Notes from The Naked Trader

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This article provides a succinct overview of the main trading strategies, methods and suggestions made by Robbie Burns in his 2011 book The Naked Trader [Burns, 2011]. Its purpose is to enable the reader to quickly access the main ideas without having to read the entire book. It should be useful for those wanting to refine their knowledge of stock selection and trading. Due to the nature of the article, some prior knowledge about equity trading is required as basic definitions are not defined.

Introduction - Day in the life of the Naked Trader

- 07:00: Check whether there are any announcements on the shares that he owns. Judge whether any action is required. For example, should you sell and take profits? Perhaps, buy some more. Also check the spread betting websites to see how the FTSE 100 is set to open.

- 08:00: Check all positions to see if any positions have crashed for any reason. It is usually not worth trading in the first hour of the day. This is because there is always an over reaction to news which can be magnified by small volume and large spreads.

- 09:45: Check the market. It is around this time that he considers a trade. He never rushes anything and usually calls a trading friend to discuss ideas and options.

- 10:00: Read the daily news paper. Review the current portfolio - is there anything bothering him? Look at level 2 data to get a feel for liquidity. He only buys if the timing is right. The worst thing to do is to make a boredom trade! He continues researching any news articles that he noticed earlier in the day.

- 11:00: The markets go quiet around 11am.

- 11:45: Look through short list of potential buy and sell shares. Have any been rising or falling significantly in the morning? This is probably the best time of the day to buy.

- 13:30: The market sometimes changes around 13:30 due to the US and can and shares can often move. This does not both him too much, however if he is betting on the FTSE falling via spread betting he will usually take profits at this point.

- 14:15: Takes a look at his higher risk short list of shares.

- 14:30: The Dow Jones opens, UK shares tend to follow the US movements. He will use this time to decide whether to sell falling shares or to buy shares just after a negative overreaction in the US.

- 15:00: Have a chat with his trading friends to share observations and ideas with one another.

- 16:00: Take one last look at the portfolio. How did it do? What did he miss? How much money was made or lost?
- 16:30: Take one last look though ADVFN.com then turn off the computer and spend time with his family.
- 21:00: Check to see where the Dow Jones finished the day. The US market will usually have a strong impact on where his portfolio will open in the morning. Spend a little bit of time researching companies flagged up by the mornings news feed. Check to see whats being launched on the market over the coming days.
- 22:00: Have one last check of the news.

Warning

Do not share trade if you 1) cannot afford to loose a large percentage of your starting capital and 2) ARE A COMPULSIVE GAMBLER.

Section 1 - Getting started

Starting capital

If you only have £500 there is little point share trading as commission costs will significantly eat into any potential gains. In this scenario wait until you have more capital and paper trade in the mean time. You should have around £3000 or more before you start to buy shares. To become a full time trader you will realistically need a starting capital of 4 * your required income. In other words, you can and need to be looking to make between 20-25% annual profit on the investment capital.

Types of traders - See the problems so you know what to avoid

1. Small cap oil/miner: Over exposed to small cap oil miners in the hope of finding a massive riser. Too often invests in bad shares and ends up loosing large amounts of capital. 2. Day trader: 95% of day traders lose. It is very hard to do well and along with high stress levels, most people are unable to make a living from it. 3. Chart guy: Concentrates purely on technical analysis. In the naked traders opinion these traders are missing the bigger picture. Charts should be used along side other research methods. 4. System addict: Buys expensive black box trading systems and is unwilling to carry out proper research. Mr Safe and Steady: Only buys shares that are perceived as being 'safe'. 5. Long term investor: Does adequate research but holds onto shares for too long before taking profit. 6. Medium term investor: Buys and holds shares for between 3 months and 2 years. Does careful research, sticks to stop losses, takes profit when necessary and keeps an eye on the portfolio. 7. Analyser: Over-analyses and avoids buying shares due to worry. 8. Accountant: Only focuses on fundamental ratio and as a result misses out on a lot of opportunities. 9. Shorter: Only focuses on shorting where as over time, shares go up more than they go down. Bull markets last longer than bear markets. 10. In and out: Often buys looking for a quick rebound, however sometimes this does not happen which reduces profits. 11. Bottom picker: Only buys failing stocks looking for overselling and cheap shares. Sometimes however bottomed shares do not rise or can fall further. 12. Scaredy cat: Sells the moment the market goes down and buy in again at a higher price. 13. Bulletin board: Spends too much time on bulletin boards. Do your own research and do not trade on others tips! 14. Penny share: Only buys shares cheaper than 20p in the hope of finding large risers. These shares are more likely to go bust than make the FTSE main market. 15. Indices: Does not bother with shares an only bets on indices. Most people lose playing indices.

Buy knowing about these trading styles you will be able to identify when you fall into them and then correct your behaviour.

Toolkit

Avoid capital gains tax by trading via a stocks and shares isa. This requires setting up an account with a UK broker. Do not bother with an advisory broker just use an execution broker and do your own research.

Use real time prices by signing up to an online website such as ADVFN, moneyAM, Proquote, Hemscott, Digitallook. When you see the offer (buy), bid (sell) and current price, realise that due to the spread you are always losing money as soon as you buy any share.

Set up a watch list of a range of buy and sell potential shares. Use a note book to document your investment ideas. It is also good practice to keep a trading diary of every historic and current trade that you make. This is useful when analysing your performance to understand why you made or lost money. It is also important that your trading environment is clutter free and that you are in an environment in which you remain clear headed.

Finally, Keep It Simple Stupid (KISS). You do not need to buy complicated chart packages or trading systems to trade shares. All you need is access to news stories, fundamentals, charts and real time prices.

Basic knowledge

To begin trading you need to understand the following topics: 1. Spreads: As soon as you buy a share you are down until the bid price rises above the offer price. Spread size is negatively correlated with market/company size. A spread of 4% is the maximum the naked trade will allow when buying. 2. Trading costs: Commission costs add up. Over trade at your peril! 3. Exchange market size (EMS): EMS are the amount of shares market makers guarantee to sell or buy at quoted prices. Each share has a quoted EMS which is found on the London Stock Exchange website. If you own more shares than then quoted EMS you may be charged extra to sell them in a market panic. Don't deal in shares with a EMS equivalent to less than £2000. 4. Trading hours: 5. Why shares move up and down: 'Buy on rumour, sell on news'. Broker upgrade/downgrade. Market/sector move. Institution move - Look for RNS entitled 'Holdings in Company'. Director buying and selling. News. Dividend dates. Magazine tips. Bulletin board manipulation. Market maker manipulation. Treeshake. Surprise event. Rights issue - Company raises money buy offering shares at a lower price. This usually drops the share price. Takeover/merger - Usually increases share price. 6. Market makers and crowds: Market makers ensure that small company shares always have liquidity. The more traders buy and sell, the more money market makers make. It is therefore in their interests to move the market around to encourage buying and selling. 7. Treeshaking: When market makers drop the share price for no reason. They are designed to make you afraid. If market makers have a big buy order they will drop the price to encourage others to sell which they can then buy immediately for their clients. Do not panic in a treeshake. Calmly check the news for legitimate market moving information. If no news, go and make a cup of tea and relax. Treeshakes usually last a few hours buy which time the share price will have recovered. If it persists over a few days there could be company information that you are unaware of. 8. Dividends: Dividends add up and are a good way of covering trading costs. Be aware of the ex-dividend date for each stock that you own or are interested in.

Loses

Taking a lot of small loses will make you a lot of money. Get rid of losses when they are little and keep onto profits when they grow - Always sell losses early! Take no more than 10% loss on a trade and look for 30% + on really good risers. Emotions lead to traders taking profit too quickly which harms long term investment gains. The inability to sell at a loss however is due to ego. Always buy winners and sell losers, not the other way around.

Gambling/Investing: The majority of spread betting accounts are owned by people who gamble on the market without doing research. Don't have 'punts', invest. 'Punts' will lose eventually.

General rules

1. Don't over trade. 2. Buy shares trading upwards and breaking new highs. Don't buy shares trending downwards and making new lows.

Section 2

References

[Burns, 2011] Burns, R. (2011). *The Naked Trader: How anyone can make money trading shares.* Harriman House Limited, 3rd edition.