INVESTMENTGAB

10 DAY TRADING STRATEGIES

FOR BEGINNERS

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Day trading is the act of buying and selling a Financial transaction within the same day or even multiple times over the course of a day. Taking advantage of small price moves can be a lucrative game—if it is played correctly. But it can be a dangerous game for newbies or anyone who doesn't adhere to a well-thought-out strategy.

Not all brokers are suited for the high volume of trades made by day traders, however. But some brokers are designed with the day trader in mind.

Online brokers have professional or advanced versions of their platforms that feature real-time streaming quotes, advanced charting tools, and the ability to enter and modify complex orders in quick succession. Be careful as all are not as they seem.

Below, we'll take a look at some general day trading principles and then move on to deciding when to buy and sell, common day trading strategies, basic charts and patterns, and how to limit losses.

Key Takeaways

- Day trading is only profitable when traders take it seriously and do their research.
- Day trading is a job, not a hobby; treat it as such—be diligent, focused, objective, and keep emotions out of it.
- Here we provide some basic tips and know-how to become a successful day trader.

1. Knowledge Is Power

In addition to knowledge of basic trading procedures, day traders need to keep up on the latest stock market news and events that affect stocks—Banks interest rate plans, the economic outlook, etc.

So do your homework. Make a wish list of stocks you'd like to trade and keep yourself informed about the selected companies and general markets. Scan business news and visit reliable financial websites.

2. Set Aside Funds

Assess how much capital you're willing to risk on each trade. Many successful day traders risk less than 1% to 2% of their account per trade. If you have a $40,000 trading account and are willing to risk 0.5% of your capital on each trade, your maximum loss per trade is $200 (0.5% * $40,000).

Set aside a surplus amount of funds you can trade with and you're prepared to lose. Remember, it may or may not happen.

3. Set Aside Time, Too

Day trading requires your time. That's why it's called day trading. You'll need to give up most of your day, in fact. Don’t consider it if you have limited time to spare.

The process requires a trader to track the markets and spot opportunities, which can arise at any time during trading hours. Moving quickly is key.

4. Start Small

As a beginner, focus on a maximum of one to two stocks during a session. Tracking and finding opportunities is easier with just a few stocks. Recently, it has become increasingly common to be able to trade fractional shares, so you can specify specific, smaller dollar amounts you wish to invest.

That means if Apple shares are trading at $250 and you only want to buy $50 worth, many brokers will now let you purchase one-fifth of a share.

5. Avoid Penny Stocks

You're probably looking for deals and low prices but stay away from penny stocks. These stocks are often illiquid and chances of hitting a jackpot are often bleak.

Many stocks trading under $5 a share become de-listed from major stock exchanges and are only tradable over-the-counter (OTC). Unless you see a real opportunity and have done your research, stay clear of these.

6. Time Those Trades

Many orders placed by investors and traders begin to execute as soon as the markets open in the morning, which contributes to price volatility. A seasoned player may be able to recognize patterns and pick appropriately to make profits. But for newbies, it may be better just to read the market without making any moves for the first 15 to 20 minutes.

The middle hours are usually less volatile, and then movement begins to pick up again toward the closing bell. Though the rush hours offer opportunities, it’s safer for beginners to avoid them at first.

7. Cut Losses With Limit Orders

Decide what type of orders you'll use to enter and exit trades. Will you use market orders or limit orders? When you place a market order, it's executed at the best price available at the time—thus, no price guarantee.

A limit order, meanwhile, guarantees the price but not the execution. Limit orders help you trade with more precision, wherein you set your price (not unrealistic but executable) for buying as well as selling. More sophisticated and experienced day traders may employ the use of options strategies to hedge their positions as well.

8. Be Realistic About Profits

A strategy doesn't need to win all the time to be profitable. Many traders only win 50% to 60% of their trades. However, they make more on their winners than they lose on their losers. Make sure the risk on each trade is limited to a specific percentage of the account, and that entry and exit methods are clearly defined and written down.

9. Stay Cool

There are times when the stock markets test your nerves. As a day trader, you need to learn to keep greed, hope, and fear at bay. Decisions should be governed by logic and not emotion.

10. Stick to the Plan

Successful traders have to move fast, but they don't have to think fast. Why? Because they've developed a trading strategy in advance, along with the discipline to stick to that strategy. It is important to follow your formula closely rather than try to chase profits. Don't let your emotions get the best of you and abandon your strategy. There's a mantra among day traders: "Plan your trade and trade your plan."

Before we go into some of the ins and outs of day trading, let's look at some of the reasons why day trading can be so difficult.

What Makes Day Trading Difficult?

Day trading takes a lot of practice and know-how, and there are several factors that can make the process challenging.

First, know that you're going up against professionals whose careers revolve around trading. These people have access to the best technology and connections in the industry, so even if they fail, they're set up to succeed in the end. If you jump on the bandwagon, it means more profits for them.

Uncle Sam will also want a cut of your profits, no matter how slim. Remember that you'll have to pay taxes on any short-term gains—or any investments you hold for one year or less—at the marginal rate. The one caveat is that your losses will offset any gains.

As an individual investor, you may be prone to emotional and psychological biases. Professional traders are usually able to cut these out of their trading strategies, but when it's your own capital involved, it tends to be a different story.

Deciding What and When to Buy

Day traders try to make money by exploiting minute price movements in individual assets (stocks, currencies, futures, and options), usually leveraging large amounts of capital to do so. In deciding what to focus on—in a stock, say—a typical day trader looks for three things:

1. Liquidity allows you to enter and exit a stock at a good price—for instance, tight spreads, or the difference between the bid and ask price of a stock, and low slippage, or the difference between the expected price of a trade and the actual price.
2. Volatility is simply a measure of the expected daily price range—the range in which a day trader operates. More volatility means greater profit or loss.
3. Trading volume is a measure of how many times a stock is bought and sold in a given time period—most commonly known as the average daily trading volume. A high degree of volume indicates a lot of interest in a stock. An increase in a stock's volume is often a harbinger of a price jump, either up or down.

Once you know what kind of stocks (or other assets) you're looking for, you need to learn how to identify entry points—that is, at what precise moment you're going to invest. Tools that can help you do this include:

- **Real-time news services**: News moves stocks, so it's important to subscribe to services that tell you when potentially market-moving news comes out.
- **ECN/Level 2 quotes**: ECNs, or electronic communication networks, are computer-based systems that display the best available bid and ask quotes from multiple market participants and then automatically match and execute orders. Level 2 is a subscription-based service that provides real-time access to the Nasdaq order book composed of price quotes from market makers registering every Nasdaq-listed and OTC Bulletin Board security. Together, they can give you a sense of orders being executed in real-time.
- **Intraday candlestick charts**: Candlesticks provide a raw analysis of price action. More on these later.

Define and write down the conditions under which you'll enter a position. "Buy during uptrend" isn't specific enough. Something like this is much more specific and also testable: "Buy when price breaks above the upper trendline of a triangle pattern, where the triangle was preceded by an uptrend (at least one higher swing high *and* higher, swing low before the triangle formed) on the two-minute chart in the first two hours of the trading day."

Once you have a specific set of entry rules, scan through more charts to see if those conditions are generated each day (assuming you want to day trade every day) and more often than not produce a price move in the anticipated direction. If so, you have a *potential* entry point for a strategy. You'll then need to assess how to exit, or sell, those trades.

Deciding When to Sell

There are multiple ways to exit a winning position, including trailing stops and profit targets. Profit targets are the most common exit method, taking a profit at a pre-determined level. Some common price target strategies are:

Strategy	Description
Scalping	Scalping is one of the most popular strategies. It involves selling almost immediately after a trade becomes profitable. The price target is whatever figure that translates into "you've made money on this deal."
Fading	Fading involves shorting stocks after rapid moves upward. This is based on the assumption that (1) they are overbought, (2) early buyers are ready to begin taking profits and (3) existing buyers may be scared out. Although risky, this strategy can be extremely rewarding. Here, the price target is when buyers begin stepping in again.
Daily Pivots	This strategy involves profiting from a stock's daily volatility. This is done by attempting to buy at the low of the day and sell at the high of the day. Here, the price target is simply at the next sign of a reversal.
Momentum	This strategy usually involves trading on news releases or finding strong trending moves supported by high volume. One type of momentum trader will buy on news releases and ride a trend until it exhibits signs of reversal. The other type will fade the price surge. Here, the price target is when volume begins to decrease.

In most cases, you'll want to exit an asset when there is decreased interest in the stock as indicated by the Level 2/ECN and volume. The profit target should also allow for more profit to be made on winning trades than is lost on losing trades. If your stop-loss is $0.05 away from your entry price, your target should be more than $0.05 away.

Just like your entry point, define exactly how you will exit your trades before entering them. The exit criteria must be specific enough to be repeatable and testable.

Day Trading Charts and Patterns

To help determine the opportune moment to buy a stock (or whatever asset you're trading), many traders utilize:

- Candlestick patterns, including engulfing candles and dojis
- Technical analysis, including trend lines and triangles
- Volume—increasing or decreasing

There are many candlestick setups a day trader can look for to find an entry point. If used properly, the doji reversal pattern (highlighted in yellow in the chart below) is one of the most reliable ones.

Typically, look for a pattern like this with several confirmations:

1. First, look for a volume spike, which will show you whether traders are supporting the price at this level. Note: this can be either on the doji candle or on the candles immediately following it.
2. Second, look for prior support at this price level. For example, the prior low of day (LOD) or high of day (HOD).
3. Finally, look at the Level 2 situation, which will show all the open orders and order sizes.

If you follow these three steps, you can determine whether the doji is likely to produce an actual turnaround and can take a position if the conditions are favorable.

Traditional analysis of chart patterns also provides profit targets for exits. For example, the height of a triangle at the widest part is added to the breakout point of the triangle (for an upside breakout), providing a price at which to take profits.

How to Limit Losses When Day Trading

A styop-loss order is designed to limit losses on a position in a security. For long positions, a stop loss can be placed below a recent low, or for short positions, above a recent high. It can also be based on volatility.

For example, if a stock price is moving about $0.05 a minute, then you may place a stop loss $0.15 away from your entry to give the price some space to fluctuate before it moves in your anticipated direction.

Define exactly how you'll control the risk of the trades. In the case of a triangle pattern, for instance, a stop loss can be placed $0.02 below a recent swing low if buying a breakout, or $0.02 below the pattern. (The $0.02 is arbitrary; the point is simply to be specific.)

One strategy is to set two stop losses:

1. A physical stop-loss order placed at a certain price level that suits your risk tolerance. Essentially, this is the most money you can stand to lose.
2. A mental stop-loss set at the point where your entry criteria are violated. This means if the trade makes an unexpected turn, you'll immediately exit your position.

However you decide to exit your trades, the exit criteria must be specific enough to be testable and repeatable. Also, it's important to set a maximum loss per day you can afford to withstand—both financially and mentally. Whenever you hit this point, take the rest of the day off. Stick to your plan and your perimeters. After all, tomorrow is another (trading) day.

Once you've defined how you enter trades and where you'll place a stop loss, you can assess whether the potential strategy fits within your risk limit. If the strategy exposes you too much risk, you need to alter the strategy in some way to reduce the risk.

If the strategy is within your risk limit, then testing begins. Manually go through historical charts to find your entries, noting whether your stop loss or target would have been hit. Paper trade in this way for at least 50 to 100 trades, noting whether the strategy was profitable and if it meets your expectations.

If it does, proceed to trade the strategy in a demo account in real-time. If it's profitable over the course of two months or more in a simulated environment, proceed with day trading the strategy with real capital. If the strategy isn't profitable, start over.

Finally, keep in mind that if trading on margin—which means you're borrowing your investment funds from a brokerage firm (and bear in mind that margin requirements for day trading are high)—you're far more vulnerable to sharp price movements. Margin helps to amplify the trading results not just of profits, but of losses as well if a trade goes against you. Therefore, using stop losses is crucial when day trading on margin.

Now that you know some of the ins and outs of day trading, let's take a brief look at some of the key strategies new day traders can use.

Basic Day Trading Strategies

Once you've mastered some of the techniques, developed your own personal trading styles, and determined what your end goals are, you can use a series of strategies to help you in your quest for profits.

Here are some popular techniques you can use. Although some of these have been mentioned above, they are worth going into again:

- **Following the trend**: Anyone who follows the trend will buy when prices are rising or short sell when they drop. This is done on the assumption that prices that have been rising or falling steadily will continue to do so.
- **Contrarian investing**: This strategy assumes the rise in prices will reverse and drop. The contrarian buys during the fall or short-sells during the rise, with the express expectation that the trend will change.
- **Scalping**: This is a style where a speculator exploits small price gaps created by the bid-ask spread. This technique normally involves entering and exiting a position quickly—within minutes or even seconds.
- **Trading the news**: Investors using this strategy will buy when good news is announced or short sell when there's bad news. This can lead to greater volatility, which can lead to higher profits or losses.

Day trading is difficult to master. It requires time, skill, and discipline. Many of those who try it fail, but the techniques and guidelines described above can help you create a profitable strategy. With enough practice and consistent performance evaluation, you can greatly improve your chances of beating the odds.