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

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Day Trading For Canadians

2nd Edition

by Bryan Borzykowski and Annie Logue, MBA

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Contents at a Glance

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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 in 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.