Jake Bernstein's

Online Trading Courses

Course #5
Short-Term
& Day Trading

Lesson #1
Essential Insights for Day Traders

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Introductory Comments

The world of futures trading has become increasingly dominated by short-term speculation. In the "good old days," markets moved slowly and steadily toward their goals or they continued in sideways trends for extended periods of time. This is not the case today. In fact, since the early 1970s, virtually all futures markets have become increasingly volatile while the time window of market moves has steadily narrowed.

This is not to say that the old adage "the big money is made in the big pull" is no longer true. It's just as true today as it has always been. There will always be large, long-term market moves.

What has changed, however, is that short-term volatility has become so significant as to necessitate the use of extremely large stop losses, thereby forcing traders to risk substantially larger amounts of capital than ever before. The "big pull" still provides outstanding opportunities, but it also entails larger risks than ever before.

Increased volatility is both a sinner and a saint. While it has made trading with limited risk less possible, it has also brought with it a plethora of short-term trading opportunities. Significant profit potential now exists in virtually all markets.

Prior to the aforementioned increase in volatility, the potential for profit from short-term and day trading did not exist other than for the floor trader. Now such opportunities are available to all traders.

But with opportunity also comes risk -- they are both sides of the same coin.

- **Without risk there cannot be reward**
- **Without volatility there cannot be intraday opportunity**

The Forces Behind Increased Volatility

In addition to increased volatility, several other fundamental factors have become powerful driving forces in the futures markets; forces which were not significant to any meaningful degree prior to the 1970s. Specifically, I refer to relatively low commissions and significant advances in personal computer technology.

Furthermore, the advent of negotiated brokerage commissions and discount brokerage services has opened a vast new arena of opportunity for all futures and futures options traders.

It is now possible for traders who do not seek the advice, input and "full service" of a broker to pay greatly reduced commissions, thereby allowing for more active trading, as well as trading for smaller price moves.

Commission -- the Single Largest Overhead Factor in Futures Trading

Commission has always been, and will always be, a severely limiting "bottom line" factor for the futures trader. Unfortunately most traders fail to realize this vital fact. Combined with losses due to system limitations, trader error and slippage, commission costs add up quickly. At the end of the year traders are often taken aback with what they have paid out in commissions and fees.

With greatly reduced commissions, however, the short-term and day trader can now trade more actively, more profitably and more aggressively. Discount commission costs must, therefore, be considered as one of the most important factors contributing to the growth of short-term and day trading since the 1980s.

The Computer Revolution and Trading

In addition to the radical restructuring of commission costs to retail (i.e., non-professional) traders, there has also been a revolution in computer software and hardware technology. Since the mid-1980s, home computers have become increasingly powerful, efficient and affordable.

The cost of owning a state-of-the-art personal computer system has been steadily declining while quality and processing speeds have been steadily rising. For several thousand dollars, one can acquire a computer so sophisticated that, by 1983 standards, their cost would easily have approached the $100,000 mark, if not more.

Computers, however, are only as good as the software that makes them productive. They are limited by the limitations of software programs. Computer software specifically designed for personal computers (PC's and Macintosh's) has also made tremendous gains, particularly since the late 1980s.

There is virtually no area of science, literature, mathematics or investments, which has been left untouched by the quantum advances in sophisticated software. The combination of advanced computer hardware, high level computer software and low cost computer memory have ushered in a new era of futures trading which, to borrow a concept from J. Peter Steidlmayer, I call "*The Age of Instantism.*"

Advances in Market Quotation Systems

Those who seek to venture into the new realm of instantism have at their disposal a multiplicity of market quotation services, which provide everything from tick-by-tick data to delayed and after-market closing data. Accurate price quotations at affordable prices are now available on-line throughout the day, for access by computer.

The availability of live tick-by-tick data throughout the trading day has enhanced public participation in an area, which for many years, was the exclusive domain of professional off-the-floor traders as well as on-the-floor pit brokers. And, this has added to the pool of short-term and day-trading participants. This, in turn, has increased liquidity, which has facilitated short-term and day trading.

The International and Domestic Political Climate

While the aforementioned technical and fundamental factors have helped accelerate the tremendous growth of short-term and day trading in the futures market since the early 1980s, the backdrop of worldwide and domestic political and economic instability have exerted a synergistic force in markets already stimulated to greater activity.

The uncertainty, which originated during the OPEC oil embargo, has spread its effect to virtually all markets during the last twenty years. Barely a market has been left untouched by international political instability and machinations.

Since the economic peak in the United States, which occurred broadly between 1975 and 1981, the stability of once revered domestic economic institutions has been seriously threatened, forcing an understandable deterioration of trader and investor confidence. Insecurities have expressed themselves in highly emotional markets and in extremely violent price moves within relatively circumscribed periods of time.

The exaggerated price movements, which occurred during the stock market crashes of 1987 and 1989, as well as the mini-crash of 1992, were symptomatic of underlying trader anxiety motivated by panic. The panics were clearly the result of diminished confidence in existing institutions and in the ability of government to regulate economic affairs.

Responsibilities and Goals of the Day Trader

My task is not to analyze or moralize about the multiplicity of factors which have stimulated the growth of short-term and day trading, rather it is to accept the facts as they are and to teach you how you may take advantage of them for the purposes of day trading. It is not the job of the day trader to understand the why's and/or the wherefore's of market movement. The day trader's sole responsibilities are threefold:

- **First, to end each day "flat" (that is without any positions)**
- **Second, to make a profit, no matter how large or small**
- **Third, to keep all losses small and manageable**

Within the context of these very general responsibilities and guidelines for the day trader, all market volatility regardless of root cause must be approached as an opportunity for potential profit.

We are neither defenders of what is right or just in the markets, nor are we pedagogues whose task it is to determine why things are the way they are. We are interested in being true to our tripartite credo as expressed above and in attaining three distinct goals, which are the essence of what this course is designed to teach you. These goals are as follows:

- **To profit consistently and significantly from day trading**
- **To become a better day trader with more experience**
- **To maintain a disciplined and business-oriented approach in order to help you attain your day-trading objectives**

Successful Day Trading

The purpose of this course is to acquaint all day traders, aspiring day traders and other interested parties with the basics of successful day trading. My goal is to expand considerably on the basic day-trading building blocks, in order to provide concise methods, indicators and guidelines, which, it is hoped, will prove beneficial on the road to profits.

Please note that this course is not designed to serve as a cookbook or "no brainer" approach to day trading. I am absolutely convinced, after my many years of experience as a trader, that effective trading can be learned and, moreover, that many traders are quite capable of doing so. One of the prerequisites, however, is to learn from a teacher who is organized, experienced, lucid and above all, specific.

My experiences as a trader have led me to the conclusion that successful day trading is built upon a unique foundation combining art and science. If pressed to "guesstimate" as to the proper mix of both qualities, I'd say that approximately 70% of successful day trading consists of technique or "science" and 30% of skill and/or art.

This, however, would be a misleading statement inasmuch as both elements are symbiotic; without one, the other would be ineffective. The successful day trader combines both elements synergistically to produce profits, consistency and longevity.

Beware of TallTales

Even if you're a newcomer to the futures markets, you have likely been exposed to the numerous tall tales of great successes by novice traders or by those who have discovered "hot new systems." This is all "old stuff."

Such tales have existed since the first trader traded the first futures contract. And, they will exist as long as there are markets to trade and traders to trade them. Don't bother chasing these dead ends -- they will lead you astray. Also, don't compete with any of them. They will lead you, more often than not, to frustration and losses.

My best advice is to compete only with yourself. If you attempt to play someone else's game by their rules, you will frequently be a loser.

The quintessential element of successful day trading is to find something that you can do well and do it consistently day in and day out. I don't mean to imply by any means that day trading is an effortless proposition or that it is something as simple as finding a good bread recipe and following it.

Who Succeeds and Who Fails

Clearly, day trading is not for everyone. There are certain qualities, which predispose a day trader to success or failure. Before we go on with a concise discussion of the techniques, systems and methods of day trading which I've acquired by long and hard experience through the years, I'd like to familiarize you with the qualities which either facilitate or limit one's probability of success as a day trader.

As you read them, I am certain you will find that many of the things I am about to say apply to success not only in the markets, but in every walk of life as well. To be successful in virtually every human endeavor requires a number of skills, which are not easily acquired.

While the struggle to achieve these skills may indeed be an arduous one, the effort is well worthwhile both in the long run and in the short run. I say this because there is a great deal of transference in skills across many different professions and undertakings.

This does not necessarily mean, however, that a good engineer will become a good trader. Nor does it mean that a bad engineer will become a bad trader. It's been my observation that choice of profession is not closely correlated with probability of success in the futures markets. The following is a list of qualities I feel are essential to success as a trader.

Essential Qualities for Success as a Trader

Flexibility

I have observed that extremely rigid personality types tend to perform poorly as futures traders inasmuch as they have not mastered the ability to think beyond the rules; a skill which is extremely important for the day trader. You will find most often that market entry is very specific and not subject to a great deal of interpretation, if any.

Market exit, however, is frequently more intuitive, although it can be subjected to more definitive and operational procedures. Consequently, when I refer to such qualities as discipline, persistence, organization and the ability to follow-through, I am not referring to any of these in rigid terms.

Perhaps the greatest single quality a day trader can possess is **flexibility or adaptability**. Such flexibility, however, must be maintained within the context of specific understandings, trading signals and/or guidelines that are the subject matter of this course. A trader must be flexible not only to new ideas about the markets, but also to situations, which develop in markets during the day.

Hence, flexibility is an important quality which, unfortunately, cannot be taught. I can, however, give you some specific ideas as to what I mean by flexibility so that you may make the necessary adjustments to your own trading style.

Perhaps a better way to express this is by saying that in order to be a successful day trader, you must be "flexible but firm." In other words, you must understand the rules, the signals and the timing indicators. However, you must apply them in a manner, which is mediated by other understandings about yourself and about the markets. I will attempt to clarify this for you in the sections, which follow.

Consistency

Another important quality, which the successful day trader must either possess or develop, is consistency. By consistency, I mean the ability and willingness to follow a particular program or trading methodology day in and day out as long as the technique continues to achieve the desired results.

In other words, if something you learn in this course or elsewhere is working for you, then continue to use it until it no longer works or until you suspect that it is slowly but surely becoming ineffective.

Too many day traders spend too much of their time attempting to improve on methods which cannot be improved. The fact is that there are not too many methods, which work consistently well in the markets, and, furthermore, those, which do work well, cannot be improved upon beyond a certain point.

To state this concisely, "if it ain't broke . . . don't fix it." Consistency is a very important quality, which must be cultivated if day trading is to become a successful proposition.

Patience

Patience is yet another important virtue. Day traders must be willing and able to tolerate a series of losses, as they patiently wait for a turn in their fortune. On the other hand, too much patience is not a virtue for the day trader. Too much patience can be a fatal flaw.

The day trader who is too patient in hanging on to a losing position will be violating one of the cardinal rules of successful day trading which is, of course, not to carry losing positions (or for that matter any positions) over night. Losses must, in all cases, be taken as quickly and as expeditiously as possible. The idea is, of course, to ride profits to their maximum while eliminating losses.

Self-Control

Another important quality which successful day traders must either possess or develop is self-control. During any given day, literally hundreds of day-trading opportunities will present themselves. While many of these may turn out to be profitable opportunities, the day trader does not know in advance which will or will not produce the desired results. The vast majority of opportunities are specious.

Furthermore, the day trader is limited in how many of these opportunities may be taken. It behooves the day trader, therefore, to begin each day's trading with a general plan of action within which the day's events may be interpreted and the proper actions taken.

The plan, however, must not be so restrictive as to blind the trader to other "unexpected" opportunities. In so doing, some of the worthless or losing opportunities will be eliminated ahead of time, while the trader will stay focused on those which seem to offer the best potential.

Hopefully, the information contained in this course will be valuable to you in making these decisions. I liken the job of the day trader to that of a hunter. The day trader and the hunter are both provided with a finite amount of ammunition. For the hunter, the ammunition consists of bullets, arrows or weapons. The day trader's ammunition is capital.

Trading capital and ammunition may both be easily squandered in pursuit of worthless targets, however, the trader and hunter who engage in this type of useless activity will eventually find themselves without the ammunition to pursue larger, more profitable game.

The day trader must be patient, methodically waiting for only the more promising opportunities upon which to take aim and fire. And then, when the opportunity presents itself, they need to follow-through according to their plan.

Willingness to Exit Trades at the End of Day

Still another important quality, which the day trader must develop, is the willingness to exit positions by the end of the day. Veteran futures traders jokingly define long-term positions as "day trades which ended the day at a loss."

The lesson here is that all too many traders enter positions originally as day trades, however, if these trades show losses at the end of the day, they are inclined to hold them overnight or longer given their refusal to take the loss. The justification or excuse is that the trade probably has more than mere day trade value.

Holding a position overnight, particularly a losing position, is perhaps the single greatest offense that a day trader can commit. Frequently, it is also the single most costly violation of the rules.

Accepting Losses

The successful day trader must learn how to accept a loss and when to recognize that this rule is being violated. There are some very specific and simple procedures for doing this, which will be discussed later on. The day trader must be willing to accept what he or she has achieved by the end of each day without undue frustration and/or wishful thinking, win, lose or draw.

As human beings we always look back on what we have done, often with regrets, thinking that we should have done things differently. While in many cases it is certainly true that things should have been done differently, lamenting the fact is not constructive.

Learning from it, however, is the appropriate response. Each loss, if taken at the right time, is a lesson. Each loss will teach you something important. If the amount of the loss is approximately what it should have been in terms of your system or method, then you have learned that you can follow your system.

If, however, your loss is not taken on time and therefore becomes larger than it might have been, then you have learned that to go against your system will cost you money.

Daily Analysis of Results

Day traders should have a formal procedure for analyzing their results at the end of each day in order that the maximum amount of learning is extracted from each trade, whether that trade was a profit or a loss. This, of course, requires some degree of organization and consistency.

I will discuss the importance of your trading diary in considerable detail later on. At this time I urge you to begin keeping a diary if you are not already doing so.

You'll be absolutely amazed how much you can learn by jotting down your comments at the end of each trading day (or preferably during the day). It only takes a few minutes and the reward is literally hundreds of times the cost.

What this Course Cannot and Will Not Do for You

Some instructors are quite accomplished at telling you what their course will do for you. I would prefer not only to tell you what this course can do for you, but moreover what it cannot, and will not, do for you. I do this at the outset so that you will not revel in any unrealistic expectations or unwarranted fantasies about what you will read within these pages.

This course, in and of itself, is not a treasure map to riches untold or a handy little instruction guide to the secrets of trading success. While it does contain many of my secrets as well as extremely valuable information, secrets without action or valuable information without direction and consistency, are nothing more than lifeless exhibits at a museum.

Within this course you will find no claims that this alone will be the vehicle for your attainment of great wealth as a day trader. If you are looking for guarantees, you'll need to look elsewhere because you won't find them here. I will only guarantee you that the ideas, systems, methods, indicators and suggestions in this course will give you the potential to achieve success.

But you, and you alone, are the instrument which will transform potential energy into actual energy. If you seek to acquire the substantial knowledge, which I have accrued since I began trading futures and stocks in 1968, then you've certainly come to the right place. This course will educate you, guide you, assist you, explain things to you and illuminate the way for you.

But it will not trade for you, put money in your pocket or in your bank account. Nor will it fill your head with misleading guarantees. I can teach you how to ride the bicycle, but I cannot ride it for you.

Any individual who has had experience as a trader, albeit limited, learns very early in the game, that to achieve consistent success in futures trading is possibly one of the most difficult undertakings a human being can attempt. Success comes only to a few.

The reasons for this will be explained clearly and carefully in the materials, which follow this as well as in the other five ***Jake Bernstein's Online Commodity Trading Courses.***

I will demonstrate that the difficulty in attaining success as a trader is primarily one of the trader as opposed to the system or method. It is my goal to facilitate success for you by teaching you techniques, as well as methods, for improvement in the hope that you will eventually join the ranks of those who are successful day traders.

No Exaggerated Claims

Furthermore, I do not make any exaggerated claims about what you can achieve as a day trader. While "the sky's the limit" in futures trading, it is up to the individual trader to maximize what can be achieved. I am only a guide who can teach you techniques, which I've found useful during my years as a trader. There are no unrealistic claims in this course.

If you want those, you'll have to read some of the magazines, which help perpetuate such rubbish . . . or you'll have to read some of your "junk mail." If anything, I've attempted to tone down all claims so that when you achieve success you'll be very pleasantly surprised. I'd rather have you keep your expectations low so that you will be happy with what you achieve.

For too many years too many unscrupulous operators have preyed upon the public, asserting absurdly fantastic claims, pandering to the weaknesses of human greed and hope. You'll find none of that in this course.

Historical Results

Throughout this course you will find references to historical results or to statistical summaries. Unless otherwise stated, these are as up-to-date as possible to the time of this writing. I forewarn you that with time, these statistics will change.

They should therefore be updated either through your own research or by consulting with my office. Should you have a question regarding their current applicability, please don't hesitate to contact me.

Note also that my examples are primarily taken from current market activity. I could easily hunt and search for historical examples, which illustrate my points perfectly. These would, however, be "text book cases" and, therefore, misleading.

The reality of day trading, indeed, of all trading is that nothing works as well in reality as it does on paper. This is a fact, which I must emphasize early and often so that you will, above all, emerge from this course as a realist.

Do Your Own Research

I always encourage individual research by traders. There are so many ideas, which can be applied to today's futures markets that any one individual does not have a monopoly on research. In fact, every trader is so very different in his or her perceptions of the markets that distinctly different methodologies and applications will be visualized and developed by different traders.

Some of the ideas presented in this course may spark in your mind, concepts and methods, which could prove highly profitable. Don't allow yourself to be restricted or encumbered by my words, rather use my work as a starting point for your own good research. Certainly if you find that my techniques are working for you, then continue to use them and adapt them to serve your own purposes.

I always look forward to hearing from the people who take my courses, attend my seminars and/or read my publications. This is particularly true if they have feedback on the techniques I've taught and/or if they have developed new methodologies that improve upon those suggested in my teachings.

If you have developed your own trading methods and are willing to share them, then I most certainly invite you to get in touch with me.

Practice

Practice is extremely important. It is absolutely necessary if you are to fully implement the indicators, concepts and topics discussed in this course. I urge you to practice in real time as soon and as often as you can. Learning to day trade from a course manual is very much like learning to ride a bicycle from a course.

None of what I am about to teach you will crystallize into profitable action until you get on the bicycle and begin to ride it. Hopefully you will not have to fall off the bicycle too many times before you understand the actions, which go along with my words.

What Else You Need to Get Started

Aside from the motivation and persistence, which are required for success in any venture, you will not need any other tools in order to get started with this course. I will make a few suggestions, however, which may prove valuable.

Read Slowly

While you may feel that the subject matter is very straightforward and simple, please read through it slowly, first for the general idea, and then a second or third time for the specifics.

Apply Your Knowledge to the Examples

Where I have provided examples, I urge you to apply what you have learned in order to make certain you understand it.

Take Notes

I also urge you to take notes both in the margins of this text and on a separate note pad. The material will be easier for you to comprehend and retain if you take notes.

Take your Learning to the Markets

Once you have internalized the concepts please observe them under real market conditions to determine how well they work for you and if they are consistent with your needs as a trader.

Summary

This section discussed the essential aspects of day trading. It also defined the limits of what can be achieved by day traders to help give you an overview of day trading in general.

Definitions & Discussions -- What a Day Trader Is, What a Day Trader Does

Perhaps the single most important issue at the outset is to define exactly what I mean when I use the terms **“day trader”** and **“day trading.”**

It will be in our best interest to define what the day trader does in order to make certain that you learn the skills, which will be necessary for you to succeed in this highly demanding task. A day trader is an individual who trades strictly within the day time frame.

The day trader, therefore, establishes positions at some time within the day and always exits these positions by the end of the trading session. Failure to exit positions by the end of the trading session violates the single most important rule of day trading.

The day trader who does not exit positions by the end of the trading session is not, therefore, a day trader. I emphasize this point inasmuch as there are many individuals who wish to day trade but who, for lack of discipline, cannot do so effectively or consistently.

To carry a trade beyond the close of trading on the day of entry is to violate not only the cardinal rule of day trading, but also to destroy the advantage that day trading offers over all other forms of trading.

While you may find my insistence that a day trader only trade within the time frame of the day somewhat annoying, I must emphasize this point strongly. I will do so repeatedly in order to impress upon you the importance of staying with your primary goal as a day trader.

For those who insist on violating the rules, I will provide some sensible alternatives and procedures, which should prove helpful. I do, however, insist that positions entered as day trades be closed out as day trades with very few exceptions to this rule. Since a day trader is one who trades within the day time frame, day trading is the job of the day trader.

What Does a Day Trader Trade?

While some would argue that only certain markets are amenable to day trading, I disagree. At some time or another, all markets are suitable for day trading, provided that certain prerequisite conditions are met.

I will teach how to recognize which markets to day trade and when to day trade them. Regardless of which markets are traded, **the day trader will adhere strictly to the policy of entering and exiting positions within the day time frame.**

Some markets lend themselves more readily to certain trading systems, methods and techniques. I will identify these for you. Some day traders will avoid certain markets feeling, perhaps, that the potential for profit is not large enough or that risk is too high. This is not necessarily true. The only thing, which should dissuade a day trader from trading certain markets, is lack of liquidity. I will be more specific later on.

For now, however, suffice it to say that all reasonably active futures markets have potential to be day traded at one time or another. There are some markets, which are suitable for day trading almost every day, while there are some markets, which should only be day traded at certain times.

I will tell you how to know when given markets should be day traded and when they should not be day traded.

Why Day Trade?

Given the volatile market environment, which I have previously described, day trading offers many advantages over position trading, however, day trading is not recommended for all traders. There are several particularly cogent reasons, which support day trading as a viable orientation within the limitations that will be presented later.

Maximizing Equity

Day trading allows traders to maximize their trading capital by avoiding the need to post overnight margins. Many brokerage firms will allow traders to trade actively and very aggressively within the day time frame, provided these individuals have the financial resources, the demonstrated responsibility and the maturity to do so.

If your broker and/or brokerage firm has the confidence that you will not accumulate a large deficit, you will be permitted to trade many markets and fairly large positions during the day -- without needing to post the large margin requirements that would be necessary if the positions were held overnight.

It is, therefore, possible for a trader to maintain a relatively small cash balance in his or her account, and to day trade considerably larger quantities in terms of total number of contracts, than might be the case were it not for day trading.

Reduced Risk Exposure

While some individuals would vehemently argue this point with me, I maintain that day trading affords less exposure to the risk of loss than does position trading. The position trader is often a victim of considerable price volatility, which results from news or fundamental developments occurring after trading hours.

It is not uncommon for a position trader to find that a trade, which showed considerable profit at the end of the previous trading session, shows a substantial loss on the opening of the next trading session, as a result of overnight news or market related developments.

While this is, of course, a two-sided coin (it can work for you or against you), it is far better to avoid the exposure of risk, than to gamble on overnight news.

Certainly, news can occur during the trading day, however, the day trader can respond within the day time frame since the markets are open and the position can be closed out. In other words, news can be used to the advantage of the trader or to indicate that the day trade should be closed out.

Opening price gaps, although potentially negative for position traders, can be used to the advantage of the day trader. While they frequently work to the disadvantage of the position trader, there are opening price gap methods (to be discussed later) which provide many profitable opportunities to the day trader; opportunities which are either unavailable to the position trader or which are actually injurious to the position trader.

The Advantages of Forced Exit

Day trading forces traders who follow their rules to exit positions by the end of the day, win, lose or draw. This, in effect, forces traders to take their losses no matter what excuses may be conjured up in favor of holding positions.

Consequently, a day trader who holds a position beyond the close of trading knows that he or she has broken one of the cardinal rules of day trading and that the consequences may be negative.

I do not suggest, by any means, that positions which show a loss at the end of the day, and which are then held through to the next trading session, invariably continue to show a loss the next day. The odds are probably 50/50.

However, losses are frequently larger than profits and, furthermore, carrying a position overnight leaves the day trader uncertain as to what should be done the next day. This is why the day trader who follows the rules will be spared the pain of loss, as well as the often debilitating anxiety and uncertainty which are part and parcel of riding losses.

Those who are committed to day trading and who follow the rules accordingly will not carry losing positions overnight and, in so doing, will avoid one of the most serious problems traders encounter in their speculative ventures. It is far better to close out a position, even at a loss, if this will prevent the loss from becoming larger the next day.

Reliability of Timing Signals

A third reason for considering day trading is that many signals and trading systems appear to be more reliable in shorter time frames than they do in longer-term time frames. I find it considerably less difficult to develop trading systems, methods and timing indicators which are more accurate within the day time frame, than indicators which attempt to trade for intermediate-term moves.

As a point of information, I have also found more trading systems and timing methods that work well on a very long-term basis than those which work well in the intermediate term.

Immediate Feedback

Another substantial benefit of day trading is the fact that feedback in the form of profits or losses is much quicker than it is in the case of position trades. This is important to the trader who is concerned about learning from his or her errors (i.e., losses).

A position trader who enters a bad trade may not get feedback (in the form of a loss) until many weeks, possibly months, later. The day trader, on the other hand, will know no later than the end of the day, and frequently within minutes, or even seconds, that the trade is not a profitable one.

Such positive or negative reinforcement (in the Skinnerian sense) is important in learning how to trade. Frequently, position traders will close out a losing trade so long after the position was entered, that the original reason for entry has been forgotten (or repressed) and, therefore, very little if anything can be learned from the loss.

Faster Development Time

A day-trading system can be tested and developed in real time more quickly than can a position trading system. The availability of continuous contract, tick-by-tick data, makes system testing by computer faster and, I feel, easier.

It is possible to test literally thousands of cases. This increases the statistical reliability of test results.

Trader Personality

A less technical reason for preferring day trading relates to the personality of the trader. I find day trading to be considerably more enjoyable and, frankly, much less stressful than carrying positions overnight.

While it is true that some methods of day trading are more time and attention intensive than position trading, there is a certain pleasure which is derived from knowing that no positions are kept overnight. And, that any unexpected international or domestic developments cannot impact me, since I do not have any open positions.

Day trading appeals to certain individuals such as yourself. It is probably more closely suited to your specific needs than are either position trading or short-term trading. That's why you're studying this course.

Summary

In summary, the day trader seeks to capitalize on moves, which occur within the day time frame. While there are many techniques, which may be used, many, unfortunately, prove to be nothing but blind alleys. The rest of this course goes on to teach and explain some of the methods I've developed over the years.

While some of my techniques are highly specific and objective, others are more subjective and fall into the category of trading methods or techniques as opposed to systems. The day-trading methods and systems which follow are one's which I've developed during my more than 25 years as a futures trader. I sincerely believe that those who take the time to learn them, to use them and to refine them will benefit handsomely.

The Basics -- a Few Definitions

Before digging too deeply into the technical aspects of day trading, we'll need to examine some "house-keeping details" which pertain to our task. First among these is a brief but necessary definition of terms.

The futures markets have their own language without which they could not function, and without which you will be unable to trade. So let's take a look at some important terminology, which will be used throughout the text. These terms are not presented in any particular order other than, perhaps, frequency of use.

All traders should be familiar with these terms. Do not bother reading this definition if you are already familiar with these terms.

Day Trading, Day Trader

In order to avoid confusion or misunderstandings, I'll first define for you the terms day trading and day trader. While you may think that this is an unnecessary waste of time and space, I cannot tell you how surprised I am at the all too common lack of knowledge which most individuals have about day trading, what it is and what it is designed to achieve.

- **A day trade is a *"day"* trade**

This means that it is a trade, which is entered and exited on the same day. It does not mean that the trade will be held overnight, that it will be kept overnight if profitable, that it will always be entered on the opening and exited on the close or that it will not entail risk.

As I said before, a day trade is a day trade. Day trades are always over by the end of the trading day. By definition they are no longer day trades if carried through to the next trading session.

The true day trader will not hold positions to the next trading session regardless of how they have fared during the day. Succinctly this means that a loss is a loss, and a profit is a profit -- all scores are settled by the end of the trading session win, lose or draw. Day trades may be entered at any time during the day but they must be closed out by the end of the day.

Position Trading, Position Trader

A day trader is one who day trades. As soon as a day trader holds a position overnight, he or she cannot refer to the trade as a day trade or to him or herself as a day trader.

A position trader, on the other hand, holds trades for an extended period of time. The position trader in futures is like the investor in stocks, albeit with a shorter time perspective, which is not necessarily limited by the life of the futures contract. There is no crime in being a position trader and, certainly, no crime or embarrassment in being a day trader.

However, you must be careful what you tell yourself, or you may begin to believe it. A day trader is an individual who is committed to a certain specific course of action. To sway from this course of action is to subvert the program. To stray from the program is to abandon its principles and to acquire a new set of expectations, which may not be consistent with the original objective. I urge you, therefore, to be committed to your course of action once you have determined it.

If you wish to be a position trader, then do yourself a service and do not refer to yourself as a day trader, lest you confuse your objectives. Simply stated, what's right for the position trader is not necessarily right for the day trader and vice versa.

Position traders may be willing, for example to carry a losing position for quite some time in the expectation that it will eventually become profitable. To the day trader, this is a violation of the cardinal rule.

Is it not possible, you ask, for traders to wear different hats at different times or many hats at the same time? Absolutely! There is nothing wrong with trading in many different time frames at the same time, provided you do so with specific structure and follow specific rules, which will be explained to you later on in this course. But remember this course is primarily, in fact exclusively, for the day trader and no one else.

Short-Term Trading, Short-Term Trader

A short-term trader as opposed to a day trader or a position trader is one who trades for relatively short-term market swings of from two to ten days duration. There is no firm definition of the exact length of time short-term traders hold their positions.

The distinction between a short-term trader and a position trader is not as precise as is the distinction between a day trader and all other types of traders. A day trader trades within the day time frame as a hard and fast rule, whereas position traders and short-term traders time lengths are not as specifically defined.

Many of the techniques described in this section may be applied to short-term trading as well as day trading.

Intermediate-Term Trading

An intermediate-term trade is one usually held for several months. Many traders, money managers and investors prefer such trades. Intermediate-term traders seek to take advantage of larger price swings.

Long-Term Trading

In reality there are very few long-term futures traders. **A long-term trader may hold positions for several years, rolling contracts forward as they approach expiration.** What the day trader does is the complete antithesis of what the long-term trader does.

For those interested in long-term trading I recommend studying my book, ***Long-Term Trading in Futures***, available from my office.

Slippage

Slippage is the tendency of price fills to be worse than what is expected. Hence, when I refer to a "100 deduction for slippage," I mean that I am deducting 100 from every trade in a hypothetical back test in order to represent more accurately what might have happened.

A market which tends to have too much slippage is, therefore, a market in which quick and sudden price moves tend to result in price fills which are unexpectedly or unreasonably far away from your price orders.

Trading System(s)

A trading system, as opposed to a trading method, timing indicator, trading technique or market pattern etc., **is an organized methodology containing specific market entry and exit indicators, as well as an operational set of procedures** *(called rules)* **including, but not limited to, various risk management** *(follow-up stop loss procedures)* **methods and procedures.**

A trading system is implemented by following specific timing signals, which dictate market entry and exit. I am defining this term specifically here in order to distinguish a trading system from other market techniques which are not as specific and/or which do not follow a predetermined set of procedures.

Trading systems must be necessarily rigid in their construction for the purpose of delineating specific procedures which, theoretically, should lead to profitable trading, provided the system is functioning as intended or tested. In practice, most traders do not follow a trading system.

They delude themselves into thinking that they are trading according to a system, however, they violate the rules of their own trading systems so frequently that one ought not to term their actions to be systematic. This definition is designed to set the stage for more extensive commentary on the subject in a later section.

In closing this brief definition, I reiterate that a trading system must be systematic or it is not a trading system, regardless of what the individual who professes to be trading a "system" may think.

There are few traders who actually follow trading systems. The vast majority of traders begin with a system, but alter it to suit their internal feelings about the markets to the extent that they are not following a system at all, other than, perhaps, in their own minds.

Timing Indicator(s), Timing Signal(s)

A timing indicator is defined as any specific technique, whether fundamental or technical, which objectively indicates market entry, exit or the underlying condition *(i.e., bullish, bearish, neutral)* **of a given market or markets.** A timing indicator can also be called a "timing signal." I will use the terms interchangeably.

The definition given above is intentionally general for the specific purposes of this course. You will find that there are literally thousands of timing indicators, which may be used in many different ways.

Timing indicators must be objective, that is, not subject to interpretation. An indicator which is subject to interpretation is not an indicator, it is, rather a technique and, therefore, subject to be interpreted differently by different traders and even by the same trader in different situations. I will make every effort in this course to differentiate between timing indicators, trading techniques and trading methods.

Trading Technique

A trading technique, as opposed to a timing indicator, timing signal or trading system, is a fairly loose collection of procedures which assists traders in making decisions about market entry or exit.

Frequently, a trading technique consists of one or more timing indicators combined with general entry and exit rules and/or risk management procedures. A trading technique is, therefore, not a trading system but rather an approach to trading which is generally objective but not nearly as precise or rigid as is a trading system.

In practice, most traders follow techniques as opposed to systems. Much of what you will learn in this course relates specifically to trading techniques, however, I have also included some of my favorite trading systems. A trading system can be used as a trading technique if you wish. As I pointed out earlier, this is, in fact, what most day traders and what most position traders actually do.

Market Entry/Exit

Market entry means simply to establish a new long, short or spread position. Market exit means to close out an existing long, short or spread position. There are many different types of orders that may be used for entering and exiting markets.

Optimization, Curve Fitting

The act of fitting a trading system to past data is called "optimizing." When a trading system developer optimizes a system, he or she does so in order to generate a set of system rules, which have performed well on historical data. Although the system appears to have worked well in the past, it is, in fact, "fitted" to the data.

Hence, the system will frequently not perform well in the future. To a given extent, most system testing involves some degree of optimization or curve fitting. While opinions on curve fitting differ sharply among market experts, I caution you to avoid such systems.

These, then, are some of the very general terms, which I will use throughout this course. Terms not noted herein will be defined as they are introduced.

Please note that my intent in redefining terms which you may already know is not to insult your intelligence, but, rather, to make absolutely certain that we are communicating with one another since this is of paramount importance when teaching specific trading systems, techniques and methods.

Furthermore, there are many terms commonly used nowadays, which are not clearly understood by the individuals who are using them.

Summary

The basic definitions of day trading were discussed and defined in detail in this section. Make certain that you are familiar with the terminology since much of what follows is based on this section's information.

Lesson #1 Quiz (Course 5)

1. What is the largest single overhead (cost) factor in futures trading?

a. Computer software

b. Slippage

c. Commission

d. Losses

2. Why is a day trader's trading capital maximized?

a. Because they avoid the need to post overnight margins

b. Because they consistently make a larger profit per trade than any other type of trader

c. Because they have learned to make more from less

d. Because all day trades have different options than any other trades

3. What two of the following four fundamental factors are conditions in today's markets that were not significant prior to the 1970s?

a. Large trading firms

b. Personal computer technology advances

c. Relatively low commissions on trades

d. Crop reports

4. What is a day trade?

a. A trade that is started in the beginning of the first day of the week and exited at the end of the week

b. A trade that is made only at the beginning of each trading day

c. A trade is occasionally held overnight if it has made more than 50% of its profit

d. A trade that is entered and exited on the same day

5. Which of the following points is NOT consistent with day trading?

a. To carry winning trades over to the next day

b. To keep all losses small and manageable

c. To end each day "flat" -- without any positions

d. To make a profit, no matter how large or small

6. What is slippage?

a. The amount you lose when you do not use a brokerage house that offers substantial discounts

b. The tendency of price fills to be worse than what is expected

c. What happens to your account size when you lose more than three trades in a row

d. What you lose through commissions paid on day trades

7. Which of the following statements about flexibility is NOT true?

a. Traders need to adapt to new ideas created by situations which develop in the markets during the day

b. Specific understandings, trading signals and/or guidelines are not to be used by day traders

c. Rigid personality types tend to perform poorly because they have not mastered the ability to think beyond the rules

d. A trader must mediate what he or she does by other understandings about themselves and the markets

8. Which of the following is an advantage created by the forced exit imposed by day trading?

a. It forces traders to take their losses no matter what excuses may be conjured up in favor of holding on to positions

b. It forces traders to trade spreads

c. It costs less in commissions

d. It avoids most losses

9. What is often the single greatest offense that a day trader can commit (and is often the single most costly violation of the rules)?

a. Not closing out a trade at the end of the day

b. Using a brokerage firm that charges full commissions

c. Not being on top of the international and domestic political scene

d. Not having an up-to-date computer system

10. What is optimization?

a. The ability to make a larger profit by minimizing your losses

b. Taking historical trading data and showing how it can always make you a winner if you follow its signals

c. The act of fitting a trading system to past data to generate a set of system rules

d. The capacity to pick winners consistently

When you have completed the questions in this quiz, e-mail your answers to: **jake@trade-futures.com**

