TSR TRADING SETUPS REVIEW

DAY TRADING WITH PRICE ACTION

VOLUME I

MARKET PERSPECTIVES

2ND EDITION

GALEN WOODS

Day Trading with Price Action

Volume I: Market Perspectives

Galen Woods

Trading Setups Review

PDF eBook Edition

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Preface to the Second Edition

In the year following the publishing of "Day Trading with Price Action", I've received excellent feedback from traders of all stripes.

Traders who were just starting their learning journey were very helpful in identifying parts where clarification is needed. As they have no pre-conceived notion of trading concepts, they were able to spot gaps in my explanations.

Experienced traders also posed thoughtful questions that prompted in-depth discussions of related trading ideas.

As these books are sold electronically, I'm able to offer continual updates. Under such an arrangement, I receive useful feedback for improving the course, while providing more value to each reader through new editions. I hope that this mutually beneficial setup will continue for future editions.

Here is a summary of the main additions and changes:

Volume II – Market Bias

- Concept for identifying markets that are suitable for day trading - Optimal Trading Environment Index
- Illustrated examples and elaboration for identifying valid pivots
- Practice exercises for marking price swings and classifying pivot types
- Discussions of trickier market bias analyses including flat trend lines, short-lived trend lines, and struggling trends

Volume III – Price Patterns

- A new versatile price pattern that focuses on what we don't want to see, rather than what we want to see - Weak Pullback
- Concept of using 50% retracement as a support and resistance zone

Volume IV – Positive Expectancy

- Price channels for exiting trades and discerning potential targets
- An additional complete example with recent price action

Typos and errors have been corrected as well. I thank the many readers who have found the errors in the first edition. I apologise for those and have done my best to avoid errors in this new edition.

I am grateful to everyone who has provided feedback to help improve the course. I thank Sigi Castle for proof-reading this edition for me.

Galen Woods
5th April 2016

Preface to the First Edition

I remember it vaguely. I sat in a spacious seminar room with dozens of other attendees. It was a free talk on options trading. The speaker was explaining the advantages of trading options and how one could do it for a living. He went through some simple illustrations to explain some basic options trading strategies. Then, inevitably, he ended by asking us to sign up for an options trading course for $3,000.

I was only 20 years old. That talk was my first exposure to financial trading. While I was intrigued by the romantic notion of trading for a living, I did not sign up for the course. I was sceptical, but the true reason was that I did not have $3,000 to spare.

Yet, the talk was enough to start me on a learning journey that occupied most of my free time ever since.

Naturally, I started trading options, holding them over several days. At some point, I even tried to day trade them. I was using sets of common trading indicators and some form of trend lines and channels. I was changing my analysis tools so often that even if I had found the Holy Grail, I wouldn’t have known.

I didn’t like the complicated options trading strategies like straddles and iron condors. Hence, I stuck to using options as a means to gain leverage and limit my risk, using only outright options or simple spreading strategies. However, the challenge with options trading is that you must not only anticipate a price movement, you must also pinpoint when it will move and when it will hit your target.

Very often, I had the right prognosis on the price direction of the underlying but failed to profit because of options pricing issues like time decay. Eventually, I got frustrated.

So I moved on to trading stocks. However, I found myself gravitating towards shorter holding periods. I grew increasingly uncomfortable with overnight risk when stock prices gapped against me. I became convinced that anticipating the price movement in the next few minutes or hours was easier than predicting what would happen in the next few days or months.

As a result, I started day trading with my limited capital and bumped into an obvious obstacle. Due to the Pattern Day Trading Rule, I had to maintain at least $25,000 in my trading account for intraday trading. It was a requirement that I could barely meet back then.

More importantly, I was still struggling for consistency in my trading performance, putting indicators on and taking them off for no good reason.

With limited capital and a desire to day trade, I turned to the spot forex market. I deposited small sums with forex brokers and traded through their platforms. The price action did not feel right and the entire spot forex brokerage industry seemed a little murky to me. I was not sure if I was trading with real demand and supply forces or just trying to mess around with bucket shops. These thoughts might be a result of me trying to shift the responsibility of my inconsistent trading results away from me to my brokers. In any case, I moved on and started trading futures.

In futures trading, I attained consistency in my trading methods and results. I stopped moving from one strategy to the next. I stopped moving from one market to the next.

The point of recounting my learning path is to show the typical path of a private trader who is not working for a financial institution. This path has many trails littered with obstacles. To make things worse, most of the time, we don’t even have a compass. Most of us have gotten lost more times than we could count.

I tried to recall the turning point in my trading career. Exactly when did I start trading consistently? What was it that made me profitable?

No matter how hard I think, I could not answer these questions. Although I would love to talk about an epiphany that changed everything, I have to admit that my trading journey has been less dramatic.

My path to consistent trading performance is a gradual one. It feels like somewhere in the ten years of trading, I had already understood what it takes to trade successfully. But I mastered it slowly.

All I know is that by the time I could trade with confidence, I had already removed the technical indicators from my charts and replaced them with arrows marking out price action patterns that I had learned to perceive. I have also developed a deep respect for risk and uncertainty. In addition, I have grown to be more aware of my emotions when trading.

This book series is my way of searching for answers within my trading approach. It has given me a great opportunity to crystallise my trading ideas. And I certainly hope that these ideas will shorten your path to trading successfully with price action.

Writing this book series has benefitted me more than I expected. After I started work on this book, my trading has improved tremendously. This is because I took each trading session as an opportunity to find trading examples for the book. This mentality held me accountable to my readers (you) and has greatly enhanced my trading discipline.

Finally, I would like to thank my family and my partner for supporting me on my crazy idea to trade for a living and to write this series of books.

Galen Woods
15th August 2015

Contents

Chapter 1 – Introduction to Day Trading

Day trading is the buying and selling of financial instruments within a trading session. In its strictest sense, all trading positions must be closed before the end of each trading session.

Financial instruments refer to anything that trades in financial markets. Common examples are stocks, options, futures contracts, and spot forex.

The objective of day trading is to make money.

You might think that I am stating the obvious. But trust me, most traders forget this obvious goal. As they trade, they grow to like the feeling of winning more than actually making money. Reminding traders that making money is their goal is formally known as trading psychology.

1.1 - What Day Trading is Not

> *"There is something feeble and a little contemptible about a man who cannot face the perils of life without the help of comfortable myths."*
>
> Bertrand Russell, Human Society in Ethics and Politics

Before we start, allow me to shatter a few day trading myths so that we can proceed with justified courage.

1.1.1 - Day trading is not a way to get rich quick.

Sit in front of the computer and click a few buttons. Spend just two hours a day and you can go home with a few hundred dollars each day. Anyone can do it. Why not you? Why not everyone in world? Seriously?

If you start day trading with the intention of getting rich in two weeks, you will end up getting broke in less than one.

People have asked me for day trading advice. Often, they were in financial difficulties and needed some quick cash to get by. My answer to them is always the same. "Day trading is the last thing you want to dabble in when you have financial woes."

THE SAME ANSWER

"Day trading is the last thing you want to dabble in when you have financial woes."

You need years of practice to hone your day trading skills and knowledge. This book will accelerate your learning, but results vary. Thus, you cannot expect to get rich quick with day trading.

To survive the learning curve, you must start with the minimum trading size. If you are trading with sound risk management techniques, you will never get rich trading the minimum size. You need to increase your trading size steadily. Your mental ability to deal with larger positions is the key. You need actual trading experience to develop your mental fortitude so that you can increase your position size while preserving your trading edge.

1.1.2 - Day trading is not investing.

By investing, I refer to the conventional idea of holding a capital asset like real estate, stocks, and bonds, with the hope that your portfolio performance will outpace inflation.

Although day trading deals with the same financial markets that your pension fund managers swim in, day trading is nothing like investing.

Investments are diversified to reduce idiosyncratic risks. Investments are held over long time horizons. Macro-economic trends, over the next decade or so, drive the performance of your investments. The returns of your investment portfolio depend largely on the returns of your chosen asset classes (i.e. stocks, bonds, commodities, forex, etc).

On the other hand, day trading concentrates our financial interest on a single position, magnified by the use of leverage (borrowed money). At most, we are only interested in what will happen in the next few hours. Ongoing market demand and supply determines our day trading results. Our day trading profits are generally independent of the long-term returns of the asset class we choose to trade.

A well-diversified long-term investment portfolio has a negligible chance of becoming worthless. However, you can easily lose your entire day trading capital if you do not know what you are doing.

Never use your retirement savings for day trading. It is suicide. I am not exaggerating.

1.1.3 - Day trading is not a hobby.

My hobbies include reading, watching historical epic movies, and learning martial arts. I spend money on them.

That's what hobbies are. We spend money on them for entertainment. But we want to make money from day trading. Remember?

Day trading is not a hobby. It is not what we do when we are free or bored. Day trading is what we commit to do well and persist in improving despite difficulties.

You either do it well. Or not do it at all.

If you want to try day trading as a hobby, I recommend going to the casino. You will lose money in both cases, but at least the food is better.

1.1.4 - Day trading is not easy.

You might have heard of this statistic stating that 90% of (day) traders are not profitable. I am not sure if this 90% statistic is exactly right. However, I am convinced that most day traders fail.

Day trading is tough. You need to acquire trading skills and develop real trading experience. If you get over-confident, you lose. If you get frustrated and overtrade, you lose.

The price action trading framework in this series will show you that trading is simple and need not be complicated by "quantum indicators" and "genetic data-mining". But it is not easy.

I truly believe that for most people, there are easier ways of making money. If you choose to day trade for a living, you must enjoy the process of day trading.

1.1.5 - Day trading is not glamorous.

You sit in front of a computer terminal watching price charts. You have no stories to tell. (Traders who behave like gamblers are more likely to have stories to tell. Consistently profitable traders are more likely to bore people.)

You do not get any long service award. You are the only employee so don't expect to get the "Employee of the Month" award. (Alright, let's be positive. You are always the "Employee of the Month".)

Most people around you fall into two groups. One group thinks that you make tons of money easily without hard work. You will feel frustrated because they do not understand the effort you put into day trading. The other group just sees you as a gambler. You earn money by luck. You get frustrated just by listening to them.

It goes back to the same point. Day trading at home is not glamorous. Retail day trading is not the cushy Wall Street investment banking job.

DAY TRADING IS NOT

- A way to get rich quick
- Investing
- A hobby
- Easy
- Glamorous

1.2 - Why Still Day Trade?

You continued reading after learning that day trading is neither an easy nor a quick way to get rich. For that, I congratulate you for accepting this challenge. I believe that, for most people, day trading is one of the toughest endeavours they will ever take on. However, if you persist and succeed, you will reap its rewards.

1.2.1 - Day trading frees you.

You can day trade with a computer and an Internet connection. You can work from anywhere in the world. You can trade any time you want because financial markets open (almost) round-the-clock.

No more meetings with pointless agendas. No more cubicle lifestyle. No more daily commute with fellow sardines.

Extract yourself from the corporate rat race.

1.2.2 - Day trading needs a smaller risk capital.

I mentioned earlier that a high percentage of day traders fail. A key reason is the low entry barrier to trading.

It is very easy to start day trading. In many parts of the world, you can fund an offshore forex trading account with your credit card or PayPal account. No minimum deposit!

SCAM ALERT

Beware of unregulated forex brokers. Fly-by-night brokers are not uncommon in the retail spot forex industry. Perform due diligence and deal only with those regulated by proper authorities.

The trading capital you need also depends on your trading time frame. Day traders risk less to earn less on a higher frequency. Swing traders who hold positions over a few days risk more to earn more on a lower frequency. Longer term trend followers risk a lot to earn a lot on an even lower frequency.

Hence, among the different styles of trading, day trading requires the least amount of trading capital.

1.2.3 - Day trading avoids overnight risk.

> *"In the dark of the night, terror comes true."*
>
> Rasputin, Anastasia

I agree with Rasputin. At least when it comes to holding positions overnight.

What terror could strike overnight?

Gaps. When our position opens higher or lower than it closed, we have an overnight gap. Gaps happen when there is new material and price-sensitive market information outside market hours.

Gaps are either terrific or terrible.

Gaps are terrific when they go in your direction. After a good night's sleep, you wake up to a windfall gain. Your long position has gapped up 20% in your favour.

Gaps are terrible when they go against you.

Imagine this. You have a long position in stock of company XYZ. You bought at $50 with a stop-loss order at $48 and a target limit order at $55. It closed at $51.

Looks good. You shut down your trading terminal feeling safe because your maximum loss is $2 per share. You have a good dinner and an even better sleep.

Then, you wake up to the news that company XYZ had committed fraud. Its stock price is literally zero. They are bankrupt with truckloads of creditors on their back. (You are an equity-holder. If you want to join the queue, you stand behind them.)

The stock is worthless now. If the stock gaps across your stop-loss order, which it did in this example, you will not exit at your stop-loss price. You will exit around the opening price of the session after the gap.

You calculated your risk to be 2% of your trading account, assuming that your stop-loss order would work. But it did not. Now, you have lost 50% of your trading capital. By any measure, it is a catastrophic loss.

With overnight gaps, you are helpless.

Trading is a game of probability. In most cases, we could not have anticipated the fraud with technical analysis (or even with fundamental analysis). This is why we have stop-losses to protect us. But gaps render stop-losses ineffective. Gaps represent a risk that is beyond our control.

I am obsessed with risk. If you want to trade long enough to reap the rewards of day trading, you should also be. Hence, I am uncomfortable with gap risk.

Day trading allows me to avoid this wild beast called “Gaps”. Gaps are rare in intraday time frames. Moreover, intraday gaps, if any, are small.

1.2.4 - Day trading accelerates learning.

A day trader takes more trades within a shorter period.

Each trade is a learning opportunity. For each trade, you analyse the market and decide to take on a market position. You gain experience in trade execution. You deal with your emotions during the trade. You decide when to exit the trade. You capture a screenshot of the trade. You record the outcome of the trade and journal your analysis of it.

These actions contribute to honing your trading skills. Every trade brings you through the entire feedback cycle. Taking more trades within a shorter period results in a shorter learning curve.

1.2.5 - Day trading rewards you for becoming a better person.

> *"What you get by achieving your goals is not as important as what you become by achieving your goals."*
>
> Henry David Thoreau

If you have the trading skills and self-discipline, you will make money from day trading.

If you get over-confident, you will lose. If you get frustrated and revenge trade, you will lose.

This is a "job" that rewards you for your skills and discipline. It rewards you for being humble and calm. As you gain confidence as a day trader, you become a better person.

DAY TRADING

- Frees you
- Needs less capital
- Avoids overnight risk
- Accelerates learning
- Rewards you for the right things

1.3 - Conclusion

This chapter is the most important chapter in this volume. It sets us on the same page with a realistic understanding of what day trading is and what it is not.

This book is not meant for people who see day trading as a way to get rich quick. It is written for outstanding and motivated individuals who want to succeed by devoting their heart and mastering their mind.

Chapter 2 – What To Expect From This Series?

This book series is titled "Day Trading with Price Action". More specifically, it focuses on day trading the **futures market** with **discretionary** price action techniques. It is directed at the individual retail trader.

Nonetheless, the price action techniques and trading concepts in this series are applicable to markets beyond futures.

This series is not the ultimate guide to day trading or price action. It does not cover every single aspect of price action trading and day trading.

However, it contains a complete approach to day trading with price action.

A COMPLETE TRADING APPROACH

1. A complete price action trading methodology
2. An analytical framework that helps you trade better
3. A risk management framework that helps you handle financial, operational, and psychological risks
4. Templates and tools to help you implement the framework

Essentially, you will get whatever it takes to build and improve a day trading plan based on price action analysis.

This book series is not the Holy Grail to trading. Its methods are not meant for mechanical trading systems. Do not programme them into an automated system and expect results. However, if you learn this trading framework well and commit to honing your trading skills, you stand a solid chance at mastering day trading.

2.1 - A Balance Between Two Extremes

The best way to teach trading is to present simple mechanical trading rules and avoid the topic of exercising discretion. The merit of using this approach to write trading books is that it is easy to read and comprehend.

However, it runs the risk of making trading look too easy and mechanical. It does not highlight the practical difficulties in the reality of trading. When following rules mechanically does not work out, the trader becomes disillusioned and moves on to the next trading method/guru/course/indicator/book. This is undesirable.

Is there an alternative approach that shows the reality of trading?

Yes. The best way to show someone the reality of trading is to go through tons of examples without condensing them into trading rules. This method directly displays the reality of trading in markets that are constantly in a state of flux. It shows how tiny nuances in the market affect decision-making and are collectively far more important than any trading rule.

However, this approach suffers from another critical drawback. The reader might get the impression that the author is a good trader but certainly not a good teacher. This is because the reader, despite being inundated with examples, has not grasped anything practical that he could apply directly to his own trading.

Most trading books fall into one of these two extremes. They either promise riches with simple mechanical rules or teach trading in a vague manner that obscures learning.

As discussed, both extremes are undesirable. Hence, I have structured this book series to strike a balance between these two approaches.

You will find objective price action tools and clear trading rules. These are useful for picking up new concepts and strategies. They offer a basic starting point for price action trading that's especially useful for beginners.

You will also find extensive discussions on the principles for applying discretion. Basically, I will show you that bending trading rules is essential for discretionary trading. However, instead of attributing the rule-bending to a simple gut feel, I will explain in detail why we bend the rules and the principles underlying them.

There will be many charts and examples that require intense studying because they are not pretty textbook examples. These examples are chosen to show what really goes on in real-time trading.

In addition, I have included a framework that will help you hone your discretionary trading skills (trading gut) in a systematic way.

Finally, we will tie everything up with the concept of positive expectancy. This is the most important concept in trading. Without understanding this term, traders are simply gamblers. It is so important that I have devoted the entire last volume to it.

2.2 - Hard Work without Guaranteed Results

Expect to put in hard work to get through this series of books and understand the trading examples.

Expect to put in thousands of hours poring over your own charts trying to apply what you have learned.

As you start to trade live, prepare to suffer from emotional turmoil as you are forced to face your worst mental ills.

The worst part is that even after your intensive efforts, you might still not be profitable and fail to become a consistent trader. The truth is that not everyone is cut out for trading, just like how not everyone is cut out for practising medicine/law.

The bright side for aspiring traders is that they can fund a futures trading account with a few thousand dollars and start honing their trading skills. On the other hand, without getting into college with a huge loan for your tuition fees, you cannot even take the first step towards becoming a lawyer or a doctor.

As a marketer of my book, I would love to say that this book will guarantee your trading success. But I cannot do so for two reasons.

The first reason is that I want to write a genuine book that crystallises the trading concepts I find effective. I do not want to lie through my teeth and promise you unbound riches.

The second reason is that I want to offer a proposition that is logical. If I can guarantee that you will be profitable, then this book is worth millions, at least. It is simply not logical to guarantee monetary success and sell it for anything less.

The same logic applies to anything else that guarantees you monetary success in any field. If I guarantee that you will make $5,000, I am basically giving you $5,000. So I am essentially giving you $5,000 in return for a couple of hundred dollars. This proposition is not logical, and I want logical people to be reading this book.

In this case, if I were to guarantee that you will be a profitable trader, I am guaranteeing you far more than $5,000.

Does it make sense?

There is no way anyone would guarantee you a certain profit while asking in return a much smaller amount. If for any reason, you believe that it is possible, you need to google "avoiding scams" right now.

Thus, what I am offering is a set of organised content designed to shorten the learning curve for you. However, whether or not you can ascend the learning curve depends largely on you. This means that, if you succeed as a trader, you made it possible. You have no one to thank except yourself.

2.3 - Conclusion

There is no get-rich-quick formula in this series.

Expect to find trading rules that work, sometimes. Expect to find trading principles that will take time to sink into your mind. Expect shades of gray.

If you are able to accept these inherent characteristics of trading and are serious about trading, you will find ample information and guidance in this series.

Chapter 3 – How To Day Trade?

Popular day trading techniques include indicator trading, news trading and price action trading. Our choice is price action. To understand this choice, we need to first examine our market perspective.

3.1 - Market Perspective

Market perspective refers to how we look at the market and how we think the market works. It is important because it forms the premise to our trading approach. For you to learn, trust, and use my trading approach, you must first share my market perspective.

Let's start with a simple and uncontroversial statement. Markets move because of demand and supply. Everyone from the theoretical economist to the man on the street agrees.

Fundamental factors cause supply and demand to shift in the market. These factors are innumerable. Some examples are interest rates, economic policy, company management, and technology. These fundamental factors lead to shifts in supply and demand, which in turn causes price to change.

Fundamental analysis studies fundamental factors and builds models to predict outcomes. Practitioners analyse every piece of information about a country, industry, or company to project their effect on demand and supply. From there, they can reasonably assess if the market price is too high or too low. That assessment becomes the basis of a trading idea.

On the other hand, in technical analysis, we observe price movements to predict future price action. In doing so, we are assuming that past and current price action causes supply and demand to shift in the market.

How could price action cause demand and supply to change? What explains this feedback loop? The answer is human psychology.

Among all the variables affecting our trading and investment decisions, price prompts the strongest emotional response from both traders and investors. Regardless of the interest rates, the fundamental value of the economy, or the “next big story” Wall Street wants us to believe, everyone pays attention to price.

Price affects our profit and loss, which defines if we are winners or losers in the game. Even fundamental analysts pay attention to price, because the difference between price and their derived fair value tells them if a market is overvalued or undervalued. Every market participant reacts to price, not just analytically, but also emotionally.

The collective response of market participants to price changes causes demand and supply to change. These changes then affect the market price.

Figure 3-1 illustrates this market feedback loop.

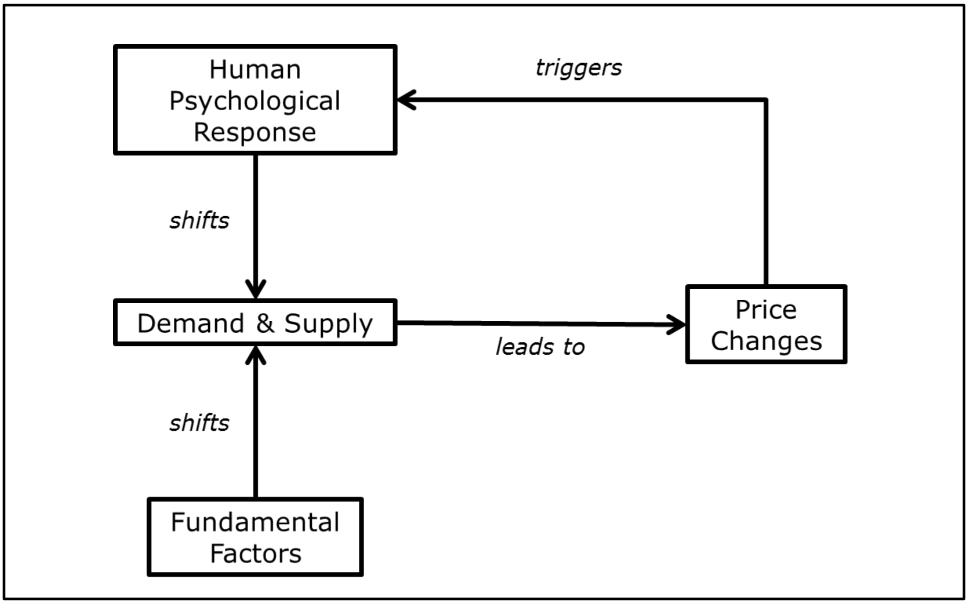

Figure 3-1 Price changes matter

The formal study of how human psychology plays a part in the market is known as behavioural finance. It is beyond our scope to delve deep into it. However, as our method of analysis depends on the psychology of market participants, we need to understand the basics of behavioural finance and the key features of a trader's psychology.

Unlike traditional finance theories, behavioural finance postulates that investors are irrational. Investors either over-react or under-react to market information. The study of behavioural finance then focuses on explaining why investors are irrational. Most explanations revolve around cognitive and emotional biases, which refer to a tendency to make illogical decisions. Some common biases found among investors are confirmation bias, bandwagon effect, loss-aversion, and endowment bias.[1]

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[1] I recommend Daniel Kahneman's book "Thinking, Fast and Slow" if you want to learn more about cognitive biases. Click here to learn more.

Instead of reading about these biases, try looking inside your mind. Have you ever felt fearful due to market price changes? If your answer is yes, then clearly you are not the average rational person that traditional finance theories assume you are. The same goes for everyone else. Thus, behavioural finance has its value.

Behavioural finance is deeply related to psychology. Psychology is a social science. It is not a natural science like physics and chemistry. This means that psychology makes statements that contain "likely" and "tend to". Psychology is not about rigid formula and hard facts. It makes probabilistic statements. The implication is that trading also revolves around probabilities.

We will discuss more about the role of psychology in trading later in the series. For now, just remember two things:

1. Price changes are important market indicators because of psychological factors.
2. Psychology is not a natural science with rigid formulas. Hence, in trading, be prepared to deal with uncertainties.

Since price plays such a key role in the market, it is logical to study price in our attempt to trade the market.

3.2 - Price Action Trading

At its core, price action trading is a form of technical analysis that uses market data (like price and volume) to predict future market movements. Technical analysis is often contrasted with fundamental analysis which uses non-market information, like the projected cash flows of a company to forecast its "fair value".

Generally, technical analysis is more prominent in short-term trading including day trading and swing trading. On the other hand, most traders agree that fundamentals do not matter in intraday trading. Launching a new killer product might start a bull trend in a company's stock that lasts for months. However, it has minimal impact on the price movement of a single trading session. An exception is sudden and breaking news.

Price action is a simple approach to trading. It does not rely heavily on indicators. It focuses on the most important variable: price. The simplicity it offers in an industry where the next magical indicator is always emerging is appealing to many traders. Earn more with less (indicators) is a tempting proposition.

However, price action is just one of the many trading approaches. It is a tool, and tools are only as good as the person who wields it.

To many traders, price action is the elusive Holy Grail. Yet, it is neither elusive nor the Holy Grail.

Price action is not elusive. One can acquire it easily, but not always use it profitably. You must accept that trading with price action is discretionary. It is not mechanical. There is no magic formula, but there are tendencies and nuances.

It is akin to the writing of narratives. In school, teachers tell us that a good narrative piece must be creative. You must show and not tell. Capture the reader's imagination. Evoke emotions. Then, the teachers would show us examples of good narratives.

Yet, ultimately, there is no magical step-by-step guide that every student can employ to write a good narrative every time. Naturally, it comes easier to some students and harder for others. Admittedly, with hard work and practice, most students will be churning out reasonably decent narratives. However, only a very small percentage of these students (if any) will be able to write narratives for a living.

The same goes for trading. I can teach you how to analyse the market with price action. You can practise and eventually learn how to analyse the market with price action. But it does not even scratch the surface of what is required to trade for a living.

Price action is not the Holy Grail for all traders, but it does illuminate the market for some traders. In most aspects, price action trading is not superior to other trading methods. However, it is clearly a method suited for the minimalist trader.

I am neither a price action purist nor an indicator-crazy trader.[2] Instead, I advocate an open approach that reviews each trading method based on its merits.

However, it is impossible to make ten thousand trading methods work concurrently. So, to trade effectively, I must focus on a core trading approach that makes sense to me. And my choice is price action.

Price is the single most important variable in the market. Volume and time are useful variables too, but nothing is as important as price. The price you buy at and the price you sell at determine your profit. And profit is what we are after. It makes sense to me that we focus on what is important.

Volume is a common complement to price action trading. It is useful and often serves to clarify price action. However, the focus of this series is price action trading. Trading with volume

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[2] On my website, I write articles on trading with both indicators and price action.

deserves an entire tome and is beyond the scope of this series. Volume analysis is an additional tool. If you do not know how to use it, you are better off without it. For those who are interested in volume analysis, after you have mastered price action analysis, add a volume overlay to your charts and observe if volume patterns add value for you.

The same goes for trading indicators like the moving average and the Stochastic Oscillator. Even if you feel that they might add value to your trading, learn to read price action before you place them on your charts.

Ultimately, our topic is on analysing the market with price action. However, I need to clarify that I use indicators for:

- Determining the time frame to trade
- Marking out price patterns
- Assessing if a trading setup offers positive expectancy

I use them to help me trade more conveniently. They are not essential to the trading approach in this series. You can definitely employ the methods without these indicators. They just make it easier, especially when you are just starting out.

I assure you that these indicators are not black-box systems. The exact logic of each indicator is laid bare. In addition, they are relatively simple and anyone with moderate programming skills can replicate them.

3.3 - Trading Framework

Our trading framework is essentially a prudent trading approach that stays with the market trend. It covers the following aspects.

A TREND TRADING APPROACH

1. Identify the market bias
2. Find stop-loss levels
3. Find target levels
4. Find trading opportunities that offer positive expectancy

3.3.1 - Identify the Market Bias

Market bias refers to the general tendency of market movements. If the market is more likely to move up than down, the market bias is bullish. If the market is more likely to move down than up, the market bias is bearish.

Market bias is a critical trading concept. Following the market bias places the odds in our favour. It gives us the chance to be the casino rather than the gambler. If we ignore market bias, we are better off in casinos. As market traders, we make money only if we go *along* with the market bias and not against it.

The traditional approach to trading is to identify if the market is trending up, trending down, or moving sideways. Then, we use the appropriate trading setups based on the type of market. The convention is:

- Trending up – Buy
- Trending down – Sell
- Moving sideways – Buy and sell

This is a valid approach. However, I believe that many traders find themselves in trouble when the market is moving sideways.

In a sideways market, traders seem to give themselves the mandate to both buy and sell without restrictions. The result is that they are constantly looking for reversals. They end up taking every buy setup and every sell setup. They keep reversing their positions. They overtrade, and they get confused.

My point is that traders do very badly when they keep looking for reversals.

“The market is going down! Oh no, it's going up! I was right! It's going down. Ahh, I should have stayed in the long position.”

This is the soliloquy of the headless trader who vacillates from being bullish to being bearish with each price bar. This trader has no focus and will have no profit.

Hence, in our trading framework, we are doing away with the sideways market. Our market perspective is always biased. At all times, we must decide if the market bias is up or down. In this sense, our trading strategy is a trend trading approach.

When it is bullish, we pay attention to buy setups. When it is bearish, we look for sell setups. In our framework, there is no market that allows us to take both long and short trades. In this way, we stay focused and disciplined.

Market bias is the subject of Volume II. I will show you how to determine the market bias for day trading with two simple tools - price swings and trend lines. It is amazing how much insights we can get out of these seemingly basic trading tools.

In addition, we will discuss which time frames are amenable to price action analysis and how to determine your trading time frame with a simple concept called the Price Action Time frame Index.

3.3.2 - Establish Stop-Losses

The market bias places the odds in our favour and helps us make money from the market. Then, what does a price pattern do?

A price pattern controls our risk. Contrary to what many traders think, a price pattern does not merely help us to pinpoint an entry. It helps to limit our losses when we are wrong.

Price patterns are tipping points. Bullish price patterns find the point where the bears surrender and the market goes up. Bearish price patterns pinpoint where the bulls are exhausted and the market falls.

Tipping points are useful because we can place stop-loss orders near them. When the market tips over to the bullish side, we can safely place our stop-loss order below the tipping point. If price crosses back below the tipping point and hits our stop-loss order, we know that our timing is wrong and we should exit.

Price patterns form the subject of Volume III. We will cover a set of price patterns that will guide our trade entries and limit our trade risk.

In the same volume, you will also find advanced trading techniques for finding high-probability trades. More importantly, there will be an extensive discussion on exercising discretion while trading. You will realise that, ultimately, your trading success comes from your trading decisions and not my price patterns.

3.3.3 - Find Targets

If we are wrong in terms of timing or market bias, our price pattern stop will protect us.

If we are right in both timing and market bias, the market will reward us and place some money on the table. Having a target (exit strategy) helps us to grab the money from the table and place it into our pockets.

Taking your profits in a disciplined manner is more important in day trading than in other styles of trading. For most trading sessions, the market movement is limited. Day traders do not get very far with "letting your profits run". We must take profits when we can.

In Volume IV, a chapter is devoted to target-setting. The main techniques rely on support/resistance and thrust-projected targets (measured moves).

3.3.4 - Find Trades with Positive Expectancy

The three aspects discussed above are not distinct and separate from one another. In fact, to trade successfully, we must integrate them and understand how they work together in a trading plan. The objective of the plan is to find trades that offer positive expectancy.

In Volume IV, you will learn to:

- Integrate the price action methods explained earlier in the series to find trades with positive expectancy.
- Transit successfully from studying historical charts to trading in real-time.
- Analyse your trading performance with a robust framework.
- Manage the financial, operational, and psychological risks facing a professional trader.

Volume IV is closely tied to the included Toolkit. It is a bundle of Excel worksheets to help you implement the trading framework.

The Toolkit contains the following:

- Checklist for Day Trading
- Trading Rules and Guidelines
- Price Analysis Matrix
- Trade Records Template
- Monte Carlo Simulator
- Trading Emotion Journal Template
- Risk Management Card Template
- Recommendations for Additional Trading Resources

Use these tools to develop your personal trading plan.

3.4 - Conclusion

How to day trade?

This is a big question with big answers.

I started this chapter with the foundational topic of market perspective. And I ended it with a detailed roadmap of our price action trading approach.

Yet, I have not answered the question. I have merely explained how I day trade. As for how you should day trade, you must decide after reading the series.

In any case, feel free to tear my trading framework apart and pick out the pieces you find useful.

Chapter 4 – What to Trade?

There are many financial instruments available for day trading. Some common choices are stocks, forex, and futures. Outside the U.S., spread-betting and contracts-for-difference (CFDs) are also popular choices.

After choosing the financial instrument, you will still need to decide on the markets to trade.

If you day trade stocks, you need to choose the companies (e.g. Apple, Microsoft) to trade.

If you day trade forex, you need to choose the currency pairs (e.g. EUR/USD, JPY/USD).

If you trade futures, you need to choose the underlying asset/index (e.g. S&P 500 Index, Crude Oil) of the futures contract.

Spoilt by the number of choices, how do you select your preferred trading vehicle?

4.1 - Factors to Consider

The price action trading approach in this book is versatile and works for most instruments. Theoretically, you can trade any market you wish to.

However, there are several caveats. The market we choose to trade must have sufficient volatility and liquidity. On top of these, there are a few other important considerations.

4.1.1 - Volatility

There are many ways to measure the volatility of a market. We will cut to the chase and focus on the measure that is most useful for day traders – daily range.

We are day traders. Thus, theoretically, the best case scenario for us is to buy at the lowest point of a trading session and sell at the highest point of it. (Not always in that sequence.) In that case, we capture the entire day's range as our profit. The daily range represents the maximum profit of a day trader, who is unbelievably lucky.

Although it is near impossible for any day trader to capture the entire day's range, the daily range still serves as a direct measure of a day trader's profit potential. Hence, generally, the larger the daily range of a market, the better it is for day trading.

In Volume II, you will also learn about the Optimal Trading Environment Index. It integrates market volatility with your trading time frame to create a proxy for potential reward-to-risk ratio. It is useful for comparing different day trading markets.

4.1.2 - Liquidity

In terms of market microstructure, liquidity refers to the level of disagreement among market participants on price.

In a market of disagreement (liquid), some participants think that the price is too low while others think that the price is too high. The former is looking to buy and the latter is looking to sell.

From a trader's perspective, it means that we can buy and sell with ease. If you want to sell, someone out there is willing to buy from you. If you want to buy, someone out there is willing to sell to you. It makes trading not only easier, but also cheaper.

Let's see why.

In a market of agreement (not liquid), all participants agree that the price is too low or they agree that the price is too high.

If all participants agree that the price is too low, they are all looking to buy. At this juncture, if you want to buy, you will find no ready sellers. The only way to buy is to pay a higher price. The difference between this higher price and the original price you intended to pay is known as "slippage".

Similarly, when all participants agree that price is too high, you will experience slippage as you sell at a lower than expected price.

In summary, a liquid market reduces slippage which is a component of trading costs. Day traders transact with higher frequency compared to traders operating in other time frames. Hence, it is important to minimise our trading costs.

To check the liquidity of a market, the traded volume is a good indicator. In most cases, higher volume indicates more participants. In a market with many participants, the liquidity (level of price disagreement) tends to be higher. Having more participants means having greater tendency for disagreement. Getting two persons to agree on something is tenable. But getting the whole country to agree is unimaginable.

4.1.3 - Other Considerations

Is the most volatile and liquid market the best one for day trading?

Not necessarily, because it depends on a trader's personal preferences, circumstances, and resources. Specifically, it depends on the following factors.

Time Constraints

When I first started day trading, I was in college. With lessons in the day, trading local markets (Singapore) was not ideal. U.S. markets were ideal as I could trade in the evenings.

Are you free to trade your local market when it is active?

If not, you can consider trading markets that are active in a different time zone. First, consider when you are free to focus on trading. Then, check out the active trading hours of each market to generate a shortlist.

Market Accessibility

Market accessibility is an umbrella term that encompasses the convenience and cost-effectiveness of actively transacting in a market.

For each market that you are considering, think about how easy it is for you to find:

- A broker offering access to the market
- Low commissions for trading the market
- Affordable data feed of the market
- Easy deposit and withdrawal of trading funds
- Legal recourse (when things go south)

These factors vary for each trader according to where you are located and the competitiveness of the brokerage industry in your area.

Generally, local markets are more accessible. You can find brokers to connect you to local markets easily and brokerage costs tend to be cheaper. You can also fund your trading account without wiring overseas.

Ease of Shorting

Shorting refers to getting into a financial position that will result in a profit if the market price falls.

If you are bullish, you will go long. If you are bearish, you will go short.

Long-term investors typically have a long bias. In fact, most investment funds (except hedge funds/CTAs) do not have the mandate to take on short positions. They are either invested in long positions or holding their funds in cash.

This is in stark contrast to the more opportunistic day traders. Day traders trade according to the sentiment of each session and are usually equally open to both long and short trading opportunities. This distinctive flexibility is crucial to most day trading strategies. Hence, the ability to short is another key consideration for choosing a day trading market.

Leverage

Leverage comes from the word “lever”. With a lever, you can raise a heavy load with a much smaller force. Financial leverage refers to trading a large amount using a smaller sum of money.

For the normal investor, leverage is optional. But for the day trader, leverage is essential. Intraday fluctuations are small. Without using leverage, it is impossible to extract any meaningful profit.

Leverage is clearly a double-edged sword. By trading a larger size, we increase our profit potential and risk potential at the same time. Please use it with care.

Market Regulation

Market regulators are concerned with matters of market fairness and transparency. They prevent market manipulation.

We do not want to trade in rigged markets or deal with dishonest brokers.

Hence, when we decide on a market to day trade, we should also consider how well it is regulated. The key here is to decide if we trust that we are facing a level playing field.

4.2 - Instrument of Choice: Futures

In this series, the trading examples are drawn from the futures market. It means that we will take on the perspective of a day trader operating in the futures market. In addition, when we discuss risk management issues in specifics, we will use futures trading jargon.

Hence, even if you decide not to trade futures, it is good to understand the basic jargon of futures trading for the purpose of following the examples.

What are futures?

A futures contract (or simply futures) is an agreement to buy or sell the underlying asset/index on a specified date in the future at a price agreed on now.

Note the discrepancy between the date of delivery and the date of pricing. We do not know the price of the asset on the date of delivery. Hence, by agreeing on the price for a future delivery, the parties to the contract are essentially speculating on the future price of the asset.

In other words, it is a direct bet on the future direction of the underlying index. If we expect the underlying asset/index to rise, we agree to buy (i.e. a long futures position). If we expect the underlying asset/index to fall, we agree to sell (i.e. a short futures position).

For instance, a crude oil futures contract is an agreement to buy or sell crude oil on a specified date in the future at a price agreed on today. If you agree to buy, you have a long position in the crude oil futures market. If you agree to sell, you have a short position in the crude oil futures market.

Instead of a physical asset like crude oil, a financial composite can also form the underlying of a futures contract. Stock indices like the S&P 500 and NASDAQ 100 form the underlying for some of the most heavily-traded futures contracts in the world.

4.2.1 - Why Day Trade Futures?

There are two reasons for the focus on futures in this series. The first is that I day trade futures. Thus, I can provide examples and relate experience from my personal trading. The second is that considering the factors mentioned above, futures do offer an excellent choice for day traders.

Let's see why.

First, there are no restrictions on shorting in the futures market.

A day trader's job is to take only the best trades, regardless of whether it is a long or short trade. With the unfettered ability to take on long and short positions, a day trader can stay neutral and act according to his or her current market analysis.

You can short most but not all financial instruments.

Typically, shorting derivatives is straightforward. Derivatives are financial instruments that are priced based on an underlying asset/index. Hence, for derivatives like futures, options, and CFDs, the ability to short is unquestioned.

Despite not being a derivative, the spot forex market also offers the ability to short. This is because the spot forex market trades in currency pairs consisting of a base currency and a quote currency.

For the currency pair EUR/USD, EUR is the base currency and USD is the quote currency. A long position in a currency pair implies that you are buying the base currency with the quote currency (buying EUR with USD). A short position in the pair is simply the reverse (buying USD with EUR).

Stocks (equities) pose the greatest difficulty to shorting. Although day traders can short-sell stocks, they are still limited by the shortable stocks offered by their brokers. This is because you need to first borrow a stock through your broker, before you can sell them to profit from a bearish move.

Moreover, financial regulators all over the world frown upon short-selling. Although short-selling bans rarely solve fundamental problems of a stock market, regulators have resorted to short-selling bans on occasion as a short-term solution to prevent stock market collapses.

The next point is of concern if you intend to day trade U.S. stocks. According to FINRA, you are a Pattern Day Trader if:

- You use a margin account; and
- You day trade the same security for more than four times within five business days; and
- The day trades form more than 6% of your total trading activity for the same five-day period.

And if you are a Pattern Day Trader, you must keep at least $25,000 in your trading account to day trade.

It is very difficult for a day trader to avoid the label of Pattern Day Trader. Of course, you can trade very infrequently, or use a cash account. Both are not ideal and impede the goal of a day trader to use his capital efficiently.

Day traders want take the best trades, even if the best trades occur more than four times within five business days. Day traders want to make the most out of small intraday swings. To do that, using a margin account for leverage is essential.

Those are the bad news, at least for stock and options traders. **The good news is that the Pattern Day Trading Rule does not apply to futures traders.**

As a futures trader, you can have less than $25,000 in your account and still day trade to your heart’s content, subject to your rigorous market analysis of course.

Day traders in the futures market can also make use of the lower day trading margins to use their capital more efficiently.

As mentioned, to enter a futures position is to enter a contract to buy or sell. You are not really buying or selling anything, yet. Thus, you do not have to pay.

However, you need to post an initial margin (also known as the performance bond) as a guarantee of your ability to fulfil the contract. Theoretically, the amount of initial margin depends on the volatility of the underlying asset/index. Practically, the futures exchange set the margins required.

While the futures exchanges set the initial margin for overnight trading, futures brokers are free to decide on the margin for intraday trading. The difference is significant.

For instance, the initial margin for the E-mini S&P futures (ES) traded on the Chicago Mercantile Exchange is $5,060 per contract[3], while many futures brokers offer day trading margins as low as $500.

For day traders, this means that you can trade one ES contract for every $500 in your futures trading account. Given that the size of one ES contract is $50 x S&P 500 Index (now at around 2100), you are able to control a value of $105,000 with only $500, if you close your position before the trading session ends.

A note of caution: lower day trading margin is not a reason to take on large trading positions with excessive day trading risk. Your position size should still be determined by a sound model

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[3] Trading margins are revised regularly by the futures exchanges. For the most updated figures, check the website of the respective exchanges.

based on the expectancy of your day trading strategy and your risk capital. We will be covering these in Volume IV.

Nonetheless, you should certainly make use of the lower margins to manage your trading capital more efficiently.

Our last point concerns market regulation. As futures are contracts, they are technically exposed to the risk of contracting parties failing to act according to the contract terms. This risk is known as counterparty risk.

However, standardised futures trade on exchanges and the exchange clearing house is the counterparty to both sides of the contract. Futures regulation demands daily marking-to-market and performance bonds pledged to the clearing members.

These measures ensure that the counterparty risk of futures contracts is almost zero.

On the other hand, in another popular day trading market, the spot forex market, this is not the case. Many retail spot forex brokers are market makers. This means that when you buy or sell forex, your broker sells it to or buys it from you. If your broker is unable to fulfil the deal, which is possible, especially for small forex brokerages that are not well-regulated, your paper profit is worth less than the paper it is written on.

The same goes for any other financial instruments where your broker is in fact the liquidity provider. Another common example is spread-betting.

Table 4-1 compares the common day trading vehicles with respect to the relevant factors.

	Futures	Spot Forex	Equities	Options
Unrestricted ability to short	Yes	Yes	No	Yes (using puts)
Day trade without restrictions	Yes	Yes	No	No
Greater leverage for day trading	Yes	No	No	No
Central clearing	Yes	No	Yes	Yes

Table 4-1 Comparing common day trading instruments

In the above, I have generalised my observations of the financial trading landscape. Exceptions apply.

For instance, not all futures trading brokers offer lower margins for day traders. Also, the Pattern Day Trading Rule obviously does not apply outside the U.S., but similar rules may be in effect.

However, the trading approach and frameworks in this series are applicable to other instruments of comparable liquidity and volatility. In any case, ensure that you understand the financial instruments and markets that you are trading.

I have explained why futures offer a good day trading vehicle. Nonetheless, you can definitely trade other instruments successfully as well. Ultimately, you need to decide on what to trade based on your personal circumstances, resources, and knowledge.

If you decide to give futures trading a try, carry on reading this chapter for a quick introduction on the must-knows of futures trading. If not, you can skip the rest of this chapter.

4.2.2 - Essential Knowledge for Futures Day Trading

Before you start trading any new financial instrument or market, you must understand what it is and obtain the essential information about it. The same goes for futures trading.

Fortunately, for futures contracts, it is very easy to get the information. Every futures exchange provides the contract specifications for each futures contract that it lists. From the contract specification, you will learn the essential information and jargon you need to comprehend the basics of futures trading.

Figure 4-1 shows the E-mini Standard & Poor 500 (ES) contract specification taken from the website of Chicago Mercantile Exchange. This contract is the most popular equity index futures in the world.

E-mini is an electronically traded and smaller sized version of a futures contract. E-minis trade round the clock and generally offer excellent liquidity. Their smaller size makes them popular among retail day traders with limited capital.

Standard & Poor 500 is an index of 500 large stocks listed on American stock exchanges. It is commonly used as a barometer for the U.S. economy. Unlike any individual stock, this index is impervious to manipulation. When we trade the ES contract, we are basically trading smaller-sized futures contracts with the Standard & Poor 500 index as the underlying.

Let’s go through the ES contract specifications line-by-line to gather the essential pieces of information day traders need to know.

Contract Unit	$50 x S&P 500 Index	
Trading Hours	MON – FRI: 5:00 p.m. previous day – 4:15 p.m.; trading halt from 3:15 p.m. – 3:30 p.m.	
Minimum Price Fluctuation	OUTRIGHT	0.25 index points=$12.50
	CALENDAR SPREAD	0.05 index points=$2.50
Product Code	CME Globex: ES CME ClearPort: ES Clearing: ES	
Listed Contracts	Five months in the March Quarterly Cycle (Mar, Jun, Sep, Dec)	
Settlement Method	Financially Settled	
Termination Of Trading	Trading can occur up to 8:30 a.m. on the 3rd Friday of the contract month	
Settlement Procedures	E-mini S&P 500 Settlement Procedures	
Position Limits	CME Position Limits	
Exchange Rulebook	CME 358	
Price Limit Or Circuit	Price Limits	
Vendor Codes	Quote Vendor Symbols Listing	

Figure 4-1 ES Contract Specification[4]

Contract Unit - $50 x S&P 500 index. Remember that by entering a futures contract, we are contracting to buy or sell an asset/index. However, what is the size that we are buying or selling in the contract?

In the case of the ES contract, when you take a long position, you are undertaking the purchase of *$50 x S&P 500 index* worth of value. For instance, given an index value of 1967, the contract is worth $98,350.

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[4] Retrieved from the CME website on 18 September 2015.

This is the amount of your financial commitment. You might have posted a margin of $500 to open this position for day trading. However, you are controlling a far larger amount. The large disparity between the contract size and your posted margin is the extent of your leverage. This is why you need to be very careful with the use of leverage.

Trading Hours – Most futures contracts trade almost round the clock. In this case, the ES contract trades from 5:00pm (previous day) to 4:15pm Central Time, with a trading halt from 3:15pm to 3:30pm.

The trading hours are important to a day trader because our day trading margins are effective only if we close our positions before the close of each session. However, some futures brokers might have different terms for day trading margins. We'll discuss more about day trading margins later.

Minimum Price Fluctuation – This is the minimum fluctuation of the contract value. We are only interested in the OUTRIGHT tick size value. When traders refer to a tick in ES, they are referring to a 0.25 index point movement.

1 index point is $50. However, the market move in units of 0.25 index point which has the value of $12.50 per contract.

This piece of information is absolutely essential for a day trader. If you trade one contract and your stop-loss order is 10 ticks away (2.5 points), you have $125 at risk. (Assuming your stop-loss order is filled without slippage.)

Product Code – The symbol required to retrieve the market data from your trading platform and to trade this contract though your broker. If you key in the wrong symbol, you are trading the wrong contract. Never get this wrong.

To trade the E-mini S&P 500 index futures, use "ES".

Note that there might be variations on different data feeds and trading engines. Check out the link under "Vendor Codes" for additional information. To confirm, click on the "View product and vendor codes" to check or clarify with your broker.

Listed Contracts – Remember that a futures contract is an undertaking to buy or sell the underlying at a future date. These futures dates are fixed at regular intervals. Most futures contracts expire monthly or quarterly.

The ES contract expires quarterly - March, June, September, and December. As day traders, we trade the contract with the nearest expiry, also known as the nearby month. The nearby month has the highest liquidity until the rollover date.

The rollover date occurs before the last trading date of each contract. On the rollover date, traders roll their contracts to the next nearby month. Thus, on the rollover date, trading volume shifts to the next lead month.

Day traders should trade the new contract on the rollover day.

Check the futures exchange's website for the rollover date of each contract. When in doubt, check the volume of the current contract and the next one. You should always be trading the one with higher trading volume.

For instance, June ES contract expired on 20 June 2014 but its rollover date was 12 June 2014. Hence, although you were able to trade the June ES contract until its expiry date, you should have started trading the September ES contract, and not the June contract, on 12 June 2014.

Settlement Method – A futures contract can be settled financially or physically.

Contracts that are financially settled do not involve the delivery of the underlying product. At expiry, the imputed profit/loss will be calculated and updated into your trading account. Most index futures are financially settled.

As for contracts that are physically settled, remember to close the position before expiry so that you do not need to deliver or receive any products. We just want the profit or loss.

Termination of Trading – This information helps us to determine the expiry of each contract.

For the ES contract, it expires at 8:30am on the third Friday of the expiry month. As in the example given above, 20 June 2014 was the third Friday of June 2014.

However, as mentioned, the rollover date has more practical implications for a day trader.

The rest of the information in Figure 4-1 consists of technical information that governs the settlement and highlights the applicable regulations. You should read them for a comprehensive understanding of futures trading.

Beyond the contract specifications, we also need to find out the day trading margin requirements of the futures contract.

Day Trading Margins - While the overnight margins are listed on the exchange's website, the day trading margins are determined by individual brokers. Hence, you should check your broker's website or contact them for the information.

Many futures brokers offer $500 day trading margin for one ES futures contract. This means that you need to have $500 in your day trading account for every ES contract you want to day trade.

DAY TRADING MARGINS

Check with your broker regarding the usage of day trading margins

However, day trading margins are not typically granted on an unrestricted basis. Common restrictions include:

- Trade Risk (Maintenance margin)
- Time
- Trading Size

Day trading margin refers to the amount you need in your trading account to initiate a position in the futures contract.

Maintenance margin refers to the amount you need to maintain in your trading account in order to keep your position open. The calculation of maintenance margin takes into account the paper profit/loss of your trading positions. Failure to meet maintenance margin will result in the liquidation of your trading positions.

For instance, to initiate a single contract position in ES, your broker requires you to have $500 in your trading account. Your broker also requires you to maintain at least $100 as maintenance margin for each contract. Assuming that $500 dollars is all you have in your trading account, your trading position should not suffer more than a $400 paper loss. If it does, your broker will most likely close your position. If they do not close the position in time, you are liable for additional losses.

To enjoy day trading margins, traders must close their positions by a cut-off time before the market closes each day. Different brokers have different cut-off timings for the usage of day trading margins. Although the timings are usually based on the closing time of each market, it is best to check with your broker to avoid unpleasant surprises.

Day trading margins are usually applicable up to a certain number of contracts. If your trade size is too big, your broker will demand additional trading margin.

Remember that day trading margins are granted at your broker's discretion so they could revoke your use of day trading margins or change the terms of using them. Always check with your broker to be sure.

Make sure that you understand how day trading margin works in futures trading. Misunderstanding this critical process may give you an unwelcome surprise. Examples include getting your position closed at your broker's discretion or getting your subsequent margin requirements increased.

In any case, you should not be pushing day trading margins to the limit. Even if you have $5,000 in your trading account and enjoy a day trading margin of $500 per contract, it does not mean that you should be trading 10 contracts. That is financial suicide.

Generally, day trading margins give you more leverage than you should be using. That is unless you are scalping the market for very small profits with tight risk management. Note that this series does not cover such a scalping approach. Hence, you should not size your trading position according to margin requirements. Instead, you should use a position sizing model that takes your volatility of your trading edge into account. We will discuss more about this in Volume IV.

In the above explanations, we used the ES futures as an example. You should gather the same set of information on any other futures contract you intend to trade. You should be able to get the essential information from the contract specifications and your broker.

4.2.3 - Which Futures Contract to Trade?

There are numerous futures contracts in the world, including currencies, energy products, commodities, stock indices, and even temperature futures.

Your choice will depend on a function of trading costs, volatility, liquidity, and your preference.

Table 4-2 shows some of the popular day trading futures contracts.

Contract	Symbol	Exchange
E-mini S&P 500	ES	CME
E-mini NASDAQ 100	NQ	CME
E-mini Dow	YM	CBOT (CME)
Russell 2000 - Mini	TF	ICE
EUR/USD	6E	CME
Crude Oil	CL	NYMEX (CME)
DAX (German)	FDAX	EUREX
Euro Stoxx 50	FESX	EUREX

Table 4-2 Popular futures contracts for day trading

Most of the examples in this series are based on the intraday charts of the futures contracts listed above.

There is no best futures contract for day trading. A seasoned day trader who trades large positions might be restricted to extremely liquid markets like ES. A day trader who can only trade during European hours will be restricted to choices like FDAX and FESX.

While price action trading works in all markets, each futures contract has its own nuances and volatility. By nuances, I refer to the observation that some price action features are more reliable in some markets and less in others. These nuances depend on the traded time frame and change over time.

Hence, choose your preferred contract and take time to familiarise yourself with it. Preferably, aim to be a specialist in a couple of markets. Skipping from one market to another will definitely impede your learning progress.

Trading profitably is easier when you specialise and focus using a simple approach in a single market. It can be boring but is more likely to be profitable. Trying to dabble in multiple trading approaches and markets is fun but less likely to be profitable.

I trade mainly the CL and FDAX contracts. However, I draw the examples in this book from a variety of markets to show how the same principles apply.

4.3 - Conclusion

I prefer futures as a day trading vehicle. This preference explains the focus of the bulk of this chapter.

However, futures might not be your best option. Remember that as long as the market offers sufficient volatility and liquidity, it is possible to day trade it. Volatility gives you the room to make meaningful profits. Liquidity gives you the space to trade efficiently.

Ultimately, you need to explore your options and decide what you want to trade. This is not a static decision. Your choice might evolve over time due to changes in the market or your personal circumstances.

Last but not least, in the next volume, you will find two simple concepts that I use in my selection of my trading time frame and market. They are the Price Action Time Frame Index and the Optimal Trading Environment Index. Pay attention to these concepts in Volume II if you want more inputs to help you select your day trading market.

Chapter 5 – What Do You Need?

This chapter covers what you need to follow the price action trading methods explained in the next three volumes. Get them ready and prepare to surf the market.

5.1 - Pre-requisite Knowledge

I always start from basic principles before building up to more complex ideas. Hence, there is no strict pre-requisite knowledge for understanding this series.

If you are completely new to trading, you can refer to my website, Trading Setups Review, for a collection of free articles that covers various basic trading concepts. Start with this compilation of price action trading articles, "How to Trade with Price Action".

To benefit from this series, an open mind and perseverance is more important than any requisite trading knowledge.

You can apply this framework in its entirety or combine its aspects with your current trading strategy to form a sound day trading plan that works for you.

5.2 - Trading Tools

If you have been day trading, you probably already have these tools. If not, they are simple tools that are readily available.

This section focuses on the basic tools you need to follow the techniques in this series. In Volume IV, you will find a more extensive discussion of these tools as we consider a risk-based trading plan.

> *"An artisan must sharpen his tools in order to execute his task well."*
>
> Confucius, Analects

5.2.1 - Trading Computer

Contrary to popular belief, you do not need a supercomputer to day trade. This is true for most day traders.

However, you should get a decent mid-range computer to ensure that you can trade reliably. Most gaming computers are good enough for day trading. For a rough guide, refer to the minimum system requirements of your trading platform. Then, get a computer system that is at least one or two tiers above the minimum requirements.

For trading price action, assuming that you just want to trade a single market, one monitor is sufficient.

While many traders revel in having an array of monitors and trying to replicate NASA's control room, it is simply unnecessary. Your trading edge should come from your trading skills and not your computer's power. As individual retail traders, we will never match professional institutions and funds in terms of computing power. So don't go down that path. Find an edge that does not rely on superior computing resources.

5.2.2 - Internet Connection

You definitely need a broadband Internet connection. Get at least a connection with 1 mbps download speed and 0.5 mbps upload speed. The download speed determines how fast you get the market data (i.e. how fast your chart plots). The upload speed determines how quickly you can send your trading orders out.

It is difficult to pinpoint the exact speed you need for day trading. This is because there are many factors affecting the speed of your Internet connection. Hence, always conduct a speed test when you are unsure. Also, start live trading with the smallest trade size to test if the Internet connection speed is up to expectation.

The stability of your Internet connection is more important than its speed. Having your Internet connection dropped while you are day trading is worse than having a slow connection.

5.2.3 - Charting Platform

One of the advantages of trading price action is that you do not need to rely heavily on fancy indicators. A basic charting platform that can plot horizontal lines (support/resistance) and diagonal lines (trend lines/channels) is all you need. We will be using candlestick charts which can be found in most charting platforms.

I recommend NinjaTrader. It has solid support through its forum and I can help with any queries you might have on NinjaTrader as well. Furthermore, you will also be able to use my price action indicators[5] to help you pick out price patterns. I am not saying that it is the best trading platform, but it has worked well for me.

5.2.4 - Market Data

Most futures trading brokers offer demo accounts with free market data feeds. You can easily get a limited demo account

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[5] Available separately. Not required but helpful.

from most of them. It is enough for picking up the price action trading techniques in this series.

If you intend to demo trade longer, try to extend the demo period with your broker. For a longer term solution, you may want to purchase a data feed for the markets you want to trade.

Eventually, when you want to move on to live trading, you can then fund your trading account.

5.3 - Conclusion

Since you already have this book series, you do not need much more to start learning how to trade with price action.

Most of you should already have a computer and an Internet connection. Downloading a trading platform and requesting for a demo futures trading account with market data take less than half an hour.

To get the most out of these books, get your charting platform ready and practise the techniques as we go along.

Get ready. Let’s begin.

“Don't waste life in doubts and fears; spend yourself on the work before you, well assured that the right performance of this hour's duties will be the best preparation for the hours and ages that will follow it.”

Ralph Waldo Emerson