LEARNING MADE EASY

5th Edition

Day Trading

for dummies®

A **Wiley** Brand

Manage risk as you buy and sell

Trade stocks, options, and currencies

Set up for day trading success, from the start

Ann C. Logue, MBA

Author of *Hedge Funds For Dummies*

Day Trading

for dummies®
A Wiley Brand

Day Trading

5th Edition

by Ann C. Logue, MBA
Author of *Hedge Funds For Dummies*

for dummies®
A Wiley Brand

Day Trading For Dummies®, 5th Edition

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

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: 2024930151

ISBN 978-1-394-22756-3 (pbk); ISBN 978-1-394-22758-7 (ebk); 978-1-394-22757-0 (ebk)

Contents at a Glance

Table of Contents

Introduction

A lot has happened in the world since the first version of *Day Trading For Dummies* came out. Mobile apps, tax law changes, and an entirely new asset class — cryptocurrency — have changed the work of day trading. There have also been changes in global politics and economics that have created increased volatility, and traders love volatility. Savvy people looking for success in day trading need an up-to-the-minute reference like this new edition to steer them straight.

And in 2021, a group of amateur investors got together online to cause a short squeeze in shares of GameStop that ended up strangling a hedge fund and causing chaos in the financial markets.

Day trading is a business in which you use real money to take on the markets. If you love the thrill of the markets 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 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 Dummies, 5th Edition, is for people who are looking for a new 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, to lay out your home office, to research and plan 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, I give a wider perspective. Instead of telling you to use a particular trading strategy, for example, I help you research and evaluate the different day trading methods available so that you can find one that works for you. And I also tell you upfront that if you decide to day trade, this book shouldn't be your only guide.

About This Book

First, let me tell you what this book is not: It's not a textbook, and it's not a handbook for professional investors. Several of those are on the market already and they're fabulous, but they're often dry and assume you already have a lot of knowledge about day trading.

This book doesn't make those assumptions. It contains straightforward explanations of how day trading works, how to get started, what the pitfalls are, and what some of the alternatives are for your portfolio and for your career. It's designed for you to be able to skip around and read the chapters or sections that interest you, without having to read every word that comes before them. This book has more than enough content to get you started — or to guide you to something that's a better fit for your sensibilities. If you really want to read some textbooks, I list a few in the appendix.

Oh, and I like to think this book isn't dry, either.

During printing of this book, some of the web addresses may have broken across two lines of text. If you come across such an address, rest assured that I haven't put in any extra characters (such as hyphens) to indicate the break. When using a broken web address, type in exactly what you see on the page, pretending that the line break doesn't exist. Or simply use your favorite search engine to search for the topic yourself.

Foolish Assumptions

In writing this book, I 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 goose up your portfolio returns.
» You have some understanding of the basics of investing — that you know what mutual funds and brokerage accounts are, for example. If you don't feel comfortable with that much, you may want to read the latest editions of *Investing For Dummies* or *Mutual Funds For Dummies* both by Eric Tyson (Wiley) and then come back here. I can wait.

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. They go as follows:

REMEMBER

This icon notes something you should keep in mind about day trading. It may refer to something I cover 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

I include nothing in this book that can cause death or bodily harm, as far as I 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

I 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.

Where to Go from Here

Well, open up the book and get going! 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 can either turn the page and start at the beginning or flip through and see whether a topic catches your eye.

Need more guidance than that? Then allow me to give you some ideas. You may want to start with Chapters 1 and 2 if you know nothing about day trading. If you need to get set up to start trading, look at Chapters 15 and 16. If you want to know some different ways to trade, turn to Chapters 6, 7, 9, and 10. If you want to learn the key to better trading, Chapter 8 covers trade planning. For ideas about developing strategies, whether you're going to hold for a few minutes or several years, go to Part 2.

In addition to the book content, you can find a free online Cheat Sheet that includes information on accounts, definitions, indicators, and performance calculation. Go to `www.dummies.com` and search for "day trading" to access this handy reference material; you can print it and keep it by your side as you get started.

Bottom line: Anywhere you go, you'll find interesting and useful information.

1

Getting Started with Day Trading

IN THIS PART . . .

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

Understand how the financial markets work.

Learn about trading stocks, bonds, and commodities.

Explore trading contracts based on other assets, such as ETFs, options, and futures.

Find money making opportunities trading money, whether traditional currency or cryptocurrency.

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

Learn why managing your money makes a huge difference in your profitability.

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

» Setting up a trading business

» Knowing what being a successful trader takes

» Dispelling a few day trading myths

Chapter 1
Doing Day Trading Right

Looking to conquer the markets from the comforts of home? Some people can. But day trading is a crazy business. Traders work in front of their computer screens, reacting to blips, each of which represents real dollars. They make quick decisions because their ability to bring in profits depends on successfully executing a large number of trades that generate small profits. They close out their positions in the stocks, options, and futures contracts they own at the end of the day, which limits some of the risks. A lot can happen in a year when you're a day trader, increasing the likelihood that your trade idea will work out, but in a day? You have to be patient and work fast. Some days offer nothing good to buy. Other days, every trade seems to lose money.

The individual human day trader is up against a tough opponent: high-frequency algorithms programmed and operated by brokerage firms and hedge funds that have no emotion and can make trades in less time than it takes to blink your eye. Artificial intelligence has the potential to level the playing field, but the market will still crush unprepared players all the time.

In this chapter, I cover what day traders do, share the advantages and disadvantages of day trading, list the personality traits of successful day traders, and give you information on your likelihood of success if you choose to be a day trader. The more you know before you make the decision to trade, the greater your chance of being successful. If you decide 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.

Defining Day Trading: 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; *investors* sometimes hold for years. The short-term nature of day trading reduces some risks, because nothing that happens overnight will cause losses. Meanwhile, many other types of investors go to bed thinking their position is in great shape only to wake up the next morning to find that the company has announced terrible earnings or that its CEO is being indicted on fraud charges.

Ah, but there are two — or more — sides to every story: The day trader's choice of securities and positions has to work out in a day or it's gone. Tomorrow doesn't exist for any specific position. Meanwhile, the swing trader and the investor have the luxury of time, because 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, a few days of short runs may need to occur 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 no longer apply. Day trading 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* look to protect against a price change. They make 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.

As an example of hedging, consider a food-processing company and the farmer who raises or grows the ingredients the company needs. The company may look to hedge against the risks of price increases of key ingredients — like corn, cooking oil, or meat — 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 it has to pay for those ingredients. If the prices stay the same or go down, the company 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, benefits if prices go up and suffers if they go down. To protect against a price decline, the farmer sells futures on those commodities. Their futures position makes money if the price goes down, offsetting the decline on their products. And if the prices goes up, they lose money on the contracts, but that loss would be offset by their gain on their harvest.

TECHNICAL STUFF

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 closing 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 (which you can read about in Chapter 2).

REMEMBER

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

Understanding zero-sum markets

A *zero-sum game*, discussed in Chapter 2, has exactly as many winners as losers. And 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. There's no net gain or net loss in the market as a whole.

Now some of those people 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 who loses in a zero-sum market? Some days, whether you win or lose 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 rather than 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 the economy grows, company profits grow, which in turn leads to growing stock prices. The stock market really has more winners than losers over the long run. That doesn't mean that any given day will have more winners than losers, however. 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 that you choose to trade, you have a better awareness of the risks that you face as well as the risks that the other participants are taking. People do make money in zero-sum markets, but you don't want those winners to be making a profit off you.

Some traders make money — lots of money — doing what they like. Trading is all about risk and reward. The traders who are rewarded risked the 90 percent wash-out rate. Knowing that, do you want to take the plunge? If so, read on and check out Chapter 6 where I discuss risk and reward in greater detail. And if not, read on anyway, because you may get some ideas that can help you manage your other investments.

Being disciplined: Closing out each night

Day traders start each day fresh and finish each day with a clean slate. This daily regimen 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.

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

REMEMBER

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'll close out every night.

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