, that doesn't mean there will be more winners than losers today. In the short run, the stock market should be treated like a zero-sum market.

If you understand how profits are divided in the markets you choose to trade, you'll have a better understanding of the risks you face as well as the risks that are being taken by the other participants. People do make money in zero-sum markets, but you don't want those winners to be making a profit off of you.



REMEMBER

Some traders make money — lots of money — doing what they like. Trading is all about risk and reward. Those traders who are rewarded risked the 80 percent washout rate. Knowing that, do you want to take the plunge? If so, read on. And if not, read on anyway, as you might get some ideas that can help you manage your other investments.

Keeping the discipline: Closing out each night

Day traders start each day fresh and finish each day with a clean slate. That reduces some of the risk, and it forces discipline. You can't keep your losers longer than a day, and you have to take your profits at the end of the day before those winning positions turn into losers.

And that discipline is important. When you're day trading, you face a market that doesn't know or care who you are, what you're doing, or what your personal or financial goals are. No kindly boss who might cut you a little slack today, no friendly coworker to help through a jam, no great client dropping you a little hint about her spending plans for the next fiscal year. Unless you have rules in place to guide your trading decisions, you will fall prey to hope, fear, doubt, and greed — the Four Horsemen of trading ruin.

So how do you start? First, you develop a business plan and a trading plan that reflect your goals and your personality. Then, you set your working days and hours and you accept that you will close out every night. Both of these steps are covered in Chapter 2. As you think about the securities that you will trade (Chapters 4 and 5) and how you might trade them (Chapters 6 and 7), you'll also want to test your trading system (Chapter 14) to see how it might work in actual trading.

In other words, you do need to prepare and have a plan. That's a basic strategy for any endeavour, whether it's running a marathon, building a new garage, or taking up day trading.

Committing to Trading as a Business

Many people are attracted to day trading because they can set their own hours and, hopefully, make money at the same time. They think they'll trade when their baby is napping, or on their lunch break, or in between games of golf and tennis. Well, if you plan on day trading for a few minutes here and there per day, then you can might as well burn your money in a fire pit instead. At least you won't have spent money on monitors and computers.

Day trading is a business, and the best traders approach it as such. Like any good entrepreneurs in any business, they have a business plan, which, in this case, will include what they will trade, how they will invest in their business, and how they will protect their trading profits. Much of this book is about this business of trading: how to create a business plan, how to set up your office (both in Chapter 2), tax considerations (Chapter 18), and performance evaluation (Chapter 14). Day trading can be a lot of fun, but if you want that fun to last, you have to dedicate your time and your energy to the enterprise to make it work.

Trading part-time: An okay idea if done right

Can you make money trading part-time? You can, and some people do. But they still treat it like a job, not something to do in between hockey game periods. A part-time trader may commit to trading three days a week, or to closing out at noon instead of at the close of the market. A successful part-time trader still has a business plan, still sets limits, and still acts like any professional trader would, just for a smaller part of the day.

Part-time trading works best when the trader can set and maintain fixed business hours. Your brain knows when it needs to go to work and concentrate on the market, because the habit is ingrained.

The successful part-timer operates as a professional with fixed hours. Think of it this way: Bryan's wife's kindergarten teaching partner only works half days. She shows up when she's scheduled and, when she's there, she's doing as much work as any of the other educators. She commits her attention to her job when she's in the classroom; when she's not there she's teaching spin classes and is as focused on getting people into shape as she is getting children to learn. She doesn't pop into school to teach an extra lesson during a break from her spin class gig, nor does she sneak around setting up meetings with parents while she's helping people exercise. If she worked on one job while she was at the other, her work would suffer. And what parent wants their children to be taught by someone who won't dedicate themselves to the kids, even if it's just for a few hours a day?



TIP

If you want to be a part-time day trader, approach it the same way that a part-time teacher, part-time lawyer, or part-time accountant would approach work. Find hours that fit your schedule and commit to trading during them. Have a dedicated office space with high-speed Internet access and a computer that you use just for trading. If you have children at home, you may need to have child care during your trading hours. And if you have another job, set your trading hours away from your work time.



WARNING

Trading via an app during your morning commute is a really good way to lose a lot of money (not to mention your life if you try it while driving).

Trading as a hobby: A bad idea

Because of the excitement of day trading and the supposed ease of doing it, you may be thinking that it would make a great hobby. If it's a boring Saturday afternoon, you could just spend a few hours day trading in the forex market (foreign exchange), and that way you'd make more money than if you spent those few hours playing video games! Right?

Uh, no.



WARNING

Trading without a plan and without committing the time and energy to do it right is a route to losses. Professional traders are betting that there will be plenty of suckers out there, because they create the situations that allow the pros to take profits in a zero-sum market.



WARNING

The biggest mistake an amateur trader can make is to make a lot of money the first time trading. That first success was almost definitely due to luck, and that luck can turn against a trader on a dime. If you make money your first time out, take a step back and see if you can figure out why. Then test your strategy, using Chapter 14 as a guide, to see if it's a good one that you can use often.

Yes, we have two warnings in this section, and for good reason: Successful day traders commit to their business. Even then, most day traders fail in their first year. Brokerage firms, training services, and other traders have a vested interest in making trading seem like an easy activity that you can work into your life. But it's a job — a job that some people love, but a job nonetheless.

Working with a Small Number of Assets

Most day traders pick one or two markets and concentrate on those to the exclusion of all others. That way, they can learn how the markets trade, how news affects prices, and how the other participants react to new information. Also, concentrating on just one or two markets helps a trader maintain focus.

And what do day traders trade? Chapter 3 has information on all of the different markets and how they work, but here's a quick summary of the most popular assets with day traders right now:

- » **Derivatives:** Futures, options, and CFDs (contracts for difference) allow traders to profit from price changes in such market indexes as the TSX/S&P Composite Index in Canada, or the Dow Jones Industrial Average in the U.S. They give traders exposure to the prices at a much lower cost than buying all of the stocks in the index individually. Of course, they tend to be more volatile than the indexes they track, because they are based on expectations.
- » **Forex:** *Forex*, short for *foreign exchange*, involves trading in currencies all over the world to profit from changes in exchange rates. Forex is the largest and most liquid market, and it's open for trading all day, every day except Sunday. Traders like the huge number of opportunities. Because most price changes are small, they have to use *leverage* (borrowed money) to make a profit. The borrowings have to be repaid no matter what happens to the trade, which adds to the risk of forex. (Leverage isn't unique to forex — investors can borrow money to trade derivatives and stocks too.)

» **Common stock:** The entire business of day trading began in the stock market, and the stock market continues to be popular with day traders. They look for news on company performance and investor perception that affects stock prices, and they look to make money from those price changes. Day traders are a big factor in some industries, such as technology. The big drawback? Stock traders can get killed at tax time if they are not careful. (See Chapter 18 for more information.)

Managing your positions

A key to successful trading is knowing how much you're going to trade and when you're going to get out of your position. Sure, day traders are always going to close out at the end of the day — or they wouldn't be day traders — but they also need to cut their losses and take their profits as they occur during the day.

Traders rarely place all their money on one trade. That's a good way to lose it! Instead, they trade just some of it, keeping the rest to make other trades as new opportunities in the market present themselves. If any one trade fails, the trader still has money to place new trades. Some traders divide their money into fixed proportions, and others determine how much money to trade based on the expected risk and expected return of the security that they are trading. Careful money management helps a trader stay in the game longer, and the longer a trader stays in, the better the chance of making good money. Chapter 2 has more information on this.

To protect their funds, traders use *stop* and *limit orders*. These are placed with the brokerage firm and kick in whenever the security reaches a predetermined price level. If the security starts to fall in price more than the trader would like, *bam!* It's sold, and no more losses will occur on that trade. The trader doesn't agonize over the decision or second-guess herself. Instead, she just moves on to the next trade, putting her money to work on a trade that's likely to be better.



REMEMBER

Day traders make a lot of trades, and a lot of those trades are going to be losers. The key is to have more winners than losers. By limiting the amount of losses, the trader makes it easier for the gains to be big enough to generate more than enough money to make up for them.

Focusing your attention

Day traders are often undone by stress and emotion. It's hard, looking at screens all day, working alone, to keep a steady eye on what's happening in the market. But traders have to do that. They have to concentrate on the market and stick to their trading system, staying as calm and rational as possible.