Taken from <http://www.thestockbandit.com/stock-trading-methodology/>

Stock Trading Methodology

Profitability begins with a plan, and good plans require establishing some boundaries.  Every decision we make at TheStockBandit.com comes only after weighing that decision against specific criteria.  Experience has shown us that by starting with better trade candidates and working through our checklist of requirements, the best potential plays will make the final cut.  We’re left with a much more systematic, repeatable process by which our decisions are made.  It’s all about **S-P-E-E-D** (Selection, Projection, Efficiency, Execution, Defend), which we’ll elaborate on shortly.

That translates into less emotion, increased consistency, and greater net profitability.  If you’re looking to become more methodical in your trading efforts, narrow the search for only the best opportunities, and have a structured plan for making your trading decisions, you’ve come to the right place.  TheStockBandit approach will streamline your trading process, and we’re eager to show you how.

# Selection

There’s a sea of stocks out there to choose from, and today it’s easy to get lost in the list when searching for actionable stocks.  Finding the best plays begins by looking in the right place.

## Price & Volume Requirements

By eliminating the stocks which are outside our criteria for price and volume, we’re not only quickly narrowing down the potential list of candidates, but we’re also avoiding what can be the most dangerous segments of the market.  The ability to effectively enter and exit stocks at or near the price levels we want cannot be underestimated in these times of extreme volatility.  Furthermore, we want a competitive market when we go to place that trade.  Reducing our list of stocks to only those which meet our standards will help to ensure that there’s adequate interest in the stock.

## Technical Analysis

Once we’ve reduced the universe of stocks to a more manageable list, it’s time to hone in on the stocks which meet our next requirement – an identifiable [chart pattern](http://www.thestockbandit.com/chart-patterns/).  Locating stocks which are poised to continue their existing trends can offer up well-defined areas for entering trades, thereby allowing us to participate in those trends.  Additionally, finding stocks which may be set for a meaningful turnaround may prove equally beneficial.  Not only does this approach help us to narrow the field of prospective plays, but it also greatly improves the timing aspect of our activities.  It’s important here at TheStockBandit that we’re only putting our money at risk when the chances for success are the highest, so accurate timing is a crucial element in our method.

# Projection

Having located an identifiable chart pattern, we now have some critical elements to our trading formula.  Perhaps the most important one is the risk we’ll be taking on the trade.  An identifiable pattern enables us to have a directional expectation for the stock, which we can act on.  That pattern will also provide us with a well-defined level at which we’ll place a trade to enter the stock as the pattern is confirmed.

So, we’ve decided on the direction we’ll be taking and the price at which we’ll initiate a position, but what about getting out?  Well, that’s another decision we want to make during the planning stages of a trade, and fortunately this method provides us with that part of the equation.  The chart pattern being traded will also reveal an area which, if crossed, will raise a warning flag that the pattern has failed.  It is at that point that we will need to quickly move to limit losses on the trade.  Knowing where that level is and the risk associated with it gives us a worst-case scenario of sorts, which will also play an important role in other facets of our trade that we’ll be discussing in the next few steps.

Chart patterns don’t just offer us a directional bias for the stock; they also offer us entry and stop loss levels.  Another important element that chart patterns provide is the profit target.  This is the level which we’re expecting the stock to reach as the pattern plays out.  Different patterns carry with them a variety of price projections, so our familiarity with the patterns is a necessity.

Beyond that, it’s equally important to recognize how the stock has behaved and historically responded from similar situations, so the past can serve us as a guide going forward.  Here at TheStockBandit, a vital aspect of our approach is to utilize historical price action in ways which benefit our trading.  Understanding the patterns allows us to set conservative, yet confident, targets for plays.  As a result, this step ensures that we’re aiming to profit on an appropriate scale compared to our risk – a facet of our trading method called Efficiency.

# Efficiency

Now that we’ve located a potential play and have well-defined entry and exit levels which are based upon the chart pattern, it’s time for a decision.  Here at TheStockBandit, we’re not interested in flipping coins.  Rather, we want to put money at risk when there’s potential for real gains.

Gains aren’t the only element to consider in the decision-making process.  We know there is inherent risk with every trade being placed.  So the real key – and the deciding factor for us – is how risk compares to reward.  Risking $1 to make $1 will place added importance on our accuracy, and that’s going to fluctuate.  However, we could alternate wins and losses and still realize a net gain if our money management skills are on point.

That’s at the heart of the Efficiency step – weighing risk and reward, and only accepting trades which tip the scales in our favor by offering much greater profits than risk.  Our starting ratio for reward to risk is 2:1, so any stock which does not meet those criteria is a stock we’re unwilling to trade.  The higher the ratio, the better the opportunity, but we refuse any setup under 2:1.

# Execution

With the previous steps having provided us with a trade candidate and a specific game plan for managing the trade, the next step is to ensure that the plan is carried out.  Today, most brokerages offer sophisticated order types, which truly enable us as individuals to take a ‘set it and forget it’ approach.  That means the tools are in place for us to plug in the trade variables and allow the stock to determine what happens next.  This prohibits the need for us to jump to conclusions or be overly anticipatory or emotional about what the stock will do.  Further, it gives us the ability to structure trades exactly how we want to and then move our attention to something else.

The Bracket Order is the most common way to achieve this, and it’s an all-in-one combination of orders.  Included in the Bracket Order is the entry order and at least two exit orders which offset each other.  The entry order can be set to be any type of order (such as a market buy).  The first exit order is the stop loss (such as a sell stop), which is our safety net in case the trade turns against us after our entry is made.  This of course limits our losses in case we are wrong.  The second exit order is a limit order (such as a limit sell) set at our profit target so that when the stock reaches that level, profits are booked.  The way Bracket Orders work is that once the entry is made, the two exit orders then go live.  They will automatically cancel each other out as soon as one order gets filled.  So for example, if the stock generates an entry and moves straight to the profit target, profits are booked and the stop loss order is automatically canceled.  This ensures that only one entry and one exit are made, even though there are three total orders.  The Bracket Order offers wonderful flexibility, while still covering all the bases, which is why it’s the order type we recommend at TheStockBandit.com.

# Defend

The final facet of our methodology is Defend.  Not only must we defend our trading capital, but we also must defend our profits when we have them.  This step includes the trading rules by which we abide, as those give us guidelines for when to take action and when to stand aside.  With a trading plan in place, conditions may still call for adjustments to be made to that plan.

When entering positions, at times we won’t be able to execute our trades at or near the levels we originally intended to get.  Sometimes that’s due to a [gap in the stock](http://www.thestockbandit.com/stock-gaps/), causing prices to open at a different level than where it finished the previous day.  Common gaps are insignificant, but the larger gaps will tend to skew the risk/reward profile for the trade, which will warrant an adjustment.  At that point, we may need to simply reduce our position size for the trade, or it may mean we skip the trade entirely.  We follow our [gap guidelines](http://www.thestockbandit.com/swing-trading-strategy/) in order to adjust our trades appropriately, scaling down to offset any added risk.

When exiting positions, it’s equally important to defend our capital and profits.  Once winning trades become profitable to a certain extent, we don’t want to allow that trade to turn into a losing position.  That will mean an adjustment to our stop loss, which will either create a theoretical ‘free trade’ with a stop loss being moved to our entry price, or lock in a winner by moving it to a level which is in profitable territory.  When we’re right in a trade, it can also be helpful to book profits incrementally, allowing us to take some gains off the table while still participating in a continued move should it occur.  And at times, a trade which isn’t moving in a constructive way may warrant a reduction in our position or a premature exit, depending on the situation.  In every case, we’ll defer to our [swing trading strategy](http://www.thestockbandit.com/swing-trading-strategy/) when making these decisions.

The **S-P-E-E-D** method complements our Bandit style by encompassing every element necessary in order to trade effectively – regardless of the timeframe or trading style being employed.  By having a checklist to utilize for every single trade we place, we’re better prepared, more decisive, fully informed, and more successful traders.