The Stock Mentor Prep

Independent Study Curriculum

Version 1.0

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CHAPTER

1

Mindset of a Trader

There are old traders; and there are bold traders; but there are no old bold traders.

– James L. Fraser

Chapter One
Mindset of a Trader

Your Comprehensive Guide to a Successful Mentor Experience

We commend you for your commitment and dedication to your trading training. In the progress of learning to trade you have experienced many milestones; your participation in the Mentor Program is evidence of that progress. The Mentor Program is a continuation of that progress and will be beneficial in transitioning your knowledge into trading skills. This manual is designed to:

- Explain the Mentoring process
- Provide you with the background to successfully complete your Mentor experience
- Make the most of your time with your Mentor by eliminating as much of the ground work as possible

The Mentoring Process

The Mentoring Program is designed to help you develop your trading skills. Most customers will agree that spending time with their Mentor was the most valuable part of their training. It was a climactic turning point in the development of their trading skills. With that in mind, you should understand that success is largely a function of your commitment and preparation. In an effort to enhance your success, we have sectioned the Mentor Program into two separate phases.

Phase I Mentor PREP!

Phase I of the Mentor Program begins now. The Mentor PREP! prepares you for your Mentor experience. In business terms, it is the briefing; a time in which you are presented with all the information you will need to work

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effectively with your Mentor. The exercises and activities in this manual are to be completed prior to your scheduled appointment. It is important that you complete Mentor PREP! for the following reasons:

1. You will be able to spend more time practicing and applying these trading principles live in the markets and less time learning these principles during the valuable time you spend with your Mentor.
2. You identify your trading strengths which can be developed and enhanced through Phase II of the Mentor Program.
3. You identify your trading weaknesses which, with the help of your Mentor, you can develop a plan to overcome.
4. You set goals that will guide your Mentor sessions.
5. You begin to develop a set of trading rules which will direct your trading style.
6. Every trader develops their own style. You begin to identify your personal preferences that can be developed through the personal guidance of your Mentor.

In short, Mentor PREP! helps you develop the mindset of a trader. Your Tigrent Learning Inc. advanced trainings have been an excellent source of training material. You have been introduced to new concepts and trading ideas. In order to successfully deploy your trading knowledge you must take inventory of your skills, and resources. This information can then be shared with your Mentor and fine-tuned into a trading system that works for you.

While you complete your Mentor PREP! assignments and activities your Mentor is available to answer questions that may arise. You will have the opportunity to talk with your Mentor during three pre-Mentor phone sessions. Your Mentor will be using these sessions to hold you accountable that you are getting yourself prepared by attending your trainings and understanding the material contained in the Mentor PREP!.

Phase II Mentor NOW!

It is important that you stay on track with your training, attend your trainings, complete the Mentor PREP! assignments and activities, and are confident in your goals and direction so that you will be ready for your Mentor NOW! sessions. This is an intense two days of “on-the-job training.” You will begin by sharing your goals and expectations for your trading with your Mentor. (If your goals and expectations are reasonable, your Mentor will lay out a path for you to reach them and start you on that path, live in the markets, while you are there with them.) If your expectations are not reasonable, then you would be setting yourself up to fail, and since that is something that is not an option your Mentor will help you re-set your expectations to things that are reasonably attainable.

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Your Mentor will also expand on the knowledge you have attained thus far and work with you through live demonstrations of market activity. Mentor NOW! is the training ground where the rubber meets the road, where you actually get in the cockpit and fly. Your time is limited so we encourage you to come prepared.

We wish you success as you take the next step toward mastering the markets. We are confident you will enjoy this "once-in-a-lifetime" opportunity to learn from the best!

Inventory of Trading Resources

"If your success is not on your own terms, if it looks good to the world but does not feel good in your heart, it is not success at all." - Anna Quindlen

To start developing a trading plan involves taking an inventory of the resources you have that will help you become a successful trader. This doesn't mean that you have to meet a minimum requirement for any of the resources listed here; only that you need to evaluate how those resources apply to you and your situation. Your subsequent trading rules and other aspects of your trading system will reflect where you stand.

Time: How much time should I dedicate to the market everyday?

You undoubtedly have a busy life with plenty of demands on your time. How do you intend to fit trading into your busy life? Active traders look at their portfolios and potential trades on a daily basis. Some traders trade throughout the day while the market is open, while others trade only at specific times of the day. Still others may choose not to watch the market while it is open, but rather to view the day's activity at the end of the day after their normal obligations such as work and family duties have been satisfied. The question of when you spend your time studying the markets is not as important as the quality of time you spend studying the markets. In short, make sure that the time you spend studying the market fits your lifestyle.

The markets in context of your life...15 min.

The following exercise is designed to help you inventory your time, and discover the amount of time you have available to spend studying the markets. Consider a typical day in your life as a reference for your answers.

What activities (work, sleeping, driving to work, family, etc.) take up the most of your time everyday?

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Do you have the ability or flexibility to multitask at work? In other words, can you watch the stock market while you work? Or would it distract you from your duties?

After you come home from work, how is your time spent?

Would it be easier to track the market and your stocks at the end of the day or perhaps at the beginning of the day rather than at work? If so, how would you fit it into your normal at-home activities?

Do I have to watch the market all day to be successful?

The frequency with which you watch the market has an impact on your trading system and style. For example, if you track the market at the end of the trading day you won't be able to respond to the types of opportunities you would get if you watched the market all day. Don't be alarmed, each style can be equally successful despite the fact that one will probably trade more frequently than the other. If you decide to watch the market during the day, you will probably be placing frequent trades that won't last more than a couple of days. If you choose to track the market after it closes, then your trades will tend to be longer-term: Your trades may last a few days to several weeks. This is useful to keep in mind as you develop your trading rules and trading system.

Thinking about the trades you will place and their place in time…10 min.

Define short-term, intermediate, and long-term in your own words:

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Using your trading experience thus far, how would you classify most of your trades? Would you define them as short-term trades, intermediate-term trades, day trades, or buy-and-hold investments? What type of trader would you like to be?

Money: *How much money should I have to begin trading?*

There is a saying: "It takes money to make money." This is a true statement when it comes to trading, but many people misconstrue this statement to mean that you have to have a lot of money before investing in the stock market. While it is true that more capital gives you greater flexibility in your trading system, it is possible to start small and build wealth. Whether you start with $2,000 or $700,000, you can develop the skill to be a successful trader.

Identifying and thinking about the money you will trade with…15 min.

How much money do you intend to risk as your initial trading capital while you learn?

How much of your trading capital could you afford to expense on a single trade?

The amount of money you are starting with has a direct impact on the development of your trading plan. You must determine how much money you can afford to lose on any single trade, since every active trader has expense trades, streaks of failed trades, as well as income trades. Your trading plan has to reflect this expectation and account for how you will deal with the expense trades as well as income trades. If you are starting small, you can't endure significant losses in a single trade or series of trades, so you have to look for more conservative trades. If you have a larger amount of capital to start with, you can afford to develop a slightly more aggressive trading plan and take a little more risk.

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For example, suppose you have developed a trading system that produces successful trades 80 percent of the time. When you are right you win an average of $100,000; when you are wrong you lose $8,000. If you start with an account size of $10,000 and lose your first trade, you are now down to $5,000. Frustrated but still hopeful, you try again…and lose a second time in a row. That's it, end of game, you're out of money. You hit your 20 percent losing streak on your first two trades, completely wiping you out. Even though your odds of winning far outweigh your odds of losing, and you make profitable trades more often than lose, you have already lost your ability to trade due to poor risk and money management decisions. In this case, you would have to revise your system by employing strategies such as enforcing tighter stop losses and trading more conservative, less volatile stocks. Then your losses won't be as significant.

On the other hand, if you started your trading with $80,000, you would be able to endure these kinds of losses better. It's okay that you lost on your first two trades because you still have $40,000 to trade with and two losing trades out of the way. Now, you have a much higher chance of winning on the next trade, which could gain $100,000.

These examples serve to reinforce another common saying: "Cut your losses quickly, and let your profits ride." No trading system can be profitable unless you have specifically planned for how you intend to deal with income and expense trades. Make sure you evaluate your expense trades to determine how much loss you can afford to bear and mold your plan to get out of a failed trade around that number. That way you will still have investment capital to trade with so that your income can exceed your expenses.

How much of my trading capital should I put into a single trade?

Your trading capital has an impact on how much you diversify your portfolio. Diversification is an effective risk management technique that lowers your risk by combining multiple trades. In essence, if you are diversified, all your eggs are not in the same basket. The more diversified your portfolio is, the more conservative your approach is. Many conservative investors will risk no more than 10-15 percent of their total trading capital in any one trade, while more aggressive traders will often go higher than that.

Thinking about your tolerance for risk…5 min.

Are you cautious about new situations or risks in life, or do you jump in enthusiastically to take advantage of new opportunities?

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Your answer to the previous question should give you some insight into your tolerance for risk in the stock market. If you are a cautious person when it comes to new things or you shy away from taking risks, then you will probably need to follow that same path in the stock market. You should work to maintain a fairly high level of diversification in your investments, and look for conservative stocks to work with like the index tracking stocks. If, on the other hand, you are the type of person who anxiously reaches for new opportunities and are used to handling risk in your life, then you likely can handle the dramatic swings that many stocks have. You should still diversify your portfolio, but you may be able to withstand larger losses as a percentage of your available capital and accept having larger portions of your capital in a single trade.

If you are starting with a relatively small amount of money, it is more difficult to have a diversified portfolio, but it is still doable. The first thing to remember is to make sure that only a smaller portion of your capital goes into a single trade; if you are starting with $2,000, for example, you may decide to only invest $500 in any single position. This is acceptable even on more expensive stocks because you don't have to buy stock in round lot, 100-share chunks. You can buy 10, 25, 50, or whatever number of shares fits your budget.

Another consideration when it comes to your investment capital is cost. Your broker will charge you a commission for each trade your make. When you buy a stock, you are charged a commission, and when you sell it, you are charged again. This is an expense that will act against your profits. Depending on the type of broker you use, commissions can run anywhere from around $1 to $30 per trade, or possibly even more for some full-service brokerage accounts. If you are trading a large number of shares, the commission cost is probably not a significant issue, but if you are trading 100 shares or less, it can eat at your profits. Make sure you know what your cost is, and if it seems too high, you may want to find a broker with lower commissions while you are learning.

Information and Training

How much do I have to know before I start trading?

How much experience do you have in the stock market? Have your previous investments been left to the advice and discretion of brokers or investment advisors, or have you been responsible for your own investment decisions? Have you ever bought shares of stock before? Experience is usually the primary source of information people have had with the stock market. The level of knowledge you have about how the stock market works is another consideration that weighs heavily in the approach you should take to your stock trading. If you are a new investor, you should take a cautious, conservative approach to trading initially and track your results very carefully. This process will help you determine what level of risk you are comfortable

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with and what strategies work for you. If you are an experienced trader, you have probably gone through at least a portion of this process already. You may only need to fine tune or refine your knowledge. You may feel comfortable with a higher level of risk, but you should still apply the same method: if you are going to try a new strategy out, start on paper or with very small amounts to see how it works, then if you think it is going to work for you, you can incorporate it more fully into your trading system.

New investors will sometimes operate under the assumption that they should study as much information as possible and have a thorough understanding of the market before they actually start trading. This is a dangerous fallacy to give credence to, because it can paralyze and cripple you (analysis paralysis) from starting to place trades. Remember that the single most important contributor to your knowledge of the stock market is experience. The sooner you start trading, the sooner you will be able to determine what information you need to use, what strategies work best for you, and exactly how your trading system and trading rules need to look. If you aren't comfortable putting your real investment dollars at risk yet, paper trade until you are or even better, trade live in the market with very small size, 10 shares at a time.

Paper trading on brokerage demo platforms has great value in helping you to learn order entry and trade execution, but paper trading has little value when it comes to actually learning to trade the markets. It is common to hear in the trading world that trading is 20 percent mechanical and 80 percent emotional. Paper trading eliminates 80 percent of the challenge to success, the emotional side. Now that would be great if it didn't also eliminate the profits. I don't think we have ever met someone who wasn't successful paper trading. The reality is that the emotional side is every trader's greatest challenge. So the sooner we bring this into your trading and start dealing with it, the better.

Besides experience, there is an abundance of information readily available about the stock market. You can go to any bookstore's Personal Finance section and find numerous titles on the inner workings of the market and how the average investor can succeed. You have already taken advantage of another great resource, which is to learn from people who have done it before. At this point, you have likely participated in advanced trainings, home study courses, coaching programs, or some combination of all of them. These courses, along with the Mentoring course you are about to take, give you the chance to learn from market professionals who can personalize your market training.

Your attitude about training…5 min.

In the space provided below, write about your training experience. Did you finish high school or college and feel that you had all of the knowledge you needed to succeed in life, or do you view learning as a lifelong process?

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As with anything in life, learning about the market is an ongoing task. Think about professions such as teaching, technology, or medicine. Many of these professions have continuing training requirements to enable professionals to stay on top of changes in their field as they happen. You should use the same mindset about the stock market. It is extremely fluid and always changing, so you should be proactive about learning as much as you can about it at all times. Strategies that worked effectively a decade ago or even last year may not work now. Successful investors are always striving to learn new things by reading books about the market, talking to fellow investors, attending investment conferences, and so on. This gives them the ability to adapt as the markets change and stay on top of current trends and information.

Strengths: What are my strengths?

We all have characteristics that help or hinder our success in any area of life. The personal strengths you have that have made you successful in any past endeavor can be used or translated in some manner to the stock market. A valuable part of establishing your trading plan is to think about what your strengths are and find a way to relate them to the stock market. For example, suppose that you are a very detail-oriented individual. That has direct application to stock trading because it is critically important to make sure that before you place any trade every portion of your analysis points to a buying or selling opportunity. You have to be able to think quickly through the various criteria required by your trading system while you are looking at a stock graph or financial report and make sure you don't miss any information. A detail-oriented person can accomplish this without great difficulty.

By the same token, suppose that although you aren't used to paying a lot of attention to small details, you find it very easy to take the critical first step of any new endeavor, where many people shrink in fear. Venturing into the unknown is an exciting process for you. Again, this has direct application to trading, because no matter what the analysis indicates, you still have to be able to make the emotional leap of pulling the trigger on that trade. Even when all signs point to "Go" on a trade, it is still a fact that some of those trades will be expense trades. This prospect paralyzes many traders, but if uncertainty isn't a problem for you, you will be able to place the trade and manage it effectively. Never forget that trading is a business built on odds. This means that you can do the right things and still have an expense trade. Can you emotionally deal with that?

List your strengths...15 min.

Take a few minutes now and think about your strengths; write them down on the left side of the chart, then on the right write down how you think that strength translates to stock trading.

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Strengths	Impact on my trading

Weaknesses: What are my weaknesses?

Just as it is important to understand the characteristics you possess that should help you be successful, you need to identify the things that will hinder your progress as a trader. We all have hang-ups, quirks, and attributes that prevent us from taking risks or managing bad situations. Examples of these kinds of characteristics may be a fear of trying new things, or maybe you have a tendency to make assumptions in stressful situations.

It is necessary to equate your weaknesses to their impact on stock trades. For example, if you are afraid of trying new things, you will probably get emotional and scared when the time comes to place a trade. Some characteristics that can contribute to your success can also hinder it. For example, if you embrace the unknown, you may not adequately analyze the risks of a situation. This could lead you to high-risk, low-reward trades that will do nothing but drain your account.

When it comes to trading, you must be prepared to check your pride at the door. Trading will expose your emotional weakness to yourself whether you like it or not. Face them, deal with them and succeed, or ignore them at your own peril. We have a saying in trading that really applies to everything in life, but especially to trading and it is this: "The misakes that I make are a 'perfect' reflection of my current level of development and I accept full responsibility for them; learn from them, and become better because of them."

Outline your weaknesses…15 min.

Think about what your weaknesses are and write them down on the left side of the chart, then on the right side write down how you think that could affect your stock trading. As with our personal strengths, just about anything that you would categorize as a weakness can and will affect your stock trading, so be honest with yourself as you go through this exercise.

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Weakness	Impact on my trading

The biggest reason for identifying these weaknesses is to help you begin to compensate for them in your trading plan. For example, an investor whose weakness is not paying great attention to detail would compensate for that by developing a rule stating that every phase of analysis – fundamental and technical – must be performed and specific signals must be in place before a trade is made. This allows you to turn your weaknesses into strengths. Trading rules are desigend to "cage" our weakness so that they cannot hurt our trading. We say "cage" because many of our emotional trading responses are difficult to eliminate, we are, after all, only human. But recognizing and caging the emotional responses that hurt our trading is critical to success. Oftentime we refer to this as slaying our dragons. This process will be reviewed in developing your trading rules, which we will cover later in this chapter.

Goals, Expectations and Ambitions

Plan to spend several hours of your time developing your objectives and planning on how you will reach them. Knowing your destination greatly affects your journey. One of the most distinguishing factors of success is the objective; you cannot accomplish anything without defining your objective first. The world is full of mediocrity. If you do not enthusiastically define your objective you will continue trading the way you have always traded, and your results will be predictable.

Tom Landry once said that, "Setting a goal is not the main thing. It is deciding how you will go about achieving it and staying with that plan." Imagine getting tickets to the event of a lifetime. It is finally here and you are prepared and ready to go. You jump in the car and realize that you have no idea how to get there. You end up driving in circles for 13 hours and completely miss the event. What good is an objective without a map or a plan of achieving it?

The world of trading is no different than life. Big goals get big results. No goals get no results. The market is no respecter of persons. It does not care who you are, president or peasant. If you do not know what you want to achieve or fail to set a plan, you will be tossed wantonly through gains and losses, lucky to yield market averages. Remember that wealth is rarely an accident; there is no reason why you can't live the lifestyle of your dreams.

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Observation: We have noticed two groups of traders: those who consider themselves successful, and those who do not. In trying to discover the difference between these groups, we have observed a direct relationship between trading success and goals. Those traders that set goals, and try to accomplish them, have better numbers in three-key areas. They have a higher win-loss ratio, they have a greater reward-to-risk ratio, and smaller-draw downs. At this point do not be overly concerned with the exact plan you need to achieve your goals. This is a work in progress that will change and adjust as you get to know yourself better. The important thing right now is to "get started."

Description of your life's dream…15 min.

Now that you have an understanding of the importance of trading goals, plan to spend 15 minutes dreaming of the life that you wish to live. Remember that you will never accomplish something that you haven't dreamed first and it is never too late to start working toward your objectives. At the end of 15 minutes describe your life's dream below:

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Description of the role trading plays in your dream…15 min.

Look back over your description of the life you wish to live. Carefully consider the role trading plays in that dream. Is trading a means to an end? Is trading an integral component of that life? Does trading provide you with an income to sustain the life you wish to live? Is trading the source, or one of many sources of income? In the space provided below describe in detail the role of trading in your life's dream. Describe all income sources, and their roles in your life's dream.

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Trading and Your Life's Dream

You should now have a preliminary picture of your life's dream and the role trading can play in reaching that dream. Now it is time to start planning the road map to reach your goals. We'll start by breaking up your ultimate goals into smaller mini-goals. Most people fail to achieve their goals simply because they don't break them down into digestible pieces. All they can see

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is this big overwhelming goal, like the dinner table at Thanksgiving, and they don't know where to start. Mini-goals are bite sized portions that let you efficiently track your progress. They are not so overwhelming, and are easier to achieve. In short, by breaking down your overall goals into mini-goals, you get to feel and experience progress.

Every goal can be broken into mini-goals. Mini-goals should never be too difficult or too long. You don't want to be overwhelmed by them. Ask yourself: "What steps do I need to take to achieve my ultimate goal?" These steps will be your mini-goals.

Your two mini-goals

Given your life's dream and the role that trading will play in that life's dream, record two mini-goals that will guide you toward your ultimate objectives. An example of a mini-goal is to master the Bull Pullback Buy Technique you learned in the MachTrader™ Training. You should share these mini-goals with your Mentor.

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Achieving your goals will be even easier by breaking down every mini-goal into small easy-to-accomplish tasks. Tasks are the simple things you must do to accomplish a mini-goal. Each of these tasks must be defined and set with a deadline. By focusing your mind on the easy-to-accomplish tasks, and completing those tasks, you'll be making great progress toward your mini-goals without feeling overwhelmed.

For example, if you've set a mini-goal to master the Bull Pullback Entry Technique by June15th, you will have to accomplish a number of tasks:

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Task	Deadline
Scan daily for the Bull Pullback development using Trade Seeker Software.	Daily
Place two paper trades per week.	Weekly
Monitor and record the results of your paper trades.	Daily
Calculate the reward-to-risk ratio for each of the paper trades.	Before I trade
Calculate the win-loss ratio for each of the paper trades.	After the first 25 trades
Calculate the drawdown statistics for the trades.	After the first 25 trades
Check the long, short, and intraday charts for a clue when to enter the paper trade.	Daily

Tasks to Accomplish Your Mini-Goals

Using the mini-goals you previously created, describe the tasks that will move you toward accomplishment. Make sure to write down ALL tasks, even those that take only minutes to complete. Be sure to include a deadline!

Task	Deadline

Post your mini-goals and tasks in a conspicuous place. When they are accomplished, check them off. As more tasks are accomplished, and checked off, you'll find yourself becoming more encouraged, and more confident about your abilities. The more tasks you complete, the closer you'll be to success.

Passion for Your Tasks and Mini-Goals

Your mini-goals and tasks must be internalized. You must have a passion and desire for accomplishing your goals. The single most common reason why people don't succeed in trading is because they lack sincere desire. Some people may argue with this and rationalize, "But I had a strong desire

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and I still didn't get there." Sorry, but if you didn't reach your goal, you may have had desire, but you didn't have enough to take you all the way. The type of desire we are talking about leads to proactive and sustained effort with an absolute refusal to fail, a true passion.

Passion combined with motivation is what keeps people working to master the market. That desire dominates conversation, thinking, and actions. Take a moment to think about your life goals. How committed are you to achieving those goals? Under what conditions would you give up? What if you wanted them so badly that you knew with absolute certainty that you would never give up? Can you clearly see yourself reaching your goals? You can see that with this type of passion and motivation, market success is inevitable. Successful trading is a skill and like any skill it can be learned! If someone else can do it, then it can be done and you can learn it.

Describe Your Motivation

Motivation is a golden key to success in the markets. There are two ends to the key that represent two-major types of motivation: "away from" and "toward." Both types of motivation work to help you reach your goals.

> "Away-from" motivation is what motivates you by avoiding consequences of your choices. You do not want to experience pain, discomfort, or negative consequences. An example of away-from motivation is not trading during earnings announcements because the extreme volatility can devastate your account.
>
> "Toward" motivation is what motivates you by embracing the opportunities of your choice. You want to experience happiness, rewards, and accomplishment. An example of toward motivation is taking a highly leveraged trade because of the high probability of a positive payout.

Do not fall into the trap of assuming that one type of motivation is better than the other. Both types of motivation are effective in their own right. A healthy dose of "away-from" motivation can help you cut loosing trades which is absolutely critical to success in the markets. A healthy dose of "Toward" motivation can help you spend more time searching for the perfect trade. Motivation is motivation and it takes any and all the motivation we can find to be successful in the markets.

Understanding your "away-from" motivation…10 min.

To get an understanding of your "away-from" motivation, record all the bad things that will happen if you don't learn to trade successfully. For example, you may lose your job and have nothing else to fall back on. You may get nasty phone calls from credit collectors because you can't pay your bills. It

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doesn't matter what the motivation is, if you don't want it to happen to you, write it down.

Understanding your "toward" motivation…10 min.

To get an understanding of your "toward" motivation, write all the good things that can happen if you successfully learn to trade. For example you might be able to spend more time shopping. You might have the resources to go fishing in Alaska. You might be able to send your kids to a better university. It doesn't matter what the motivation is, if you want it to happen, write it down.

Both types of motivation can be useful in reaching your goals, however, most people are dominated by one type of motivation over the other. In the space provided below combine your list of "away-from" and "toward" motivators and prioritize them from the most motivating to the least motivating. You should refer to this list often.

In this section you have learned that a successful game plan is critical to success in the markets. You have learned that goals help you reach your dreams and that motivation and passion help you reach your goals. This is as important in trading as it is in life.

Aligning Your Resources with Your Goals and Ambitions

Once you have detailed what resources are available to you and what your goals and ambitions are, you can begin to put them together. As you align your resources with your goals, you can begin to put together specific rules that will act as a blueprint you can follow on each trade you make.

Did your mother ever tell you, "Your eyes are bigger than your stomach?" Traders often have the same problem! Dreaming about our ambitions and

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what we want to do with our money usually leads people to big ideas. Being human, we are often impatient to realize our goals. The result for traders is that they often set unrealistic mini-goals and tasks.

Here is an example: Todd is a new investor. He has attended several Advanced Trainings including the Master Trader™ course, and is a new Mentoring student. He has $10,000 in investment capital to start his trading with. Since he is a sports nut, his dreams and ambitions include purchasing an NBA franchise. He is highly motivated to succeed and confident in the knowledge he has acquired. As he set his mini-goals and tasks, however, he has stated that he intends to have enough assets to make a bid on his local NBA team in two years.

So what is the problem with this example? Todd's dream is to buy his favorite pro basketball team which realistically will cost hundreds of millions of dollars. Is his dream possible? The problem here lies in the fact that turning $10,000 into hundreds of millions of dollars in a span of two years through the stock market isn't practical. In order to accomplish this kind of result, Todd would need to double his money on every trade he makes…over 119 times in a row.

As we think about our big dreams, it is important that we temper our mini-goals and immediate tasks with reality. Remember that investing and building wealth is a gradual process. There is no "get-rich-quick" element of stock investing. It takes time, effort and discipline. That doesn't devalue our big dreams – we should keep them as powerful, vivid and vibrant as the first time we thought of them. But we should approach the steps to accomplishing those dreams from a realistic mindset.

In Todd's case, reforming his mini-goals and tasks to build sufficient wealth to purchase an NBA team in 19 to 20 years may be more appropriate. This gives Todd more time to work on finding higher-probability trades and take a more gradual, patient approach to his investing experience.

Match your goals and ambitions to your resources and time…20 min.

On the left side of the space provided below, write your mini-goals and the tasks that correspond to each. In the corresponding space on the immediate right, write down how much time you anticipate will be required to accomplish your goal.

Mini-Goals & Tasks	Time Frame

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Now go back to your inventory of trading resources at the beginning of this section. On the left side of the space provided below, write how much money you are going to be trading with. On the right, write down how much time you are going to be dedicating on a daily basis to your trading and what kind of trades you are likely to place – short-term, intermediate, or long-term.

Investment Capital	Your Trading Profile

Now compare your mini-goals, tasks and time frames with your capital and your trading profile. Do they complement each other? Are your goals and tasks achievable in the amount of time you have given yourself? Are they within your normal lifestyle? Have you allowed yourself sufficient time to build your initial investment capital to the levels you want in a gradual, achievable manner? If your answers to any of these questions are "No," then you should revisit your mini-goals, tasks, and time frames and make adjustments until they do.

Revised Mini-Goals and Tasks	Revised Time Frame

You should now have a reasonable, achievable set of mini-goals, tasks, and time frames to work with. This should help you to follow a disciplined, methodical trading system.

Revisit these goals from time to time to track your progress and see how you're doing. You may find it necessary to make further adjustments on occasion.

Develop a Set of Rules

One of the most important steps in developing a trading plan is identifying specific trading rules. Trading rules are the essence of disciplined trading. Think of a jet airplane. Before takeoff, the pilot and crew go through an exhaustive checklist of items ranging from making sure the flaps work correctly to the air pressure in the landing gear tires. If any one of those items are not just so, the plane doesn't move. The same principle applies to trading stocks. Trading rules allow us to establish specific Do's and Don'ts to

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guide our trading. Trading rules will help us to "cage" our emotions.
The concept of trading rules is simple; as soon as you begin thinking about a trade, make sure to compare the trade against your rules. If the trade breaks any of your rules, then the decision is made for you; the trade doesn't happen. This concept is new to most people, even to experienced investors. Consider the following:

Richard Dennis had an office tucked away on the 23rd floor of the Chicago Board of Trade building. The outside hallway had dingy brown paneling. The office door was etched with the words 'C&D Commodities, Richard J. Dennis and Company.' The entrance disguised the performance of an individual who, in his own estimates, turned $400 into $200 million. The legendary Chicago futures trader and his long-time friend, Bill Eckhardt, had a fascinating debate. They wanted to know if "anyone" could learn to make huge profits trading, or was trading success due to some inherent ability or talent that someone is born with? They agreed to an experiment.

They placed an ad in the Wall Street Journal: "Traders Wanted. No experience necessary." The response was enormous, with over 1000 people responding to the ad. Through a rather subjective selection process 13 people were chosen to settle the raging debate. The 13 freshly designated traders were given a bankroll, two weeks of training, and a list of specific trading rules. They were warned to follow the rules explicitly and if they failed to follow the rules they would be cut from the experiment. This group of 13 inexperienced traders performed so well that another group of 10 traders were selected the following year to verify the results. This group of exceptional traders, known as the Turtle Traders, earned an average 80 percent return per trader.

The success of the Turtle Traders was attributed to a comprehensive yet simple system with very specific rules covering every aspect of trading. Richard Dennis was quoted as saying:

> "I always say that you could publish my trading rules in the newspaper and no one would follow them. The key is consistency and discipline. Almost anybody can make up a list of rules that are 80 percent as good as what we taught our people. What they couldn't do is give them the confidence to stick to those rules even when things are going bad."

Defining your trading rules has many benefits, but the primary benefit is a stabilizing effect on emotion. For example, the police academy trains its officers to react to hazardous situations subconsciously, then they do not have to think about what to do, their reaction is automatic. Similarly, we want to have a set of rules that guide our actions in the market. That way we don't make emotional decisions, which are, in most trading circumstances, the wrong decision.

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Most of you will read this section and think, "That makes sense. Great." But when you think about the rules you need to incorporate into your strategy, you may get stuck, and wonder, "What kinds of rules should I use?" Not to worry, your Mentor will work with you in developing your rules. In the meantime the following exercise will help you lay the foundation for your rules; you should complete this exercise prior to meeting with your Mentor.

How to Develop Trading Rules

If you are an experienced trader, you already have a resource to draw on. Think about your previous trades. Doubtless you have your fair share of horror stories and hopefully a collection of glory stories. Think about these experiences. What did you do right? What did you do wrong? In the space provided below, record your thoughts about those previous trades. This is the beginning to a set of trading rules.

If you are new to trading, don't fear. Your advantage is that you get to learn from the experiences of others. Think about what you have learned about trading thus far and imagine what you feel might be important as you begin your trading career. Record your thoughts in the space provided below:

Your trading rules should be specific to your individual needs. You must identify those things that you feel are significant to your success in the market. Therefore it is a personal document and your own private recipe to realize your trading goals. However, in the process of training thousands of customers how to trade the markets, we have discovered three foundational truths that should form the basis of your set of rules.

Rule #1: I will adapt to change because when it comes to the market, anything can happen.

A proficient sailor planned a sailing tour to a remote island in the Caribbean. His trip was flawlessly planned. He had consulted the weather forecast the night before and the prevailing winds were perfect. He proceeded to gear up and head out the next morning. Two hours into his tour, the winds shifted and began blowing a different direction and blowing him way off course. What was the sailor supposed to do?

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The first rule of trading is to understand that the winds of the market change, and in order to reach your destination you must learn to adjust and adapt. Trading rules represent a dynamic, living document. Developing your rules is not an exercise you go through once, store them away and never change them again. Just like a sailor, when the winds of change come, you must adapt your trades and compensate in order to reach your destination. Hence the following is a subset of Rule #1:

Your rules are a dynamic document subject to change.

Use the experience you gain in the market as a learning tool for your subsequent trades. You will also be introduced to a variety of principles and strategies that will launch your trading career as you work with your Mentor. Sometimes you will read something in a book, or look at a chart to review an idea you have studied, and the light will go on. We call them "AHA!" moments. When you have an "AHA!" moment, take time to write it down. This can be the embryo of a new trading rule. Even as you become more disciplined and experienced, you will find occasion to add, change, or otherwise modify your trading rules. Make sure to revisit these rules frequently. The following is the second subset of Rule #1:

Review your rules and your decisions frequently.

If you are like most people, you study out a trade, make the best decision you can, and place the trade not knowing what the future will bring. If the market gives you roses, you are happy. If the market gives you a skunk, you begin looking for reasons why your skunk should be a rose. It is a simple rule when it comes to market decisions that a rose is a rose and a skunk is a skunk. This means that if the market gives you a skunk, expense it and move on. This is the foundation of the third subset of Rule #1:

Don't look for information to support a bad decision.

Should the sailor have persisted in saying that the winds are coming from the south, because that is what the forecast said? If he does, he will find himself off course and will never reach his destination. If you persistently defend your decisions in the market you will persistently lose money. The markets change, and you have to be ready and willing to adapt to the changes. Trading is not about being right or wrong, trading is about correct responses to current market conditions.

Rule #2: I don't need to know what is going to happen next to be successful in the markets.

Many customers begin their training hoping to find the crystal ball that will lead to inevitable market success. Do yourself a favor and purge this thought from your mind. There is no golden ticket; there is no crystal ball or holy grail. The market is rooted in the world of probabilities and uncertainty. This is bad news to some; good news for others. It is bad because people

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naturally like certainty. It is good because the most successful businesses in the world are probability based business: Insurance, Gaming, Banking, Sales etc. It is good news because you have the opportunity to be a part of the income producing side of this industry, but you must learn how the game is played.

In a probability-based business, you invest on the side of higher probability. Think of your insurance company. Does your insurance company know if you are going to get in an accident next week? If they knew, they would cut your insurance this week. Your insurance company has no idea when or if you will get in an accident. However, they do know the probabilities of you getting in an accident, and they structure their business so that the probabilities produce more overall income than expenses.

Consider a casino. You walk into a casino and put a few quarters in the slot machine and win $100. The casino just lost $100, but are they upset you took home more money than you came with? No, in fact, when someone wins in the casino, sirens go off, you hear the sounds of money pouring out of the machine, and they come out and congratulate you. They just lost money and they are celebrating? The casino does not care how much and how often people win, because they have structured their business so that the probabilities work in their favor. This is the difference between a professional and a gambler. The professional only plays when the odds are in their favor, while a gambler has no problem going against the odds. Though there are many gamblers that enter the markets, you are not to be one of them.

Both industries understand that in the short run it really doesn't matter if they have to pay out on a claim, or if someone hits a winning streak in the casino. They are confident that in the long run things will work out in their favor. The markets are no different. Not knowing whether your next trade will be income or expense is not a problem as long as you have created a system that structures the probabilities to work in your favor over the big picture. This provides the basis of the first subset for rule #2:

It doesn't matter what happens in the short run, it is the long run that matters.

Have you ever gone surfing? When you go surfing you swim out to a point where the surf is just beginning to break, then you tread water waiting for the right wave to carry you back to shore. In the markets you may have to tread water while you wait for a good trade to bring you back to shore. This means that you may have several expense trades in a row before you actually take a winning trade. Treading water can be devastating if you have not created a system that minimizes your losses and maximizes your gains. A good surfer understands that the right wave will take them all the way to shore. A good trader understands the right trade will more than compensate for "treading-water" losses. This leads to the second subset of rule #2:

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Cut your losers and let your winners ride

Remember that the markets are full of uncertainty, but you do not have to know what will happen next in order to be successful in the markets. Just like the casino doesn't have to know who is goning win the next hand of blackjack to succeed in the long run. While the markets may be uncertain, you want your responses to be certain, precise, and calculated. Uncertain markets plus uncertain reactions equals market failure. Uncertain markets plus certain, precise and calculated responses equal market success.

Rule #3: I need an advantage to be successful in the markets.

You have learned that it is not necessary to know what is going to happen next in the market as long as you have developed a system that skews the probability in your favor. Your "advantage" is the mechanism that skews the odds in your favor.

Every trader is different. Each has their own set of skills, resources and goals, so each must discover their own advantage. Perhaps your advantage is in chart reading, fundamental analysis, or perhaps it is in Zen meditations. Whatever your advantage, you must quantify its properties and qualify its success. Hence the first subset of Rule #3:

Your advantage must be quantified and qualified

To quantify an edge you must be able to define it. When someone asks how you trade the markets you must be able to tell them in simple words, what makes you successful in the market. One trader quantifies his advantage as follows:

> *I trade market gaps. Gaps represent an abnormal trading interest and are the fingerprint of a trading "rush." The odds of a quarterback sack are significantly increased when the defense rushes, similarly when market gaps are accompanied by increased volume my probability of a successful trade increases.*

Think back on your training and experience, and record a trading advantage that really makes sense to you. Record your edge and share this with your Mentor. Please note that your edge may change as you progress in knowledge and understanding of the markets. An example may be a certain chart pattern like the Pullback Buy pattern that you have noticed preceeds moves higher more often than it preceeds moves lower. In other words it puts the probabilities in your favor giving you an edge.

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More than just defining your advantage, you must qualify it with statistics, which means that you take an objective measure of the success of your advantage. Remember that it does not matter what happens in the short run. Anyone can step into a casino and win; it is a result of luck. Anyone can step into the market and make a few good trades. The distinguishing factor of success is how well you perform over the long run.

How do we measure success? Take a minute to list the things you would like to know when evaluating your long-run performance. Record your responses and share them with your Mentor:

Included in the list above should be your win loss ratio, reward to risk ratio, capital risked, average drawdown, max drawdown, min drawdown, average time in trade, etc. By now you should have a basic understanding of these

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concepts. If any of the terms are foreign to you, please discuss them with your Mentor.

After you have defined and quantified your advantage you can begin to recognize trading as a business. This is the second subset of Rule # 3.

Treat your trading like a business

A successful business begins as an idea. The idea is quantified and qualified through a business plan. The business is then built upon the plan and modified through experience. It is the objective of the business to operate profitably. The manager tracks and monitors the health of the business to ensure the company reaches its objectives. You should now be able to see the similarities of trading and business.

As you create your trading business, approach it with a goal of profitability. The casino industry operates an extremely successful operation with as little as a three percent advantage. For example out of 100 games played, the casino will win on average 53 times and the patron 47 times. If you consider the amount of games that are played in a casino, this rather small advantage creates significant profits over the long run.

In your trading business, your objective is to turn your market advantage into profits. Your market advantage may give you a 6 out of 10 win-loss ratio. This means that out of 10 trades 27 will produce an income and 4 will produce a loss. You should consider your winning-trades income, and your losing-trades expenses. Isn't an expense just the cost of doing business? Looking at it in these terms will help you overcome the emotions of a losing trade. Now, failed trades just become a cost of doing business like paying the lease on your building.

You want any business to be profitable. Profitability is defined as income minus expenses. To become a profitable trader your income must exceed your expenses. Is it possible to have nine-losing trades and one-winning trade and still be profitable? Certainly, if your winning trade brought in $2700 and your nine-losing trades cost you $250, you were profitable. This illustrates the point that you must have a mechanism in place that will help you get out of a losing trade quickly, before your expenses get too big. Your Mentor will play a simple marble game with you to drive the importance of this point home when you meet with them. This also introduces a third subset of Rule #3.

Part of your trading advantage should be an exit strategy

According to Kenny Rogers, "you've got to know when to hold 'em, know when to fold 'em, know when to walk away, and know when to run!" Sports fans understand this concept a different way, "the best offense is a strong defense." However you understand it, remember that you will never be

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profitable in business by letting your expenses get out of control. And just as important is to keep your income trades until they reach your targets. Your exit strategy is an integral part of your trading plan.

Everything we have discussed to this point is geared to help you determine your trading resources, establish your trading objectives and develop your trading rules. Your trading rules become the basis for your trading system. Your trading system with your accompanying market advantage becomes a profitable business that will provide you with a way to reach your life goals. Keep in mind that you will have a business plan for your trading business with its accompaning rules and guidelines and you will develop a trading plan for each and every individual trade. Your ability to manage your trading business, and follow your system, will ultimately dictate your success in the market.

Paper Trading

If you are an experienced investor, you have probably used paper trading to one extent or another in the past. If you are new to the stock market, this may be a new concept. Paper trading gives you a way to act as if you are trading stocks based on the analysis and signals you will learn to recognize in this program without risking any of your hard-earned money. For the beginning investor, paper trading is an acceptable way to get started and begin to build experience. Experienced traders will "backtest" and use paper trading from time to time to reinforce new concepts and systems they are interested in integrating to their existing investment plan to quantify it and make sure it stands up to the test of the market.

You can paper trade using a couple of different methods. One is to simply keep a paper log of each trade you make. As you find a stock that seems to fit your requirements, write down a buy order for the stock. Include the "Ask" price of the stock at the time, how many shares you purchased, and the total dollar amount. Also write down the logic you followed to place the trade, and why it seemed like a good move.

Your justification for the trade, how much money you allocate to the paper trade, and every step of your analysis should follow the Threshold Trading Method™ you will be going through in this manual. The more closely you follow the specifics of the Method, the more paper trading will work for you.

After you have entered your initial buy order, put the stock in one of your software watch lists and keep track of it on a daily basis. If the time seems appropriate to sell the stock and realize your profit, write down a sell order. If the stock moves in the opposite direction you had anticipated, write down a sell order. Include the "Bid" price for the stock at the time, how many shares you sold, and the total dollar amount, and the reason you sold. Write down the difference between your buying and selling price. This is the stage where paper trading becomes valuable. If you have an income paper trade,

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then you have your first profitable trade under your belt. Look at the trade from beginning to end. Did you get lucky, or did you make the correct read? The fact that you are profitable doesn't necessarily mean that you hit the nail right on the head the first time. Don't feel bad if you got lucky; traders will take luck when they get it. But they will also make sure to analyze the trade from beginning to see if there was something else they should have seen or done differently. Hind sight is 20/20 when it comes to trading. Write down your observations about what went well or what you could do differently, and how you intend to use that information in future trades.

When you have a profitable trade, make sure that you keep track of how profitable the trade actually was. Part of the purpose for paper trading is to log as many trades as possible. After you have several profitable trades, you can begin to compare each trade against the others and calculate your average profit level. This is an important number to keep track of as you develop your trading system. Make sure that you write this number with the other information in your trading log.

If your paper trade was a losing trade, don't be discouraged. It is perfectly normal for every investor regardless of knowledge and experience to have expense trades. The beauty of paper trading through these expense trades is that you have risked nothing, and can use the information about the trade to figure out what happened. Look at the trade from beginning to end. Was there a signal you missed or should have been waiting on that would have kept you out of the trade in the beginning? Was there a signal earlier in the trade that would have gotten you out at a better time? It is entirely possible, in fact likely, that you will have trade setups that look technically perfect, but simply don't work. Looking at the trade objectively will allow you to identify if you misread the trade or if it was just doomed to failure. Write down all of your observations about what happened in the trade and how you intend to use that information in future trades.

Just as it is important to evaluate how successful you are in income trades, it is important to quantify just how much money you lose when you expense a trade. You will expense many trades; every trader does. Keep track of just how wide or narrow the expense in each one was. After you have logged several of them, compare each expense trade against the other and calculate your average expense. This is commonly referred to as your "drawdown." Make sure that you write this number with the other information in your trading log.

Once you have both average income and average drawdown levels, you can begin to evaluate them against each other. This will help you figure out how much money you should put into individual trades and apply other critical money-management principles, which you will be learning about in more detail in the chapters to follow.

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You can apply the same discipline and learning experience to paper trading in an electronic format. Some third-party websites can provide you an opportunity to paper trade, some even allow you to compare your results in a competition-type atmosphere. Many brokerages also provide a paper-trading platform through their web-site. Although the order entry and tracking process is easier than what you would be doing by writing orders down on paper, you should still be careful to write down your analysis of the stock, your rationale for making the trade, and your summation of the end result and how it will apply to future trades.

The best thing about paper trading is that it allows you to build some experience without risking capital. Do keep in mind, however, what we said earlier about paper trading. The only way to “really” learn to trade is to actually get into the market with live trades. So we would much prefer to see you actually get into the market trading with very small lot sizes in the beginning. Paper trading though is useful anytime you are trying to learn a new trading system, which is why even experienced traders come back to paper trading from time to time to initially test a new idea or strategy.

CHAPTER 2

Trade Information

Experience is that marvelous thing that enables you to recognize a mistake when you make it again.

– Franklyn P. Jones

Chapter Two: Trade Information

Information That Works for You

The purpose of this section is to reinforce the basic components of trading. These concepts should be familiar to you. If you are having difficulty with mastering any of these concepts be sure to discuss it with your Mentor before you move into the practical, hands-on application.

In this section of the Mentor manual we will cover trade basics, including the following:

1. Trend
2. Support
3. Resistance

Trade Basics

Chart reading is the foundation of trading. A successful trader anticipates future-price movement by studying current market action. Certain aspects of technical analysis are challenged by the investing community, but the two technical tools that have near universal appeal are that of trend, and support and resistance. We call these the basics; they are a firm foundation upon which you can build a profitable trading system.

Trend

A dictionary definition of the word trend is, "the general direction in which something tends to move; a general tendency or inclination." As it relates to the market, it is the general direction in which price moves. While the specific development of a trend is unique and random, there is a basic pattern of development that is common to all trends. We refer to it as the Four Stage

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Trend Development Process. It is important to know what these stages are and how to identify them.

Stage I – Trend Development

As a trend begins, there is very little direction in the market. The market is classified as flat, consolidating or sideways. Stage I is highly speculative and few traders participate during this phase of the trend. Traders assume high levels of risk in hopes of large gains. At this stage the market is normally oscillating within a range of support and resistance. The beginning stage will end with a breakout of the trading range. A breakout can be fast or slow, depending on the amount of popular interest in the stock; it is usually associated with an increase of volume. Breakout and increased volume are early indications that a trend is about to begin. Figure 2.1 provides an illustration of Stage I.

Fig. 2.1

The market escapes the sideways action by breaking a key resistance level.

Stage II – Trend Development

Stage two begins after the breakout has occurred. The beginning of stage II is shrouded with uncertainty. However, more traders enter the market with the hopes of participating in the trend. Many traders look for the market

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to return to the breakout point before they will enter. However, depending on the force of the breakout, the market may or may not come back to the breakout point. In stage II, you would look for the market to begin developing a trend of successively higher supports. You would also expect the market to increase in volume as the trend gains more participation. Figure 2.2 provides an illustration of Stage II.

Fig. 2.2

In Stage II, a stock must continue to measure higher and higher peaks, along with higher and higher valleys, in order to maintain the trend.

Stage III – Trend Development

Stage III is where the masses join in the trend. You may notice a spike in price or volume as the investing public enters the trend. The psychology behind this stage of a trend indicates that everyone who wants to participate in the market does so now, when the trend is well established. Stage III also marks the beginning of the end. After stage III, there is very little money left sitting on the sidelines. Most interested investors have already joined the trend. Figure 2.3 demonstrates Stage III.

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Fig. 2.3

You will notice that in Stage III volume picks up significantly and more and more traders join in the upward march.

Stage IV – Trend Development

Stage IV marks the final stage of the trend. As noted above, there is very little money left to continue the trend's progress. The trend begins to test key-support areas. Speculators begin dumping their shares on signs of strength. The market fails to break previous resistance levels and begins to move sideways.

This sideways movement tells us that we ought to proceed with caution, as a new opposing trend may be looming. It is difficult to know where the market will go after Stage IV. The market can maintain its sideways action, resume its up trend, or reverse, and begin a downtrend. Figure 2.4 illustrates Stage IV.

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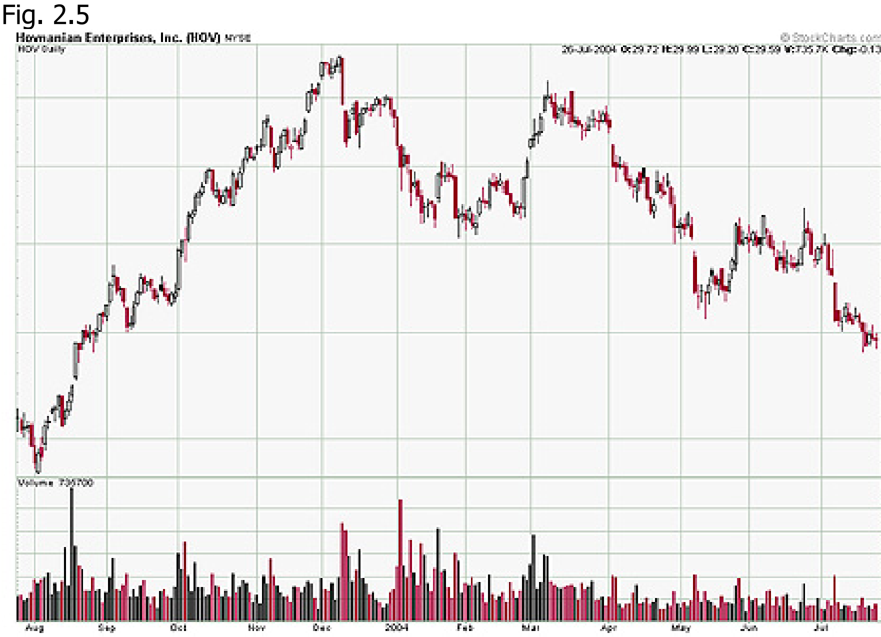
Fig. 2.4

Trend Identification Exercise… 10 min.

Using the chart in Figure 2.5, circle and label Stages I through IV of the trends.

Fig. 2.5



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Trends and Time

Another basic tenet of trend analysis is this: "A trend in motion stays in motion until an equal or opposite force acts upon it." The driving force of any market trend is basic supply and demand. If demand exceeds supply, stock price will go up. If supply exceeds demand, price will go down. You know that in an upward trend, price will continue to rise until it reaches a point where it is so high that it begins to attract sellers that were previously not interested in selling and no one is left that wants to buy it. Then the supply exceeds demand prices begin to fall.

For our trading purposes, we will always be interested in three-major time frames:

1. Primary or Longer-Term Trend
2. Intermediate or "Set Up" Trend
3. Short-term or "Entry" Trend

Primary trends. This will be our Longer-Term trend that will give us the big picture of our trading. The overall direction or push. We will always want to trade in the direction of the trend. Depending on our chosen trading objectives we may use the Monthly, Weekly or Daily charts to measure our Longer-Term trend. Figure 2.6 is an example of the primary trend shown from a weekly chart perspective and would be useful for the person whose trading objective is longer-term investment type trades with an average hold time of two to eight Months.

Fig. 2.6

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Intermediate or Set up Trends. They are considered market corrections, where the market responds to problems of over-supply or over-demand. An event that might precipitate a change in the intermediate trend could be an earnings announcement or a management change. These corrections or pullbacks which occur in the context of an overall up trend simply give us an opportunity to buy an otherwise strong stock (evidenced by the longer-term Primary trend) at a "wholesale" level. For example if you were using a monthly chart to identify your Primary trend then you would look for the stock to "SetUp" on the weekly chart before you would be interested in purchasing. Figure 2.7 is an example of an intermediate trend.

Fig. 2.7

Short-term or Entry Time frames. We will use the shorter-term time frame to time our actual entry into the stock. We will be looking for signs that the intermediate-term trend is beginning to reverse and start heading back in the same direction of the Primary trend. This shorter-term time frame will help us identify these inportant entry points. To continue with our example, if the stock is "SetUp" on the weekly chart then we would look to the daily chart to time our entry. This is one of the ways we stack probabilites on our side, by using three different time frames to stack the odds of success on our side to qualify the stock for "Entry" at this time. Figure 2.8 is an example of a short-term trend.

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Fig. 2.8

Trend/time relationship

It is important to note that longer-term trends are made up of shorter-term trends. The primary trend is formed by a series of intermediate trends. The intermediate trend is formed by a series of short-term trends. One of the first steps in trend analysis is to identify which trend you are looking at, and how the current trend relates to trends of other time frames. Figure 2.9 demonstrates the relationship of each trend to one another.

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Fig. 2.9

The trend is your friend

There is a popular saying in the market that the "trend is your friend." This means that when you are trading stock, you should always trade in the direction of the next larger trend. For example, if you are looking for a short-term trade, identify the direction of the intermediate trend first.

There is simple logic behind this idea. Look at Figure 2.10. Let's determine that we want to trade the intermediate trend. First, notice that the direction of the primary trend is up; this means that you are bullish on the stock, so you can look for a favorable-entry point on the intermediate-term trend. If you bought at point B and exited the trade at point C, you would have made approximately $141. The reward is always greatest when you trade in the direction of the trend. We only risk our capital where the greatest reward lies and that is always with the trend.

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Fig. 2.10

Point B is an excellent entry point. The primary trend is up — Point B is the bottom of the intermediate trend, and the bottom of the short-term trend. Point B is also called the "triple crown" of trading because all three-trend lines are merging, while the primary trend is up; all signals point to buy.

Trend Direction

The market can take any of three directions: up, down, or sideways. A simple way to determine the direction of a trend is to look at the peaks and valleys of the market. An up trend shows higher and higher peaks (also called "swing highs"), along with higher and higher valleys (also called "swing lows"). A downtrend is defined by lower and lower valleys, along with and lower and lower peaks. A trendless market has peaks and valleys that are not moving any higher or lower. Trend direction gives us our first tool in technical analysis: the trend line. A trend line is a graphical representation of a current trend.

While there is no "right" way to draw a trend line, because it is your interpretation of the market, we have put together some guidelines to help you begin drawing trend lines. Also keep in mind that the most recent peaks and valleys carry the greatest weight when drawing trend lines. Also keep in mind that when we draw these lines it is simply to identify areas, not exact points. They are somewhat flexible.

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Trend line guidelines: Up

An up trend line must have a positive slope. It will be formed by connecting two or more valleys, where the second valley is higher than the first. The up trend line acts as support and indicates that demand and price are increasing. A rising price combined with increasing demand is considered bullish; it shows a strong buying conviction on the part of buyers. As long as price remains above the trend line, the up trend is considered solid and intact. A break below the up trend line indicates that demand has weakened and a change in trend could be imminent. Figure 2.11 demonstrates an Up trend line.

Fig. 2.11

Trendline guidelines: Down

A down trend line has a negative slope. This line will be formed by connecting two or more peaks, where the second peak is lower than the first. Down trend lines act as resistance and indicate that supply is increasing even as the price declines. A declining price combined with increasing supply is bearish; it indicates strong resolve on the part of sellers. As long as price remains below the down trend line, the downtrend is considered solid and intact. A break above the down trend line indicates that supply and demand are balancing out and a change of trend could be imminent. Figure 2.12 demonstrates a Down trend line.

Notes

Fig. 2.12

Validation

Two or more points are needed to form a trend line. The more points you use to draw the trend line, the stronger the support or resistance level represented by the trend line will be. Sometimes it can be difficult to find more than two points from which to construct a trend line; sometimes the lows or highs just don't match up. In this case, it's best not to force the issue. The general rule of technical analysis is that it takes two points to draw a trend line, with a third point to confirm the trend. Figure 2.13 gives an example.

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Fig. 2.13

In Figure 2.13, we could have drawn the trend line after the second bounce off resistance; however, it is the third bounce that confirms the trend. Points 4, 5, 6, and 7 are evidence of the strength of the trend.

Strengthening or Weakening Trends

At times a chart will show what appears to be the possibility for drawing a trend line, but the points do not quite match up. The highs or lows may be out of whack, the angle may be too steep, or the points may seem too close together. A solution to this dilemma is to draw another trend line at a sharper or weaker angle; this is useful to the trader because it signifies a strengthening or weakening of the trend. The method is simple: when you are identifying the current trend of the stock, if you have a steep trend that may not be sustainable, wait until the trend line is tested before making any buying or selling decisions. If it is broken, that is your first strike and you have to re-draw the line. Keep re-drawing until a trend line is identified and the stock can be traded comfortably. If the trend line is broken on the third re-draw, you should move on to a different stock.

As you find yourself drawing and re-drawing trend lines, you may ask, "How often can I adjust the trend line to accommodate a strengthening or weakening market?" We recommend following the baseball rule: three strikes and you're out. It is common for the initial phase of the trend to be too steep to maintain. Figure 2.14 gives an example.

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Fig. 2.14

In Figure 2.14, note that the market's initial surge formed a nice, clear trend line (A). Notice, however, that angle A is too sharp; the market is not able to sustain the pattern. This is strike one. As the market corrects back to a more sustainable trend, you must redraw the trend line (B). Unfortunately, this new trendline is still too steep for the market to sustain. Strike two! The final trend line (C) is comfortable and sustainable; the trend continues for several months.

Trend Identification Exercise…15 min.

Use the chart in Figure 2.146 to identify the direction of the primary, intermediate, and short-term trends. On the chart, draw and label each trend line.

Fig. 2.15

Primary-trend direction:	Up	Down	Sideways
Intermediate-trend direction:	Up	Down	Sideways
Short-Term trend direction:	Up	Down	Sideways

Peaks and Valleys

As we have already discussed, trends move in a series of peaks and valleys. It is the nature of those peaks and valleys that define the trend of the market. Peaks and valleys also indicate levels of reversal in the market. Valleys are called support levels; peaks are called resistance levels. They can also be referred to as swing highs (peaks) and swing lows (valleys).

Think of the market as a head-to-head battle between a bull (the buyer) and a bear (the seller). The bulls push prices higher and the bears plunge prices lower. The direction that a price actually moves reveals who is winning the battle. Peaks and valleys represent areas where one combatant dominates the battle.

Support and Resistance

Support comes at the end of a sell off or decline; it is commonly defined as the price level or zone where demand for a stock overwhelms supply. This change in supply and demand stops the decline and pushes the price higher. Logic states that as price declines towards support and gets cheaper, buyers become more inclined to buy and sellers become less inclined to sell. The

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more the market hits this zone and moves higher, the stronger the support becomes. A support is also called a floor. Figure 2.148 gives an example of support bolstering the price of a stock.

Fig. 2.16

Resistance comes at the end of a rally or rising price; it is defined as the price level or zone where the supply for a stock overwhelms the demand. This stops the current advance in price. Logic states that as price rises towards resistance and becomes more expensive, sellers are more inclined to sell and buyers are less inclined to buy. The more the market hits this zone and moves back down the stronger the resistance level becomes. A resistance is also called a ceiling. Figure 2.17 gives an example of resistance inhibiting a further rise in the price of a stock.

Notes

Fig. 2.17

The concept of support and resistance is a critical factor for successful trading. In developing your trading system, you will want to coordinate entry points with support zones and exit points with resistance zones. Recognizing these zones of support or resistance, you will make better forecasts and improve entry and exit timing.

Let's come back to the word zone in the definition of support and resistance. A zone means that support and resistance is not a hard and fast price, but rather a general price area where you will need to take some kind of action. Think of the zone as a trampoline: When you jump on a trampoline, you break the plane of the mat before bouncing up. In the same manner, a stock that crosses a support line for a few days will often bounce up again.

Traders consult support and resistance zones for an idea of where markets will change direction. For example, if your stock has had a previous peak at $35, then you would look at that price level as the stock approaches that level again to mark a zone where the markets might turn around in the future. Likewise, if you had a previous valley at $20, you would look at that price level to give you support in the future as the stock drifts lower.

Benchmark Highs and Lows

Remember our definition of an upward trend? An upward trend must have higher and higher highs, and higher and higher lows. If we are in an upward

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trend, we must beat the previous peak to continue the trend. If we fail to make a higher high, then we are in danger of breaking the trend. To compensate for this fact, we call the previous resistance a benchmark high. Figure 2.18 demonstrates the use of a benchmark high.

Fig. 2.18

In Figure 2.18, the benchmark high is a standard which must be passed if the trend is to continue. If the market fails to exceed the benchmark high, the trend is in jeopardy of reversing. A downward trend, of course, is identified by lower and lower highs with lower and lower lows. Hence, the previous valley, which we identify as a support level, should be passed in order for the downward trend to continue. In a downward-trending stock, the previous valley is considered a benchmark low, a standard used for comparison that we must pass in order to continue the downward trend. Figure 2.19 demonstrates the use of a benchmark low.

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Fig. 2.19

In Figure 2.19, the benchmark low is a standard which must be passed if the trend is to continue. If the market fails to exceed the benchmark low, the trend is in jeopardy of reversing. Support and resistance are like floors and ceilings of a multiple-story building; they reverse roles as you climb up and down the stairs. If you start out on ground floor and climb the stairs, your old ceiling becomes your new floor. Similarly, as you rally through a previous peak, or benchmark high (your ceiling), then you look for that point to become your new support (your floor). There is an industry adage to help you remember this concept: "Old resistance becomes new support; old support becomes new resistance."

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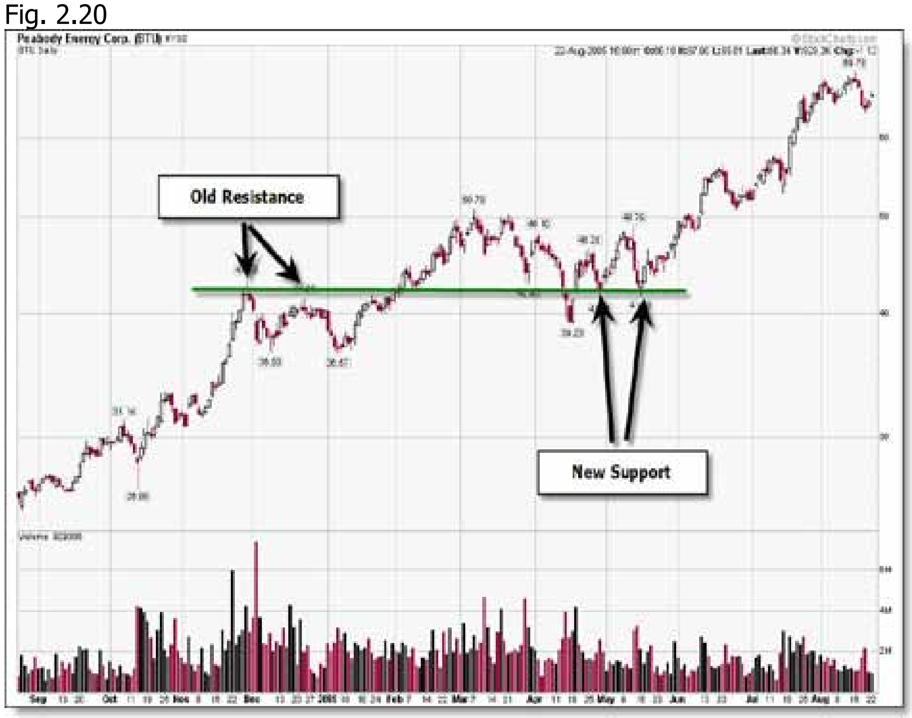
Figure 2.20 gives an example of how support and resistance often reverse roles.

Fig. 2.20



Moving Average as Support or Resistance

We will discuss moving averages in more detail later, but it is important to note here that moving averages are an excellent tool for identifying support and resistance zones. As a market is trending higher, you can use the moving average as a support zone. Likewise, as a market is trending lower you can use the moving average as a resistance zone. Figure 2.21 demonstrates a moving average providing support.

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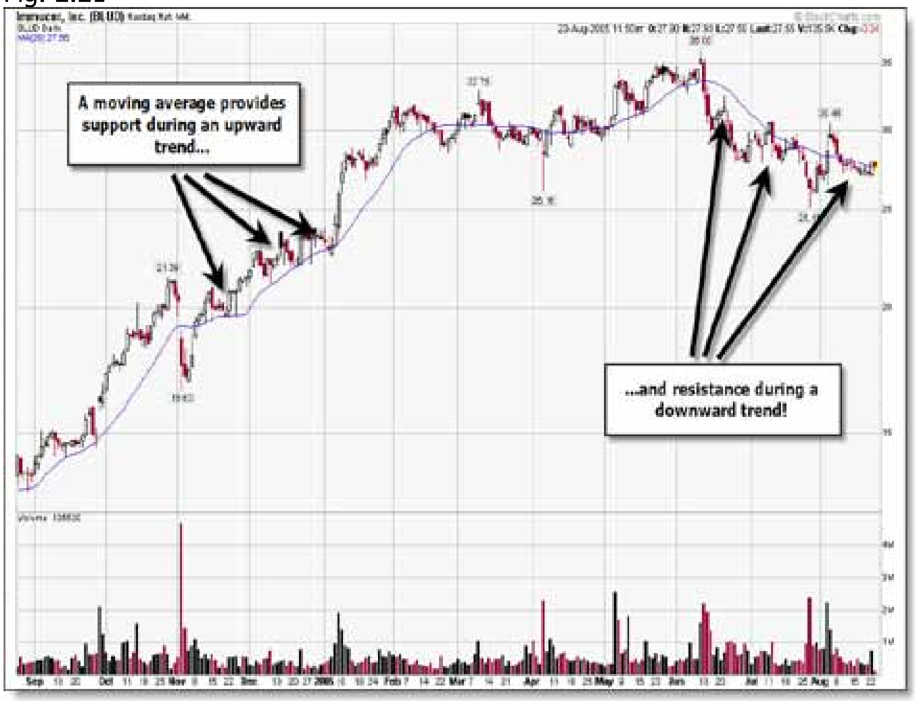
Fig. 2.21



Although moving averages are convenient and easy to see in identifying support and resistance they are less useful in a sideways or trendless market. During these times, you will get multiple false breakout signals, as demonstrated in Figure 2.21. As a general rule, do not use moving averages as support or resistance in sideways or trendless markets. In these cases, you will need to identify support and resistance levels based on historical trading patterns.

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Fig. 2.22

The roles of support and resistance reverse as the market breaks the moving average. In an upward-trending market, the moving average provides good support and buying opportunities. As the market breaks down through the moving average, it reverses roles and becomes resistance. The opposite is true as well — as the downward-trending stock breaks up through the moving average, the resistance reverses roles and becomes support.

It can be hard to know whether the market is actually breaking a support or resistance level or whether it is bouncing off it like a trampoline. The markets are not always clear cut, but there are some guidelines for filtering out bad signals. Keep in mind that support and resistance levels are action zones. If you identify a support zone, you will be looking to take action, or buy, anywhere in that zone.

Summary

Technical analysis is the discipline of using historical price action to forecast future price trends. We cannot emphasize enough the importance of trends, support, and resistance. Since the market is not an exact science, we are working in the world of probabilities. These three concepts tip the scale of stock market probability in your favor.

CHAPTER 3

Trade Management

Emotions are your worst enemy in the stock market.

– Don Hays

Chapter Three: Trade Management

What Triggers Your Trade?

To this point, you have discovered the mindset of a trader, and inventoried the skills that will help you succeed. Next you explored the concepts of trend, support, and resistance, and built the foundation for technical analysis. This section is an introduction to concepts and techniques that will allow you to enter, monitor, and exit a trade. You will learn:

1. Charts, the Traders Blueprint
2. Multiple Time Frame Analysis
3. Bull Pullback Entry Technique
4. Trade Entry Techniques
5. Tracking Your Trade
6. Trade Exit Techniques

Charts, the Traders Blueprint

Remember the movie "Men in Black?" There is a scene at the end of the movie where the camera zooms out from earth. As the camera zooms out you see a different perspective of earth, beginning with a street, then a neighborhood, continents, world, and galaxy. The movie provides a visual example of how things may not be as they seem. As you begin to understand charting, you will notice that your charting software provides you the option to view different time formats. You can view monthly, weekly, daily, hourly, and minute charts. Just as the changing view of earth provides you a different perspective, changing your charts time format changes your perspective of the markets.

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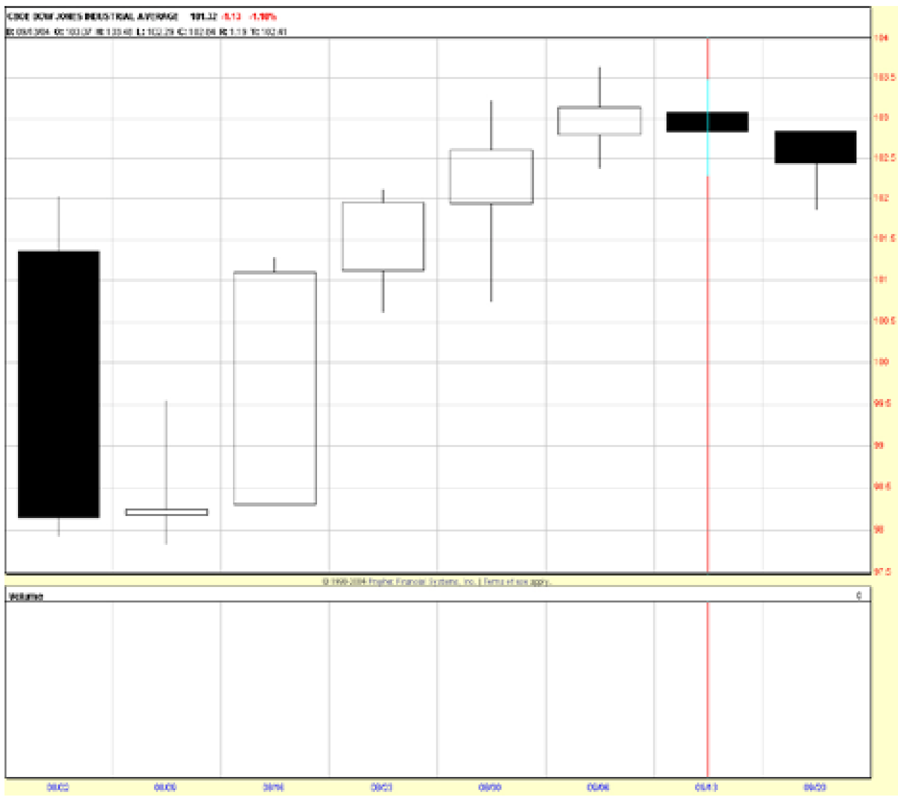
The question is often asked, "What time setting do I use for chart analysis?" You can discover the answer to this question by completing the following exercise:

Charting Exercise

Look at the following weekly chart for the Dow Jones Industrials. The chart begins August 2, 2004 and ends September 22, 2004:



You will notice that except for the first and the last two bars of the chart the market was trending positive.

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Now look at the same time period on the daily charts:

The vertical red lines highlight five-consecutive trading days, and correspond to the weekly bars of the previous chart. You will notice that the blue arrows illustrate that during the seemingly positive upward weekly trend, there are actually down days.

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Now look at the hourly chart of the same time period:

Again, the vertical red lines highlight five-consecutive days of trading. You will notice a couple of developments: First, over a third of the weekly uptrend is composed of shorter-term down trends, as highlighted by the blue trendlines. Second, you will notice that the upward thrusts, indicated by the vertical orange lines, are usually stronger and sharper than the shorter-downward movement.

The example shows progressively more detail as you zoom in to shorter-time frames. Weekly charts provide different buy and sell signals than the daily and hourly charts. The chart you choose for your analysis should be a result of your risk tolerance and the time you are willing to spend watching the markets. If you choose to trade the hourly charts and if you were not tuned into the markets, you may miss the quick upward thrusts. If you choose to trade the weekly charts and if you are tuned into the market all day long, you might get frustrated to see the market moving against you over 33 percent of the time.

When trading longer-time frames, keep in mind, that even in long-term upward trends you will still experience down times. In the previous exercise, over 1/3 of the time the market was heading lower. It is easy to make mistakes. You can have a hold signal on the weekly charts and get excited

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the market is moving higher. The anxiety of seeing the market move higher can tempt you to buy more. This is akin to shopping on an empty stomach; you walk down the aisle and grab all the stuff that looks good knowing full well that your cupboards are full at home. Your short-term signals are saying buy, buy, buy, and your long-term signals are saying hold, hold, hold.

Multiple-Time Frames

This leads to a discussion on using multiple-time frames in your analysis. A common strategy used by many traders, incorporates using one time frame to provide the set up, and a shorter-time frame to provide the entry point. Think of a fly fisherman, and how he scans the water for a formation that is known to attract fish. Once the fisherman finds the attraction, then he surveys the current to determine the best place to land the fly. As a trader, if you use a multiple-time frame strategy, you will use longer-time frame charts to provide you the set up, and smaller-time frame charts to signal the entry point (the best place to land the fly).

The rule in using a multiple-time frame entry technique is that the longer-time frame dominates all trading signals. For example if the shorter time frame is giving a buy signal and the longer time frame is giving a sell set-up, you do not buy. If you are between a buy setup and a sell setup (this is the definition of a hold signal) and the shorter charts are giving you buy signals, do not buy.

You can begin to understand how important charts are to your trading. If you were to build a house, the house would be built on paper long before you start moving dirt. The features are drawn and recorded so every detail of the building process is outlined. Charts are similar in that they illustrate the features of a good trade. They show the set ups and provide signals for "building" a trade.

Bull Pullback Buying Opportunity

Now that you have a solid understanding of how to identify the trend and use moving averages, you can use this information to begin looking for trading opportunities. Perhaps the most common buy setup, and one of the easiest to identify, is the Bull Pullback. While the details of each trade setup are unique, there are common characteristics that will help you identify the Bull Pullback on any stock chart:

1. An overall upward trend – either already started or in its early stages.
2. A two to five-day retreat in price.
3. The price begins to approach the up trending moving average.
4. Lower volume on the days the stock has retreated than on its previous up days.

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Figure 3.1 is an example of a stock that may provide an opportunity for a trade based on the Bull Pullback strategy. The charts we will be looking at are based on daily movements; each candlestick in the chart represents one day of trading activity.

Fig. 3.1

Clearly, this stock is in a nice upward trend. The highlighted area is the last few day's activity. The current day activity shows that we are in the fourth day of a retracement from an all-time high. We are approaching an upward-trending moving average. Volume in the last four days has been lighter than the volume in the up days preceding them, so this four-day retreat is the kind of normal, orderly retreat from a high that we would expect to see. Although it isn't a requirement for the Bull Pullback strategy, the fact that the stock is retreating from an all-time high is another encouraging sign; if the stock bounces off the moving average as expected, it is likely to push through that previous high and begin establishing new highs.

So this stock meets all of the criteria for the Bull Pullback strategy. This stock has "setup". This doesn't mean that you would buy it yet but a set-up is a prerequisite, it is one of the things that stacks the probabilities in our favor. This means watch the stock using a smaller time frame (the 620 minute chart in this case) for the next couple of days to see if you get the confirmation of the reversal as you expect. That is when you "enter" the stock.

One way to confirm the move, or trigger an entry for your trade, comes when the stock closes above the previous day's high price. Strong or increasing volume on that day provides further confirmation of the move. For the stock in Figure 3.1, we would want the stock to close above today's high of $33.93 before we would get in. Let's look at some historical data for another stock, shown in Figure 3.2 that illustrates the entry point into a Bull Pullback trade.

Fig. 3.2

The highlighted areas show two different times you could have used the Bull Pullback strategy to identify buying opportunities for this stock. In the first, notice that after the stock drifts down to the up-trending moving average, the first up day didn't move up enough to trigger a trade. That signal didn't come until the second up day, when it exceeded both the previous day's high and the high two days previous.

The second example gives a more classic illustration of a Bull Pullback entry. After consecutive days of retracement, the stock closes significantly above the previous day's high price. As we can see, both of these signals led to appreciable moves in the stock on the upside.

Entering a Trade

If you are ready to place a trade and all signs say go, an effective approach to managing your trade is to start small. Suppose you wanted to put a total of $20,000 into a trade. Start the trade by placing 25 percent of that amount into the stock at short-term entry points. If only $5,000 of your $20,000 is in the stock at the beginning, you have a much smaller risk exposure if the setup doesn't materialize. If the stock does strengthen as you anticipated, then you can add to your position in increments until you have reached your targeted position. Although you are not maximizing your profit potential as if you were totally invested from the beginning, it significantly lowers your risk. This concept is referred to as scaling in. It is a strategy most successful trader's use, especially those who trade for a living.

Now suppose you have a profitable trade, and the stock has begun a steady rise in price. You are enjoying the increased value, but notice that the stock

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is beginning to reach a resistance area. If you apply the business mindset, you are beginning to think that it is time to sell the stock and take your profit. You have bought low and are selling high. In reality, two things can happen to the stock at this stage: it could hit resistance and break down, or it could break through that resistance level and climb even higher. If it continues its upward march, the point where it breaks its resistance is a good time to add to your initial $64,000 position and raise your stop loss. The larger position size allows you to gain greater profits from the stocks continued upward trend. Raising your stop loss protects you from downside risk if you are wrong. You can continue to follow this process until you have reached your targeted position, or the trend weakens. Keep in mind that these areas we are talking about are on the smaller “Entry” time frame. This entry time frame is the same time frame which we will use for our Trade Management as well. Trade management includes raising stop loss, setting scale in points, setting scale out points, etc.

Trade Management

Trade management is the continual process of controlling and monitoring your trades. Effective trade management allows you to make sure that you don’t put too much of your money in on a single trade, that you monitor the stock for the right signals to get in a trade, and that you act quickly when the time comes to get out of a trade – regardless of whether the trade is profitable or not.

Many people equate trading in the stock market to gambling. There are parallels, and many of the same principles you will see professional gamblers use to manage bets apply to managing trades. Refer back to the Kenny Rogers song “You gotta know when to fold ‘em.” A professional gambler knows when to get out of a losing hand and cut his losses; whereas a novice might try to increase his bet on the remote chance he just happens to get the card he needs to win. Active stock traders have the same mindset as the professional gambler; when a trade stops working, the successful trader will sell the stock and look for something else before a bad situation gets even worse.

A common market maxim says, “Buy low, sell high.” This sounds simplistic, but too many investors lose money in the market because they do exactly the opposite – they buy high, and sell low! When thinking about your trading, equate trading to running a retail business. Retail stores make money by buying their products at wholesale and selling at retail, which are marked up from the wholesale cost. You should approach your trades in the same way. You should buy stocks when their prices are low, or at wholesale levels, then sell them when they reach higher or retail levels. Use your trend lines to help you with this. Think of the lower trend line as the wholesale area and the upper trend line as the retail area.

By now you have become familiar with the terms support and resistance. As a general rule, you should buy at support and sell at resistance. Wholesale

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prices occur when stocks reach support levels, and retail prices are at resistance levels. Just as the business owner wouldn't buy merchandise at retail cost, you should stay away from buying stocks when they approach resistance levels. This sounds obvious, but the truth is that many investors who "buy high and sell low" buy high because they think the stock will continue to run along its terrific upward trend, and then are dismayed when it drops off its resistance level. A better approach to that kind of situation would be to see if the stock does indeed break that resistance level before entering the stock.

Trade Management and Technical Analysis

Simply analyzing support and resistance levels doesn't guarantee that as a stock approaches a support level it will bounce and go higher again. Another common saying in the market is "the trend is your friend." Make sure that every trade you make is consistent in following the trend of the stock, especially the trend of the larger time frame. Think of trading with the trend like riding an elevator. If you are in the lobby waiting for an elevator to carry you to the top floor of the building, do you take the first elevator that opens its doors for you? You could, but what if the elevator is heading down? You don't know how long you might have to go down before the elevator takes you back up to your destination. That is why you would wait until an elevator that was already headed in the direction you would like to go opens its doors for you. Your trades should follow the same mindset. A stock that is approaching support on a downward trend is generally more likely to break support and continue to move further down before it starts to come back up again. Just as you don't want to waste time sitting in a down moving elevator, don't sit in a losing stock because you don't know when it will finally turn around and begin to recover. Make sure that the stock is at least beginning to move up again off of support before you place the trade.

Once you have a validated buying signal and are ready to buy the stock, you will need to continue using proper trade management. Some aggressive investors will take a buying signal and put as much money as possible into their trade, hoping to maximize their gains as much as possible. The problem with this approach is that all of the money they wanted to put in the trade is at risk right away. What if the anticipated profit never materializes? Even seemingly perfect trade setups don't always work out. Suppose the stock collapses under a barrage of negative news and heavy institutional selling. Aggressive investors who have put all of the money they wanted in the trade up front are going to take the biggest hit, because they are the most exposed.

Using Stop Losses

Stop losses are critical components of an effective trade management system. There are many different approaches traders use for determining where to put their stop losses. Some identify the current support level for the stock and place the stop loss just below that level. Others use a moving

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average. Although the main point is to make sure you use stop losses on each trade you make, and not how you go about choosing a stop loss price, setting your stop loss too close to the current price can whipsaw you out of trades only to see the stock continue an upward rally. So it is important to carefully consider where your stop loss should go. The method we are about to show for making this evaluation is fairly sophisticated, but easy to do. Figure 3.3 gives us a look at a new trade setup using the Bull Pullback strategy.

Fig. 3.3

Based on the information in this chart we would go ahead and enter an order for this stock.

In order to identify the level we want to use for our stop loss price, we need to make some adjustments to our charts. By default, the software charts are one day charts, which means that each candlestick represents a single day's trading activity. You can change this setting at the bottom of the chart window using the Duration pull-down menu, as shown in Figure 3.4 on the following page.

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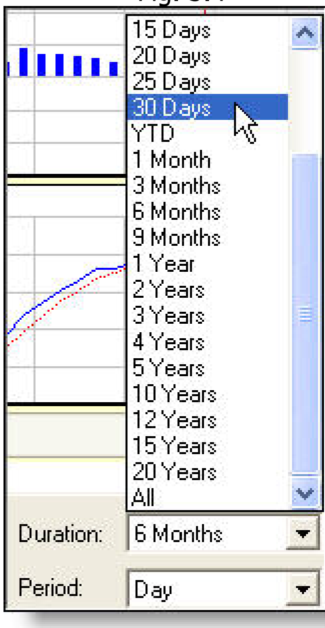
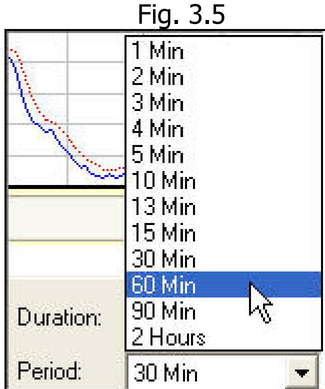
Fig. 3.4



Any duration above one Month will use one-day charts, while anything from 30 Days and below will use intraday charts based on the Period pull-down menu immediately below the Duration setting. Fig. 3.67 shows the intraday time periods that can be selected.

Fig. 3.5



For most active traders, any periods between thirty minutes and two hours are usually adequate. The periods from one minute to thirty minutes are typically used principally by day traders. After selecting the settings you prefer to use, the chart will update its information and display intraday candlesticks. Fig. 3.6 shows an intraday chart for the stock reviewed earlier.

Notes

Fig. 3.6

As we can see, the swing low price for the day has been $56.14. This method generally places a stop loss fairly close the current price of the stock, but it tends to work because if you have properly identified a Bull Pullback opportunity, support for the stock should be building on the upside. Notice the steady upward hike of the stock today as demonstrated by the stair-step appearance of today's candlesticks. If for some reason the support that is being built breaks down and the stock goes below $56.40, that is likely to be a clear indication the trade simply isn't going to work and you should move on at that point. You limited your trade to a small loss and can move on to a better trade.

Stop Loss Identification Exercise…15 min.

Look at the Java chart in Figure 3.7 and answer the questions. The candlesticks in this chart each represent a single day's activity.

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Fig. 3.7

Does this stock appear to be a good Bull Pullback opportunity? (Circle the appropriate response.)

Yes No

Why? List the reasons you believe this might or might not work.

Notes

The candlesticks in the Java chart in Figure 3.8 each represent one hour of trading activity.

Fig. 3.8

Assuming the chart in Fig. 3.8 led you to pursue a trade, what price in this chart would you use for your stop loss?

$_______________

Why? List your reasons for using this price.

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____

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____

____

Exiting a Trade

At some point in any trade, profitable or not, you are going to begin thinking about selling. It may be that the stock hasn't moved the way you thought. It is better in that case to sell the stock and move on than to cling to the fading hope that it will eventually break for you. After all this is your trading business and these stocks are like your employees, if you've hired a good one, and they are making money for you, keep them, but if you've got one that is slacking off, or even worse, costing you money, fire them.

Perhaps you are profitable. You made a good read and analysis; the stock has experienced a nice upward climb, giving you a tidy profit in the stock.

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But your current analysis leaves you unsure about the future prospects of the stock. It has reached a retail area and the probabilities have changed. Is the upward trend going to continue to push forward? If it does, you probably want to be in the stock to experience that extra push. But what if the stock is getting ready to top out? You don't want to give back all of the wonderful profit you have in the stock now. In this situation, how do you "cut your losses short and let your profits run?"

Some traders in this situation will say, "I'm profitable and I don't know if the stock is going to keep going up. I'm done." They then sell their entire position and lock in all of the profit they can. If this attitude suits you, fine. Don't ever feel bad about getting out of a stock with a healthy profit at your retail target, even if the stock does continue to move up. Realizing a profit on a trade is a reason to feel good about your success.

One thing to remember about taking all of your money out of the trade, however, is that when you do, you have completely removed the ability to "let your profits run." One of the differences between a successful trader and a highly successful trader is the ability to know how to stay in a stock as long as it continues to move up. Many traders are so quick on the trigger when they are profitable that they never realize more than modest profits. The question, then, is this: How do you know how to let your profits run while protecting profit and downside risk?

A conservative approach to solving this dilemma is known as scaling out. Let's suppose that your initial investment in the stock was $10,000, which is now worth $12,000. This is a healthy run up and you are feeling pretty good about the trade. As you run the analysis on the stock, however, you are uncertain about the future direction of the stock. Things are looking good generally, but the stock may be approaching resistance or have had such a nice run to this point that you wonder how much longer it can go on. Taking half of your position, or $6,000 in this case, out of the trade will allow you to preserve some of your profit and a chunk of your initial investment. At the same time, you have a good sized amount of money still in the stock to take advantage of any continued upward momentum the stock has. To protect the remaining amount in the event the stock does begin to drop, bring up your stop loss to the current prior swing low price on the entry time frame.

Now suppose the stock has continued to rise and your position is now worth $7,000. If you still don't want to take all of your profit but are not completely sold on the upward run, sell half of your position again, leaving $3,500 on the table. Then raise your stop loss again to the current swing low price. Out of your initial $10,000 investment, you have now taken $9,7100 – almost the entire amount of your original investment – off the table and still have $3,7100 in the trade, $3,000 of which is pure profit. You can continue to follow this process until you decide you have had enough and are ready to move on to another stock or until you get stopped out.

Notes

Notice that this approach doesn't result in HUGE profits on a single position. But placed in the context of a comprehensive-trading system over time you can extend your profitable trades by 10, 20, or 25 percent again and again. You will notice significant growth in your portfolio above and beyond what you would have if you simply took all of your profit as soon as you had it. This is an advanced trading skill that takes time to master. Practice it on a small scale in your real trades until you build confidence in using it.

One question you may have at this point is, "If I scale in to a trade, how can I scale out? It seems that the points where I would scale in to a trade are the same as the points I would be trying to scale out. How do I deal with that?" The difference between these strategies is your attitude about the trade you are in. If you are confident in the current trend and are convinced you need to stay in it, scale in and don't worry about scaling out until all of the money you designated for the stock is in it. If you are in the stock and would like to stay in it but are unsure of the strength of the trend, or you simply want to be conservative as you get out, scale out.

Another helpful guideline is to scale in when the stock is strengthening around wholesale areas on the setup time frame, and scale out if the stock weakens around retail areas on the setup time frame.

Summary

The purpose of this section is to introduce you to some of the concepts that will help you enter, monitor, and exit a trade. While this is only an introduction, your Mentor will expound on these concepts and will introduce others. With an experienced trader looking over your shoulder during your Mentor experience, you will practice the application of these and other techniques in a manner designed to protect your capital as you develop your trading skills. We wish you great success as you progress in your knowledge and understanding of the markets.

Glossary

A

AGI (Adjusted Gross Income)
A key number used by many different section of the tax code to determine the eligibility of the taxpayer for deductions and credits. As a general rule, you want "above the line" expenses, such as business expenses, which are used to reduce your AGI.

AMEX (American Stock Exchange)
Located in downtown Manhattan, this stock exchange consists primarily of index options and shares of small and medium-sized companies.

Active Account
Refers to a brokerage account in which many transactions occur. Brokerage firms may charge a fee for an account that does not generate an adequate level of activity.

Alan Greenspan
Chairman of the Federal Reserve Bank. The market reacts very strongly to the occasional comments and remarks he makes about the economy and monetary policy.

American Stock Exchange (see AMEX)

Analyst
An employee of a brokerage, fund management house, or other financial institution who studies companies and makes buy-and-sell recommendations on stocks of these companies. Most analysts specialize in a specific industry.

Announcement Date
The date on which news concerning a given company is announced to the public. It is used in event studies to evaluate the economic impact of events of interest.

Notes

Ask Price
This is the lowest price a market maker will accept to sell a stock. The quoted offer at which an investor can buy shares of stock; also called the offer price.

Asset
Any possession that has value in an exchange.

Authorized Shares
Number of shares authorized for issuance by a firm's corporate charter.

B

Basis
In simple terms, your cost of the asset. If you paid $10/share for stock and $1/share commission, your basis would be $11/share.

Bear
An investor who believes a stock or the overall market will decline.

Bearish
Refers to the attitude of an investor as being pessimistic; a pessimistic outlook.

Bear Market
Any market in which prices exhibit a declining trend for a prolonged period, usually falling by 20 percent or more.

Benchmark High
The most recent zone of resistance above the current price of the stock on an upward trend.

Benchmark Low
The most recent zone of support below the current price of the stock on a downward trend.

Notes

Beta
A measurement of the volatility associated with a stock relative to the S&P 500. A beta of 1.0 means the stock's volatility is equal to that of the S&P 500.

Bid Price
The highest price a market maker is willing to pay to buy a security. The price an investor will pay to sell shares of stock.

Bid-Ask Spread
The difference between the prices buyers are willing to pay and what sellers are asking for.

Big Money
A term used to refer to institutional money as it flows in and out of the stock market.

Black Monday
Refers to October 19, 1987, when the Dow Jones Industrial Average fell 7508 points after sharp drops the previous week.

Blue-Chip Company
A large and creditworthy company which is renowned for the quality and wide acceptance of its products and services, and for its ability to make money and pay dividends.

Bond
Debt issued for a period of more than one year. When investors buy bounds, they are lending money. The seller of the bond agrees to repay the principal amount of the loan at a specified time.

Breakout
A rise in the price of a security above a resistance zone (commonly its previous high price) or a drop below a zone of support (commonly the former lowest price). It can be used as a buy or sell indicator.

Notes

Broker
An individual who is paid a commission for executing customer orders; an agent specializing in stocks, bonds, commodities, or options, and must be registered with the exchange where the securities are held.

Bull
An investor who thinks the market will rise.

Bull Market
Any market in which prices are in an upward trend.

Bullish
Refers to the attitude of an investor as being optimistic; an optimistic outlook.

Buy
To purchase an asset, usually taking a long position.

Buy-and-Hold
A passive investment strategy with no active buying and selling of stocks.

Buy Limit Order
A conditional trading order that indicates a security may be purchased only at the designated price or lower.

Buy on Margin
Borrowing to buy additional shares of stock, and using those same shares as collateral.

Buy Order
An order to a broker to purchase a specific quantity of a security.

Buy Stop Order
An order to buy that is not to be executed until the market prices rises to the stop price. Once the security breaks through that price, the order is then treated as a market order.

Notes

Buyer's Market
A market in which the supply exceeds the demand, creating lower prices.

C

Capital
Money available to invest.

Capital Gain
When a stock is sold for a profit, the difference between the net sales price of the securities and their net cost results in your total profit, which you then report to the IRS as a capital gain and pay capital gains taxes on.

Capital Gains Tax
The tax levied on profits from the sale of capital assets. A long-term capital gain, which is achieved once an asset is held for at least 12 months, is taxed at a maximum rate of 20 percent (for taxpayers in the 28 percent tax bracket) and 10 percent (for taxpayers in the 177 percent tax bracket). Assets held for less than 12 months are taxed at regular income tax levels, and, since January 1, 2000, assets held for at least five years are taxed at 18 percent and 8 percent.

Capital Loss
When a stock is sold below cost (sold at a loss), the difference between the net cost of a security and the net sales price.

Cash Flow
Represents earnings before depreciation, amortization, and non-cash charges; sometimes called cash earnings. This indicates the ability to pay dividends.

Ceiling
The highest price, interest rate, or other numerical factor allowable in a financial transaction.

Chart patterns
The pattern made by a stock on its stock graph as it fluctuates over a given period of time. These patterns provide traders with information about support and resistance, breakouts, and so on.

Notes

Close
The period at the end of the trading session; sometimes used to refer to the closing price of a stock.

Closing Price
The price of the last transaction of a particular stock completed during a day's trading session on an exchange.

Closing Quote
The last bid and offer prices of a particular stock at the close of a day's trading session on an exchange.

Collateral
An asset that can be repossessed if a borrower defaults.

Commission
The fee paid to a broker to execute a trade, based on number of shares, bonds, options, contracts, or their dollar value.

Commodity
A fixed physical substance that investors buy or sell, usually through futures contracts. Commodities are basic goods and products, such as food, steel, metal, and so on.

Common Stock
Traditionally, units of ownership that do not give guaranteed payments or dividends to their owners, and are usually limited in their voting power. In return for accepting these restrictions, owners of common stock normally receive all growth over the amount paid to preferred shareholders.

Confirmation
The comparison of technical signals and indicators to ensure that the majority of them are pointing in the same direction; information that validates your opinion of a buying or selling opportunity.

Coupon Rate
Interest rate on a bond the issuer promises to pay to the holder until maturity, expressed as an annual percentage of face value.

Notes

The term derives from the small detachable segment of a bond certificate which, when presented to the bond's issuer, entitles the holder to the interest due on that date.

CPI (Consumer Price Index)
Measure of change in consumer prices, as determined by a monthly survey of the U.S. Bureau of Labor Statistics. Traders use this as a way to track inflation. Also known as the cost of living index.

CRB Index (Commodities Research Bureau)
An index of 21 of the most influential commodity categories, such as oil, gas, steel, etc.

D

Daily Price Limit
The level at which many commodity, futures, and options markets are allowed to rise or fall in a day. Exchanges usually impose a daily price limit on each contract.

Day Order
A request to buy or sell stock that is good only for the day the order is placed. If the buy or sell request is not filled before the close of the market, the order is cancelled. Most stock buy and sell orders are day orders unless otherwise specified by the investor.

Day Trading
Establishing and liquidating the same position or positions within one day's trading.

Debt Market
The market in which bonds are issued and bought and sold between investors.

Debt-to-Equity Ratio
Total liabilities divided by shareholder's equity. This shows to what extent owner's equity can cushion creditor's claims in the event of liquidation.

Notes

Delayed Quote
A stock or bond quote that shows bid and ask prices 180 to 20 minutes after a trade takes place.

Depressed Market
Market in which supply overwhelms demand, leading to weak and lower prices.

Discount Broker
A brokerage house featuring relatively low commission rates in comparison to a full-service broker.

Diversification
Dividing investment capital among a variety of securities with different risks, rewards, and correlations in order to minimize risk.

Dividend
A portion of a company's profit paid to common and preferred shareholders.

Domestic Market
A nation's internal market for issuing and trading securities or entities domiciled within that nation.

Dow Jones Industrial Average (Dow)
The best know U.S. stock index. A price-weighted average consisting of 30 actively trade blue-chip stocks, primarily industrial, including stocks traded on the New York Stock Exchange and NASDAQ. It is also a barometer of how shares of the largest U.S. companies are performing.

Downtick
A move down in a particular stock.

Downtrend
The stage in which a stock begins making lower highs and lower lows.

Notes

Downturn
The transition point between a rising, expanding economy to a falling, contracting one.

Drawdown
The total amount of money your trading system will lose during a losing trade or losing streak. Average drawdown can be calculated by adding all of your losing trades over a given period of time and dividing the total by the number of losing trades. This is a way to establish the amount of risk you have taken historically for the reward you have received.

E

Earnings
Net income for a company during a specified period of time.

Earnings Surprise
Positive or negative differences from the consensus forecast of earnings by institutions.

Effective Date
In an interest rate swap, the date the swap begins accruing interest.

Entrance/Entry Threshold
An entry price to buy stock at a zone of support.

EPS (Earning Per Share)
Net income for a company during a specified period of time expressed as a per share value. Net income divided by shares outstanding.

Equities Market
The various exchanges that make up the stock market.

Exchange
A location where buyers and sellers can exchange securities. This can be a trading floor, such as the New York Stock Exchange, or an electronic, computerized exchange, such as the NASDAQ.

Notes

Exit Threshold
An exit price to sell stock at a zone of resistance.

Expected Gains
In a money management system, your reward multiplied by your chances of winning over time.

Export
Goods and products produced in the U.S. and sold in foreign countries.

Exponential Moving Average
A moving average, calculated over any period of time, where the most recent price information is weighed more heavily than later information.

F

Fakeout
The event that occurs when a stock appears poised to break through a zone of support or resistance but fails to do so. A false trading signal that can be minimized through the use of filtering techniques.

Federal Reserve Bank
One of the 12 banks that, with their branches, make up the Federal Reserve System. These banks are located in Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco. The role of each Federal Reserve Bank is to monitor the commercial and savings banks in its region to ensure that they follow Federal Reserve Board regulations and to provide those banks access to emergency funds. The reserve banks act as depositories for member banks in their regions, providing money transfer and other services. Each of the banks is owned by the member banks in its district.

Fed Funds Rate
The rate banks charge to each other to cover Federal Reserve requirements. These are usually very short-term loans, often overnight.

Notes

Fed Funds Discount Rate
The rate at which banks can borrow money from the Federal Reserve Bank. Usually a relatively slow-changing rate, it is adjusted up or down in increments as the Fed deems necessary to boost the economy or guard against inflation. The stock market reacts dramatically to changes in this rate.

Filtering (see Price Filter, Time Filter, Volume Filter)
A method used to determine whether a market is breaking or holding support or resistance zones.

Financial Analysis
An analysis of a company's financial statement, usually done by financial analysts.

Financial Analysts
Professionals who analyze financial statements, interview corporate executives, and attend trade shows of companies in order to write reports recommending either purchasing, selling, or holding various stocks. Also called securities analysts and investment analysts.

Fiscal Quarter
The three-month period of time the company uses to track their quarterly performance. All quarterly statements and financial reports are tied to this time period. Although this quarter often follows standard calendar quarters, it just as often does not. The quarter period a company follows is dictated by its fiscal year.

Fiscal Year
The twelve-month period of time the company uses to track their yearly performance. All year-end statements and financial reports are tied to this time period. Although many company's fiscal years follow the standard calendar year (January – December) it is just as common that they do not. A fiscal year can begin and end in any twelve-month period on the calendar.

Notes

Fixed Percentage
A money management technique to dictate how much of the investment capital an investor has will be used in a single trade. Encourages more conservative position sizing which helps to minimize risk.

Flight to Quality
Moving capital to the safest possible investment to protect oneself from loss during an unsettling period in the market. This movement can manifest itself in any of the various financial markets; for example, unexpected volatility and risk in the stock market often results in investors selling stocks and buying more government bonds.

Float
Shares outstanding minus insider holdings. The float consists of all shares that are available for trade in the stock market at any given time. This number can help identify how liquid a stock is as well as how much control of the stock insiders maintain.

Fluctuation
A price or interest rate change.

Forecasting
Making projections about future performance on the basis of historical and current conditions data.

Full-Service Broker
A broker who provides clients an all-inclusive selection of services such as advice on security selection and financial planning.

Fully Invested
Used to describe an investor whose assets are totally committed to investments, typically stock.

Fundamental Analysis
Security analysis that seeks to detect mis-valued securities through an analysis of a firm's business prospects and historical performance, focusing on earnings, dividend prospects, expectations for future interest rates, and risk evaluation of the firm.

Notes

Futures
A term used to designate all contracts covering the sale of financial instruments or physical commodities for future delivery on a commodity exchange.

Futures Contract
An agreement to buy or sell a set number of shares of a specific stock in a designated future month at a price agreed upon today by the buyer and seller. The contract is often traded on the futures market. A futures contract differs from option as an option is the right to buy or sell, while a futures contract is the promise to actually make the transaction.

G

Gain
A profit on a securities transaction recognized by selling a security for more than security originally cost. The gain is the difference between the cost and the sale.

Gross Profit
Sales minus the cost of goods sold.

Gross Profit Margin
The gross profit divided by sales, which is equal to each sales dollar left over after paying for the cost of goods sold.

Growth Opportunity
Opportunity to invest in profitable projects.

H

Hedge
A transaction that reduces the risk of an investment.

Hedging
A strategy designed to reduce investment risk using call options, put options, short-selling, or futures contracts. Its purpose is to reduce the volatility of a portfolio by reducing the risk of loss; it help lock in profits.

Notes

Held Order
An order that must be executed without hesitation or if the stock can be bought or sold at that price in sufficient quantity.

High-Tech Stock
Stocks of companies operating in high-technology fields. Intel, Microsoft, IBM, Yahoo! and Amazon.com are example of high-tech stocks.

Hold
To maintain ownership of a stock over a long period of time; also a recommendation of an analyst who is not positive enough on a stock to recommend a buy, but not negative enough on the stock to recommend a sell.

I

IRA (Individual Retirement Account)
Tax deferred accounts one can contribute to as long there is earned income; the individual maximum annual contribution is $2,000, although spouses can also make contributions even if ythey do receive earned income. Contributions are deductible so as the taxpayer does not earn more than $861,000 and is not covered by a pension plan.

Independent Financial Market
A financial market that trades a specific type of financial instrument. The stock market, bond market, currency market, and commodity market are all examples of independent financial markets, because although each can impact the other, they don’t necessarily depend on each other to operate on their own.

Index
Statistical composite that measures changes in the economy or in financial markets, often expressed in percentage changes from a base year or from the previous month. Indices measure the ups and downs of stocks, bonds, and some commodities markets, in terms of market prices and weighting of companies in the index.

Notes

Indicator
A technical or fundamental measurement securities analysts use to forecast the market's direction, such as investment advisory sentiment, stock trading volume, interest rates direction, and corporate insiders' buying or selling.

Individual Investor
Average, typical investors who trade their own money, rather than doing it for institutions. Even wealthy, very successful investors who trade their own accounts are considered individual investors.

Industry
A subcategory of market organization below the sector level.

Industry Groups
A subcategory of market organization below the Industry level.

Inflation
Rise in the prices of good and services, as happens when spending increases relative to the supply of goods on the market – too much money chasing too few goods. Moderate inflation is a common result of economic growth, while prices rising at more than 100 percent per year are considered hyperinflation and reflective of a lack of confidence in the dollar.

Interest Rates
Cost of borrowing money, expressed as a rate per period of time, usually one year, in which case it is called an annual rate of interest.

Intermarket Analysis
The process of analyzing each of the independent financial markets to determine their impact on the stock market.

Intermediate Trend
A trend period of six to nine months. Changes in the Intermediate Trend are generally taken as market corrections.

Notes

Insider Information
Material information about a company that has not yet been made public.

Insiders
Directors and senior officers of a corporation; those who have access to inside information about a company; someone who owns more than 10 percent of the voting shares of a company.

Institutional Investors
Money invested in the market by mutual funds, investment banks, insurance companies, brokerage houses, and major corporation. Large dollar volume transactions that can dramatically impact the price of a stock in a short period of time.

Investment Income
The revenue from a portfolio of invested assets.

Investment Manager
The individual who manages a portfolio of investments; also called a portfolio manager or money manager.

Investments
The study of financial securities, such as stocks and bonds, from the investor's viewpoint.

Investment Strategy
A strategy an investor uses when deciding how to allocate capital among several options, including stocks, bonds, cash equivalents, commodities, and real estate.

Investor
The owner of a financial asset; one who is looking to earn money in the stock market through a "buy and hold" strategy. Most earnings are either long-term capital gains, dividends, or interest.

Import
Goods and services brought into a country from sources outside its borders.

Notes

K

Keogh Plan
A type of pension plan in which taxes are deferred. Available to those who are self-employed.

L

Large-Cap Stock
A stock with a high level of market capitalization, usually at least $89 billion in market value.

Leader
A stock or group of stocks first to move in a market upsurge or downturn.

Leverage
The rising or falling at a proportionally greater amount than comparable investments; a given stock price change that may result in a great increase or decrease in the value of the investment.

Liabilities
Claims on the assets of a company or individual – excluding ownership equity. Characteristics: 1) It represents a transfer or assets or service at a specified or determinable date. 2) The firm or individual has little or no discretion to avoid the transfer. 3) The event causing the obligation has already occurred.

Limit Order
An order to buy stock at or below a specified price, or to sell stock at or above a specified price. A conditional trading order designed to avoid the danger of adverse unexpected price changes.

Listed Stocks
Stocks traded on an exchange.

Long-Term
In accounting terms, one year or longer.

Notes

Long-Term Capital Gains
Gains from the purchase or sale of capital assets that are held for longer than 12 months.

Long-Term Investor
A person who makes investments for a period of at least five years in order to finance his or her long-term goals.

Lower Band
The bottom range of a technical oscillator such as MACD or Stochastic.

M

MACD
A hybrid technical analysis tool which combines the characteristics of an oscillator with trend tracking to identify buying and selling signals.

Majority Shareholder
A shareholder who is part of a group that controls more than half of the outstanding shares of a corporation.

Margin
Allows investors to buy securities by borrowing money from a broker; the difference between the market value a stock and the loan a broker makes.

Margin Account
An account that can be leveraged, in which stocks can be purchased for a combination of cash and a loan. The load is collateralized by the stock; if the value of the stock drops sufficiently, the owner must either put in more cash, or sell a portion of the stock.

Market Analysis
An analysis of technical, corporate, and market data used to predict movements in the market.

Notes

Margin Call
A demand for additional funds because of adverse price movement in a stock bought on margin; maintenance margin requirements; security deposit maintenance.

Market Capitalization
The total dollar value of a company's equity. Calculated by multiplying the current price of the stock by the shares outstanding.

Market Ceiling
The most immediate zone of resistance in a stock.

Market Floor
The most immediate zone of support in a stock.

Market Guide
A report produced by Multex.com to compile recent and current financial statement data such as earnings, revenues, etc. for the entire stock market.

Market Index
A measure of the market consisting of weighted values of the components that make up a certain list of companies. A tracking of the performance of certain stocks by weighting them according to their prices and the number outstanding shares using a particular formula.

Market Opening
The start of a formal trading day on an exchange.

Market Order
An order to buy or sell a stated amount of a security at the most advantageous price obtainable after the order is presented in the trading crowd. Special restrictions cannot be specified (all or none or good till cancelled orders) on market orders.

Market Prices
The amount of money a willing buyer pays to acquire stock from a willing seller.

Notes

Market Research
A technical analysis of factors such as volume, price trends, and market breadth that are used to predict price movement.

Market Return
The return on the market portfolio.

Market Risk
Risk that cannot be diversified away.

Market Share
The percentage of total industry sales that a particular company controls.

Market Value
The price at which a security is trading and could presumably be purchased or sold; what investors believe a stock is worth, calculated by multiplying the number of shares outstanding by the current market price of the stock.

Mature
To cease to exist; to expire.

Merger
An acquisition in which all assets and liabilities are absorbed by the buyer; any combination of two companies.

Midcap
A stock with a capitalization of usually between $1 billion and $92 billion.

Momentum
The amount of acceleration of an economic, price, or volume movement.

Money Management
A complete, holistic set of trading rules and specifications that defines how you should make your stock trades. Establishes the balance you need to maintain between reward and risk to be successful in your trading over time.

Notes

Moving Average
The mean price of a stock calculated at any time over a past period of fixed length to help define trend direction and support and resistance zones.

Moving Average Crossover
The point when moving averages reflecting different time periods (such as a 20-day MA and a 930-day MA) intersect and cross. Depending on the direction of the trend, these crossovers can be seen as critical breakthrough points to the upside as well the downside. Many oscillators use these crossover points to identify specific buying or selling signals.

N

NASDAQ
The National Association of Securities Dealers Automatic Quotation System. A nationwide computer network for buying and selling NASDAQ-listed stocks.

Narrow Market
An inactive market, which displays large fluctuations in prices due to a low volume of trading.

Narrowing the Spread
Reducing the difference between the bid and ask prices of a security.

Net
The gain or loss on a security sale as measured by the selling price of a security less the adjusted cost of acquisition.

New York Stock Exchange
The most well-known stock exchange in the world. Also called the Big Board or the Exchange.

News
Daily events reported on news programs and the Internet which can often have a sudden and dramatic effect on the price of a stock.

Notes

NYSE Composite Index
Composite index covering price movements of all common stocks listed on the New York Stock Exchange. It is based on the close of the market on December 31, 199494, at a level of 940.00 and is weighted according to the number of shares listed for each issue. The composite index is supplemented by separate indexes for four industry groups; industrial, transportation, utility and finance.

O

Offer Price
Indicates a willingness to sell at a given price.

Open
Having either buy or sell interest at the indicated price level and side.

Open Position
A long or short position whose value will change with a change in prices.

Opening
The beginning of the trading session officially designated by an exchange during which all transactions are considered made “at the opening”.

Opening Price
The range of prices at which first bids and offers are made on an exchange.

Order
Instruction to a broker/dealer to buy, sell, deliver, or receive securities or commodities that commits the issuer to the terms specified.

Oscillator
A tool used to confirm trend direction and short-term buying and selling signals. Oscillators are generally designed to measure momentum and overbought/oversold conditions.

Notes

Over the Counter (OTC)
A market in which securities transactions are conducted through a telephone and computer network connecting dealers in stocks and bonds, rather than on the floor of an exchange. The NASDAQ is an OTC market. Also, a stock that is not listed and traded on an organized exchange (bulletin board stocks, for example) are traded over the counter.

Overbought
A condition in which a stock is considered to have risen as much as it is likely to in the short-term, forecasting a short-term pullback.

Oversold
A condition in which a stock is considered to have dropped as low as it is likely to in the short-term, forecasting a short-term increase in price.

P

Par Value
The face value of a bond. A bond selling at par is worth the same dollar amount it was issued for or at which it will be redeemed at maturity.

Paper Gain/Loss
Unrealized capital gain/loss on securities held in a portfolio based on a comparison of the current market price to the original cost.

Paper Trading
Placing stock trades in paper format rather than with actual dollars to gain experience in using research and timing techniques without putting investment at risk.

P/E Ratio
The price to earnings ratio, which is calculated by dividing the current stock price by trailing annual earnings per share or expected annual earnings per share.

Notes

Peak
The high point at the end of an economic expansion until the start of a contraction.

PEG Ratio
A derivation of the P/E ratio and expected growth rates. It is calculated by dividing the current P/E ratio by the expected EPS.

Portfolio Manager
A professional who assumes responsibility for the securities portfolio of an individual or institutional investor. In return for a fee, the manager manages the portfolio and chooses which types are most appropriate over time.

Position
A market commitment. The number of shares bought or sold for which no offsetting transaction has been entered into. The buyer of a security is said to have a long position, and the seller of a security is said to have a short position.

Position Sizing
The process of determining what portion of an investor's capital should be placed in a single position. This is an important component of risk management in an effective trading system.

Preferred Shares
Shares that give investors a fixed dividend from the company's earnings and entitle them to be paid before common shareholders.

Price Divergence
A condition in which technical indicators such as Stochastic and MACD begin to move in the opposite direction of the price of the stock. Rather than confirming a buying signal, this is a warning sign in an up trending stock.

Price Filter
A method for identifying breakthroughs of support and resistance zones. Price filtering refers to waiting for a stock to break through a specific price that has been identified as support or resistance before initiating a buy order on the stock.

Notes

Primary Market
Where a newly issued security is first offered. All subsequent trading of this security occurs in the secondary market.

Primary Trend
The longest-term trend, lasting nine months to two years. This trend is most directly impacted by the fundamental strength of the broad economy.

Prime Rate
The interest rate banks charge to their most creditworthy customers, and which acts as a baseline for loans to less creditworthy customers.

Profit
Revenue earned minus the cost and the commission. Total amount made on the transaction.

Profit Forecast
A prediction of future profits of a company that could affect investment decisions.

Profit Margin
An indicator of profitability. The ratio of earnings available to stockholders to net sales. Determined by dividing net income by revenue for the same 12-month period. Also known as net profit margin.

Profit Taking
Action taken by short-term securities traders to cash in on gains created by a sharp market rise, which pushes prices down temporarily but implies an upward market trend.

Public Offering
A stock offering to the investment public, after compliance with registration requirements of the SEC, usually by an investment banker or a syndicate made up of several investment bankers, at a price agreed upon between the issuer and the investment bankers.

Notes

Public Ownership
The portion of a company's stock that is held by the public.

Publicly Held
Describes a company whose stock is held by the public.

Publicly Traded Assets
Assets that can be traded in a public market such as the stock market.

Purchase Order
A written order to buy specified goods at a stipulated price.

Q

Quarterly
Occurring every three months.

Quoted Price
The price at which the last trade of a particular security or commodity took place.

R

Rally (Recovery)
An upward movement in the price of a stock or the broad market.

Range
The high and low prices recorded during a given period of time.

Real Time
A stock or bond quote that is current with the current buy or sell price of the stock or bond.

Realized Return
The return that is actually earned over a given time period.

Recession
A temporary downturn in economic activity, usually indicated by two consecutive quarters of a falling gross domestic product.

Notes

Relative Strength
The rate at which a stock falls relative to other stocks groups in a falling market or rises relative to other stocks in a risking market. Analysts reason that a stock that holds value on the downside will be strong performer on the upside and vice versa. This logic can also be applied to industry group and sector comparisons.

Resistance
A price level above which it is supposedly difficult for a security or market to rise. A price ceiling at which technical analysts and traders note persistent selling of the security or market.

Return
The change in the value of a portfolio over a period of time, including any distributions made from the portfolio during that period.

Return on Equity (ROE)
An indicator of profitability determined by dividing net income for the past 12 months by stockholder equity and shown as a percentage. ROE is used to measure how a company is using its money.

Return on Investment (ROI)
Book income as a proportion of net book value.

Revenue
Total dollars brought into a company through sales, stated on a quarterly and annual basis.

Reversal
A change in the direction or trend of a stock.

Reward: Risk Ratio
The potential reward in a given trade or set of trades over time divided by the amount of risk taken. If a trade appears to have $2 of upside potential against $1 of downside potential, then the reward: risk ratio is 2:1. A critical component of risk and money management.

Notes

Risk
The risk that the issuer cash flow will not be adequate to meet its financial obligations. Additional risk a company's shareholder bears when the firm uses debt and equity.

Risk Factor
A set of common factors that impact returns (e.g., market return, interest rates, inflation, etc.).

Risk Management (see also Money Management)
The process of identifying and evaluating risks and selecting and managing techniques to minimize risk.

Roth IRA
A type of IRA account that allows contributors to invest up to $2,000 per year, and for assets to grow completely tax-free, and to withdraw the principal and earnings tax-free under certain conditions. This differs from a traditional IRA, however, in that yearly contributions are not tax deductible.

S

Scaling In
A conservative approach to position sizing an money management that places smaller amounts of money in a position at the beginning of the trade, then increases the size of the position as the stock extends into an upward trend.

Scan
Trade Seeker search features that allow users to scan the stock market for potential stock plays based on a variety of bullish or bearish scenarios.

SEC
Securities and Exchange Commission. A federal agency that regulates the U.S. financial markets, as well as overseeing the securities industry and promoting full disclosure in order to protect the investing public against malpractice in the securities market.

Notes

Sales Forecast
A key input to a firm's financial planning process based on historical experience, statistical analysis, and consideration of various macroeconomic factors.

S&P 500 Composite Index
An index of 10100 widely held common stocks that measures the general day-to-day performance of the market.

Sector
Used to characterize a group of securities that are similar with respect to maturity, type, rating, industry, and coupon.

Sector Rotation
The flow of institutional money into various sectors of the stock market.

Securities
Stocks and their derivatives, bonds, and commodities. Any financial instrument that can be publicly traded.

Sell Limit Order
Conditional trading order that indicates a security may be sold at the designated price or higher.

Sell Off
The sale of securities under pressure.

Sell Order
An order that may take many different forms by an investor to a broker to sell stock, bond, option, future, mutual fund, or other holding.

Seller's Market
A market in which demand exceeds supply. As a result, the seller can often the dictate the price and terms of the sale.

Selling Short
Selling a stock not actually owned. If an investor thinks the price of a stock is going down, the investor could borrow the

Notes

stock from a broker and sell it. Eventually, the investor must buy the stock back on the open market to close the position and repay the obligation to the broker.

Sentiment
The general attitude or feeling about a stock or market. Most accurately reflected by tracking buying and selling volume.

Shareholder
A person or entity that owns shares or equity in a corporation.

Shareholder Equity
Total assets minus total liabilities of a corporation.

Shares
Certificates or book entries representing ownership in a corporation or similar entity.

Shares Outstanding
Shares of a corporation, authorized in the corporate charter, which have been issues and are outstanding.

Short
One who has sold a contract to establish a market position and has not yet close out the position through an offsetting purchase.

Short Position
Occurs when a person sells stocks he or she does not yet own. Shares must be borrowed from the broker before the sale to make "good delivery" to the buyer. Eventually, the shares must be bought back to close out the transaction. This is done when an investor believes the stock price will drop.

Short-Term
Any investments with a maturity of one year or less.

Short-Term Gain/Loss
A profit or loss realized from the sale of securities held for less than a year. This is taxed at normal income tax rates if the net total is positive.

Notes

Short-Term Trend
A trend that lasts two to four weeks. Changes in the short-term trend generally come about from random news events such analyst ratings and downgrades and profit forecasts.

Sideways Trend (see Trendless)
A horizontal price movement within a narrow price range over an extended period of time, creating the appearance of a relatively straight line on a stock's price graph.

Simple Moving Average
A moving average that is calculated by adding the closing prices over a given period of time, then dividing the sum by the number of days in the period. Each day in the calculation is given the same weight. This contrasts with an exponential moving average which places a heavier weighting on the most recent days.

Slump
A temporary fall in performance, often describing consistently falling security prices for several weeks or months.

Small-Cap
A stock with a small capitalization, meaning a total equity value of less than $500 million.

Smart Money
Experienced, sophisticated investors who use advanced techniques to track sector rotation and institutional money flow as a guide for stock trades.

Speculation
Purchasing risky investments that present the possibility of large profits, but also pose a high-than-average possibility of loss.

Split
When a company splits its outstanding shares into more shares. The investor's equity in the company remains the same, and the share price of the owned is one-half the price of the stock on the day prior to the split.

Notes

Stage I Trend
The highly speculative early period of an upward trend. The immediate trend at this time is flat or sideways.

Stage II Trend
The period of an upward trend immediately after a breakout from support or resistance zones. The period of time where investors buy into a stock hoping the early price surge will continue.

Stage III Trend
The final upward thrust of an upward trend when everybody that wants to be in the stock now is. This is usually the beginning of the end of the upward trend.

Stage IV Trend
The final period of the upward trend where the stock begins to test support zones and fails to break resistance zones, resulting in a sideways movement of the stock.

Stochastic
An oscillator that measures overbought and oversold conditions in a stock over time.

Stock
Ownership of a corporation indicated by shares, which represent a piece of the corporation's assets and earnings.

Stockbroker
A person registered with the SEC who is employed by and solicits business for a commission house or futures commission merchant.

Stock Buyback
A corporation's purchase of its own outstanding stock, usually in order to raise the company's earnings per share.

Stock Certificate
A document representing the number of shares of a corporation owned by a shareholder.

Notes

Stock Dividend
The payment of a corporate divided in the form of stock rather than case; often used to conserve cash needed to operate the business. Stock dividends are not taxed until sold.

Stock exchanges
Formal organizations approved and regulated by the SEC that are made up of members who use the facilities exchange certain common stocks.

Stock Index
An index such as the Dow Jones Industrial Average that tracks the performance of a basket of stocks.

Stock Market
Also called the equities market.

Stock Split
Occurs when a firm issues new shares of stock and in turn lowers the current market price of the stock to a level that is proportionate to pre-split prices.

Stock Ticker
A letter designation assigned to securities and mutual funds traded on U.S. financial exchanges.

Stop-Limit Order
A stop order designating a price limit. Unlike the stop order, which becomes a market order once the stop is reached, the stop-limit order becomes a limit order.

Stop Loss Order
An order to sell a stock when the price falls to a specified level.

Stop Order
An order to buy or sell at the market when a definite price is reached, either above (on a buy) or below (on a sell) the price that prevailed when the order was given.

Notes

Stopped Out
A purchase or sale executed under a stop order at the stop price specified by the customer.

Strengthening Trend
An upward or downward trend that becomes steeper as buying or selling activity increases in the stock. This usually serves to extend the current trend even higher in the short-term.

Success Rate
The rate at which winning trades make money. This is correlated with drawdown rates to identify reward: risk profiles and appropriate position sizes in specific trades.

Support (see Price Floor)
Price zone at which a security tends to stop falling because demand begins to outweigh supply.

Symbol
Letters used to identify companies on the exchanges.

T

Target Price
The price an investor hopes a stock will reach in a certain time period.

Technical Analysis
Security analysis that seeks to detect and interpret patterns in past security prices.

Technical Analysts
Analysts who use mechanical rules to detect changes in the supply of and demand for a stock in order to capitalize on the expected change.

Technical Indicators
Information that confirms or supports trading signals. Oscillators such as MACD and Stochastic are examples of effective technical indicators.

Notes

Tick
Refers to the minimum change in price a security can have either up or down.

Time Filter
A method for identifying breakthroughs of support and resistance zones. Once a stock has broken a support or resistance zone, waiting one to three days to see if the stock holds the new higher price can provide confirmation of the move.

Time Order
An order that becomes a market or limited price order, or is cancelled at a specific time.

Total Cost
The price paid for a security, plus the commission and any accrued interest owed to the seller (as with a bond).

Total Dollar Return
The dollar return on a non-dollar investment, including the sum of any dividend/interest income, capital gains or losses, and currency gains or losses on the investment.

Total Return
In performance measurement, the actual rate of return realized over an evaluation period.

Total Revenue
Total sales and other revenue for the period shown.

Total Volume
The total number of shares or contracts traded on national and regional exchanges in a stock, bond, commodity, future, or option on a certain day.

Trade
An oral (or electronic) transaction involving one party buying a security from another party. Once a trade is consummated, it is considered final. Settlement occurs 1-107 business days later.

Notes

Traders
Individuals who take positions in stock investments with the objective of making profits. Traders take proprietary positions in which they seek to profit from the directional movement of prices or spread positions that can be held for either the long-term or short-term.

Trading
The buying and selling of securities.

Trading Costs
Costs of buying and selling securities, including commissions, slippage and the Bid/Ask-spread.

Trading Pattern
The long-range direction of a security's price, charter by drawing a line connecting the highest prices the security has reached and another line connecting the lowest prices at which the security has traded over the same period.

Trading Range
The difference between the high and low prices traded during a period of time.

Trading Rules
A set of predetermined, customized rules that must be followed on each and every trade you place.

Trading System
A holistic view of the trading process that encapsulates trading rules, fundamental, technical and intermarket analysis, and money management techniques to increase the odds of success over time.

Trading Volume
The number of shares transacted everyday. Because there is a seller for every buyer, trading volume is half of the number of shares traded.

Notes

Trailing Stop
A stop loss order that trails the progress of an upward trending stock. It helps to preserve profit while also providing downside protection.

Transaction
The delivery of a security by a seller, and its acceptance by the buyer.

Treasury Securities
Short-and long-term bonds issued by the Treasury Department and backed by the full faith of the U.S. government. Treasury yields are commonly used to track fluctuations in interest rates.

Trend
The general direction of the market

Trendless (see Sideways Trend)
A horizontal price movement within a narrow price range over an extended period of time, creating the appearance of a relatively straight line on a stock's price graph.

Trend line
A technical chart line that depicts the past movement of a security, and that is used to help predict future price movements.

U

Underperform
When a security appreciates at a slower pace than the overall performance of the market.

Undervalued
A stock price perceived to be too low, as indicated by a particular valuation model. For instance, a company's stock price may be considered cheap if the company price-earnings ratio is much lower than the industry average.

Unissued Stock
Shares authorized in a corporation's charter, but not issued.

Notes

Unmargined Account
A cash account held at a brokerage firm.

Up
Market indication that securities, or the market in general, is doing well in volume trading.

Up Tick
A plus tick; a price movement in the upward direction. A trade occurring at a price higher than the previous trade.

Upgrading
Raising the quality rating of a security because of new optimism about the prospects due to tangible/intangible factors. This can increase investor confidence and push the price of the security up.

Upside Potential
The amount by which analysts or investors expect the price of a security may increase.

Upswing
An upward turn in a security's price after a period of falling prices.

Uptrend
Upward direction in the price of a stock, bond, or commodity future contract or overall market.

Upper Band
The top range of a technical oscillator such as MACD or Stochastic.

V

Validation
The comparison of technical signals and indicators to ensure that the majority of them are pointing in the same direction; information that confirms your opinion of a buying or selling opportunity.

Valleys
The low point at the end of an economic contraction until the start of an expansion.

Valuation
A determination of the value of a company's stock based on earning and the market value of assets.

Variable
An element in a model; variables change through time and are not constant.

Volatility
A measure of risk based on the standard deviation of the asset return. A variable that appears in option pricing formulas where it denotes the volatility of the underlying asset return from now to the expiration of the option.

Volume
The daily number of shares of a security that change hands between a buyer and a seller.

Volume Filter
A method for identifying breakouts through support and resistance zones. Volume Filtering refers to waiting for an increase in buying or selling volume to support the breakout you are observing.

W

Wall Street
Generic term for the security industry firms that buy, sell, and underwrite securities.

Watch List
A list of securities selected for special attention as potential investments.

Weak Market
A market with few buyers and many sellers, and a declining trend in prices.

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Well-Diversified Portfolio
A portfolio that includes a variety of securities in order to approximate the overall market risk. The unsystematic risk of each security is diversified throughout the portfolio.

Whipsaw
A highly volatile environment in which a stock experiences severe fluctuations on both the upside and downside. Traders will sometimes get stopped out of these trades only to see the stock continue to rally higher after they have exited the trade.

Y

Year-End Dividend
A special dividend declared at the end of a fiscal year that usually represents higher-than-expected company profits.

Year-to-Date (YTD)
The period beginning at the start of the calendar year up to the current date.
Yield
The percentage rate of return paid on a stock in the form of dividends.

Z

Zack's
A stock research and analysis firm that publishes reports on a variety of financial data for the entire range of the stock market

Zone
A price level of support or resistance for a stock. Looking for breakouts through support and resistance zones provides opportunities to buy stocks at the early stage of new rallies.